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A

Accounting (in Eastern Europe)

Hermitage Capital Management, an international investment firm owned by HSBC London, is suing PwC (PricewaterhouseCoopers), the biggest among the big four accounting firms (Andersen, the fifth, is being cannibalized by its competitors).

Hermitage also demands to have PwC's license suspended in Russia. All this fuss over allegedly shoddy audits of Gazprom, the Russian energy behemoth with over $20 billion in annual sales and the world's largest reserves of natural gas. Hermitage runs a $600 million Russia fund which is invested in the shares of the allegedly misaudited giant.

The accusations are serious. According to infuriated Hermitage, PwC falsified and distorted the 2000-1 audits by misrepresenting the sale of Gazprom's subsidiary, Purgaz, to Itera, a conveniently obscure entity. Other loss spinning transactions were also creatively tackled. Stoitransgaz - partly owned by former Gazprom managers and their relatives - landed more than $1 billion in lucrative Gazprom contracts.

These shenanigans resulted in billions of dollars of losses and a depressed share price. AFP quotes William Browder, Hermitage's disgruntled CEO, as saying: "This is Russia's Enron". PwC threatened to counter-sue Hermitage over its "completely unfounded" allegations.

But Browder's charges are supported by Boris Fyodorov, a former Russian minister of finance and a current Gazprom independent director. Fyodorov manages his own investment boutique, United Financial Group. Browder is a former Solomon Brothers investment banker. Other investment banks and brokerage firms - foreign and Russian - are supportive of his allegations. They won't and can't be fobbed.

Fyodorov speculates that PwC turned a blind eye to many of Gazprom's shadier deals in order to keep the account. Gazprom shareholders will decide in June whether to retain it as an auditor or not. Browder is initiating a class action lawsuit in New York of Gazprom ADR holders against PwC.

Even Russia's president concurs. A year ago, he muttered ominously about "enormous amounts of misspent money (in Gazprom)". He replaced Rem Vyakhirev, the oligarch that ran Gazprom, with his own protégé. Russia owns 38 percent of the company.

Gazprom is just the latest in an inordinately long stream of companies with dubious methods. Avto VAZ bled itself white - under PwC's nose - shipping cars to dealers, without guarantees or advance payments. The penumbral dealers then vanished without a trace. Avto VAZ wrote off more than $1 billion in "uncollected bills" by late 1995. PwC did make a mild comment in the 1997 audit. But the first real warning appeared only three years later in the audit for the year 2000.

Andrei Sharonov, deputy minister in the federal Ministry of Economics said, in an interview he granted "Business Week" last February: "Auditors have been working on behalf of management rather than shareholders." In a series of outlandish ads, published in Russian business dailies in late February, senior partners in the PwC Moscow office made this incredible statement: "(Audit) does not represent a review of each transaction, or a qualitative assessment of a company's performance."

The New York Times quotes a former employee of Ernst&Young in Moscow as saying: "A big client is god. You do what they want and tell you to do. You can play straight-laced and try to be upright and protect your reputation with minor clients, but you can't do it with the big guys. If you lose that account, no matter how justified you are, that's the end of a career."

PwC should know. When it mentioned suspicious heavily discounted sales of oil to Rosneft in a 1998 audit report, its client, Purneftegaz, replaced it with Arthur Andersen. The dubious deals dutifully vanished from the audit reports, though they continue apace. Andersen claims such transactions do not require disclosure under Russian law.

How times change! Throughout the 1990's, Russia and its nascent private sector were subjected to self-righteous harangues from visiting Big Five accountants. The hectoring targeted the lack of good governance among Russia's corporations and public administration alike. Hordes of pampered speakers and consultants espoused transparent accounting, minority shareholders' rights, management accessibility and accountability and other noble goals.

That was before Enron. The tables have turned. The Big Five - from disintegrating Andersen to KPMG - are being chastised and fined for negligent practices, flagrant conflicts of interests, misrepresentation, questionable ethics and worse. Their worldwide clout, moral authority, and professional standing have been considerably dented.

America's GAAP (Generally Accepted Accounting Practices) - once considered the undisputable benchmark of rectitude and disclosure - are now thought in need of urgent revision. The American issuer of accounting standards - FASB (Financial Accounting Standards Board) - is widely perceived to be an incestuous arrangement between the clubby members of a rapacious and unscrupulous profession. Many American scholars even suggest to adopt the hitherto much-derided alternative - the International Accounting Standards (IAS) recently implemented through much of central and eastern Europe.

Russia's Federal Commission for the Securities Market (FCSM) convened a conclave of Western and domestic auditing firms. The theme was how to spot and neutralize bad auditors. With barely concealed and gleeful schadenfreude, the Russians said that the Enron scandal undermined their confidence in Western accountants and the GAAP.

The Institute of Corporate Law and Corporate Governance (ICLG), having studied the statements of a few major Russian firms, concluded that there are indications of financial problems, "not mentioned by (mostly Western) auditors". They may have a point. Most of the banks that collapsed ignominiously in 1998 received glowing audits signed by Western auditors, often one of the Big Five.

The Russian Investor Protection Association (IPA) and Institute of Professional Auditors (IPAR) embarked on a survey of Russian investors, enterprises, auditors, and state officials - and what they think about the quality of the audit services they are getting.

Many Russian managers - as avaricious and venal as ever - now can justify hiring malleable and puny local auditors instead of big international or domestic ones. Surgutneftegaz - with $2 billion net profit last year and on-going dispute with its shareholders about dividends - wants to sack "Rosexperitza", a respectable Russian accountancy, and hire "Aval", a little known accounting outfit. Aval does not even make it to the list of 200 largest accounting firms in Russia, according to Renaissance Capital, an investment bank.

Other Russian managers are genuinely alarmed by the vertiginous decline in the reputation of the global accounting firms and by the inherent conflict of interest between consulting and audit jobs performed by the same entity. Sviazinvest, a holding and telecom company, hired Accenture on top of - some say instead of - Andersen Consulting.

A decade of achievements in fostering transparency, better corporate governance, and more realistic accounting in central and eastern Europe - may well evaporate in the wake of Enron and other scandals. The forces of reaction and corruption in these nether lands - greedy managers, venal bureaucrats, and anti-reformists - all seized the opportunity to reverse what was hitherto considered an irreversible trend towards Western standards. This, in turn, is likely to deter investors and retard the progress towards a more efficient market economy.

The Big Six accounting firms were among the first to establish a presence in Russia. Together with major league consultancies, such as Baker-McKinsey, they coached Russian entrepreneurs and managers in the ways of the West. They introduced investors to Russia when it was still considered a frontier land. They promoted Russian enterprises abroad and nursed the first, precarious, joint ventures between paranoid Russians and disdainful Westerners.

Companies like Ernst&Young are at the forefront of the fight to include independent directors in the boards of Russian firms, invariably stuffed with relatives and cronies. Together with IPA, Ernst&Young recently established the National Association of Independent Directors (NAID). It is intended to "assist Russian companies to increase their efficiency through introduction of best independent directors' practices."

But even these - often missionary - pioneers were blinded by the spoils of a "free for all", "winner takes all", and "might is right" environment. They geared the accounts of their clients - by minimizing their profits - towards tax avoidance and the abolition of dividends. Quoting unnamed former employees of the audit firms, "The New York Times" described how "... the auditors often chose to play by Russian rules, and in doing so sacrificed the transparency that investors were counting on them to ensure."

Accounting (in USA)

On May 31, 2005, the US Supreme Court overturned the conviction of accounting firm Arthur Anderson on charges related to its handling of the books of the now defunct energy concern, Enron. It was only the latest scene in a drama which unfolded at the height of the wave of corporate malfeasance in the USA.

David C. Jones is a part-time research fellow at the Center for Urban Development Studies of the Graduate School of Design, Harvard University. He has been associated with the University since 1987 when he retired from the World Bank, where he served as financial adviser for water supply and urban development.

He had joined the World Bank, as a senior financial analyst, in 1970, after working as a technical assistance advisor for the British Government in East Africa. He began his career in British local government. He is a Chartered Public Finance Accountant and a Chartered Certified Accountant (UK). He is the author of "Municipal Accounting for Developing Countries" originally published by the World Bank and the Chartered Institute of Public Finance and Accountancy (UK) in 1982.

Q: Accounting scandals seem to form the core of corporate malfeasance in the USA. Is there something wrong with the GAAP - or with American accountants?

A: Accounting is based on some fundamental principles. As I say at the beginning of my textbook, the accountant "records and interprets variations in financial position ... during any period of time, at the end of which he can balance net results (of past operations) against net resources (available for future operations)".

Accountancy includes the designing of financial records, the recording of financial information based on actual financial transactions (i.e., bookkeeping), the production of financial statements from the recorded information, giving advice on financial matters, and interpreting and using financial data to assist in making the best management decisions.

Simple as these principles may sound, they are, in practice, rather complicated to implement, to interpret and to practice. About 80% of the transactions require only about 20% of the effort because they are straightforward and obvious to a book-keeper, once the rules are learned.

But - and it is a big but - the other 20% or so of transactions require 80% of the intellectual effort. These transactions are most likely to have major impacts on the profit and loss account and the balance sheet.

My colleagues and I, all qualified accountants, have heated discussion over something as simple as the definition of a debit or a credit. Debits can be records of either expenses or assets. The former counts against income in the statement of profit and loss. The latter is treated as a continuing resource in a balance sheet. It is sometimes gradually allocated (expensed) against income in subsequent years, sometimes not.

A fundamental problem with the financial reporting of WorldCom, for example, was that huge quantities of expenses were misallocated in the accounts as assets. Thus, by reducing expenditures, profit appeared to be increased. The effect of this on stock values and, thereby, on executive rewards are secondary and tertiary outcomes ***not caused directly*** by the accountancy.

Another example concerns interest on loans that may have been raised to finance capital investment, while a large asset is under construction, often for several years.

Some argue that the interest should be accounted for as part of the capital cost until the asset is operational. Others claim that because the interest is an expense, it should be charged against that year's profits. Yet, the current year's income includes none of the income generated by the new asset, so profit is under-stated. And what if a hydro-electric power station starts to operate three of its ten turbines while still under construction? How does one allocate what costs, as expenses or assets, in such cases?

Interestingly, the Generally Accepted Accounting Principles (GAAP) require that "interest during construction" be capitalized, that is included in the cost of the asset. The International Accounting Standards (IAS) prefer expensing but allow capitalization. From an economic viewpoint, both are wrong - or only partially right!

The accountancy profession should get together to establish common practices for comparing companies, limiting the scope for judgment. Accountants used to make the rules in the USA and elsewhere until the business community demanded input from other professionals, to provide a more "balanced" view.

This led to the establishment of the Financial Accounting Standards Board (FASB), with non-accountants as members. The GAAP has been tempered by political and business lobbying. Moreover, accounting rules for taxation purposes and applied to companies quoted on stock exchanges are not always consistent with the GAAP.

Accountants who do not follow the rules are disciplined. American accountants are among the best educated and best-trained in the world. Those who wish to be recognized as auditors of significant enterprises must be CPAs. Thus, they must have obtained at least a finance-related bachelor's degree and then have passed a five-part examination that is commonly set, nation-wide, by the American Institute of Certified Public Accountants (AICPA). To practice publicly, they must be licensed by the state in which they live or practice. To remain a CPA, each must abide by the standards of conduct and ethics of the AICPA, including a requirement for continuing professional education.

Most other countries have comparable rules. Probably the closest comparisons to the USA are found in the UK and its former colonies.

Q: Can you briefly compare the advantages and disadvantages of the GAAP and the IAS?

A: It is asserted that the GAAP tend to be "rule-based" and the IAS are "principle-based." GAAP, because they are founded on the business environment of the USA are closely aligned to its laws and regulations. The IAS seek to prescribe how credible accounting practices can operate within a country's existing legal structure and prevailing business practices.

Alas, sometimes the IAS and the GAAP are in disagreement. The two rule-making bodies - FASB and IASB - are trying to cooperate to eliminate such differences.

The Inter-American Development Bank, having reviewed the situation in Latin America, concluded that most of the countries in that region - as well as Canada and the EU aspirants - are IAS-orientated. Still, the USA is by far the largest economy in the world, with significant political influence. It also has the world's most important financial markets.

Q: Can accounting cope with derivatives, off-shore entities, stock options - or is there a problem in the very effort to capture dynamics and uncertainties in terms of a static, numerical representation?

A: Most, if not all, of these matters can be handled by proper application of accounting principles and practices. Much has been made of expensing employee stock options, for instance. But an FASB proposal in the early nineties was watered down at the insistence of US company lobbyists and legislators.

How to value stock options and when to recognize them is not clear. A paper on the topic identified sixteen different valuation parameters. But accountants are accustomed to dealing with such practical matters.

Q: Can you describe the state of the art (i.e., recent trends) of municipal finance in the USA, Europe, Latin America (mainly Argentina and Brazil), and in emerging economies (e.g., central and eastern Europe)?

A: There are no standard practices for governmental accounting - whether national, federal, state, or local. The International Federation of Accountants (IFAC) urged accountants to follow various practices. It subsequently settled mainly on accrual accounting standards.

Some countries - the UK, for local government, New Zealand for both central and local government - use full accrual at current value, which is beyond many private sector practices. This is being reviewed in the UK. The central government there is introducing "resource-based" accounting, approximating full accrual at current value.

The US Governmental Accounting Standards Board has recently recommended that US local governments produce dual financial reports, combining "commercially-based" practices with those emanating from the truly unique US "fund accounting" system.

In my book I recognized that fixed assets are being funded less and less entirely by debt, private sector accounting practices increasingly intrude into the public sector, and costs of services must be much more carefully assessed.

Q: Are we likely to witness municipal Enrons and World.com's**?**

A: We already have! Remember the financial downfall and restructuring of New York City in the seventies. Other state and local governments have had serious defaults in USA and elsewhere. Shortcomings of their accounting, politicians choosing to ignore predictive budgeting, borrowing used to cover operating expenditures - similar to WorldCom. In the case of the New York City debacle, operating expenditures were treated as capital expenditures to balance the operating budget.

More recently, I testified to the US Congress about Washington DC, where the City Council ran up a huge accumulated operating deficit, of c. $700 million. It then sought Congressional approval to cover this deficit by borrowing.

Even more recently, the State of Virginia decided to abolish the property tax on domestic vehicles. This left a huge gap in the following year's current budget. The governor proposed to use a deceptive accounting device and to set up a separate - and, thus not subject to a referendum - "revenue" bond-issuing entity (shades of Enron's "Special Purpose Entities"). The bonds were then to be serviced by expected annual receipts from the negotiated tobacco settlement, at that time not even finalized. This crazy and illegal plan was abandoned.

The fact that both accounting and financial reporting for local governments are very often in slightly modified cash-based formats adds to the confusion. But these formats could be built on. Indeed, in the very tight budgetary situations facing virtually every local government, it is essential that cash management on a day-to-day basis be given high priority.

Still, the system can be misleading. It produces extremely scant information on costs - the use of resources - compared with expenditures (i.e., cash-flows). More seriously, cash accounting allows indiscriminate allocation of funds between capital and recurrent purposes, thus permitting no useful assessment of annual or other periodic financial performance.

A cash-based system cannot engender a credible balance sheet. It produces meaningless and incoherent information on assets and liabilities and the ownership, or trusteeship, of separate (or separable) funds. It is not a sound system of budgetary control. When year-end unpaid invoices are held over, it creates a false impression of operating within approved budgetary limits. Thus, local government units can run serious budgetary deficits that are hidden from public view merely by not paying their bills on time and in full! A cash accounting system will not reveal this.

Still, moving to an accrual system should be done slowly and cautiously. Private sector experience, in former Soviet countries, of changing to accrual accounting was administratively traumatic. Their public sector systems may not easily survive any major tinkering, let alone an - eventually inevitable - full overhaul. Skills, tools, and access to proper professional knowledge are required before this is attempted.

Q: Can you compare municipal and corporate accounting and financing practices as far as governance and control are concerned?

A: In corporate accounting practice, the notional owners and managers are the shareholders. In practice, through the use of proxies and other devices, the real control is normally in the hands of a board of directors. Actual day to day control reverts to the company chairmen, president, chief executive or chief operating officer. The chief financial officer is often - though not necessarily - an accountant and he or she oversees qualified accountants.

The company's accountants must produce the annual and other financial statements. It is ***not*** the responsibility of the auditors whose obligation is to report to the shareholders on the credibility and legality of the financial statements. The shareholders may appoint an audit committee to review the audit reports on their behalf. The audit is carried out by Certified Public Accountants with recognized accounting credentials. Both the qualified accountants in the audit firm and those in the corporation are subject to professional discipline of their accounting institutions and of the law.

In local government accounting practice, the public trustees and managers are normally a locally elected council. Often, the detailed control over financial management is in the hands of a finance committee or finance commission, usually comprised only of elected members.

Traditionally, only the elected council may take major financial decisions, such as approving a budget, levying taxes and borrowing. Actual day to day control of a local government may be by an executive mayor, or by an elected or appointed chief executive. There normally is a chief financial officer, often - though not necessarily - an accountant in charge of other qualified accountants.

It is the responsibility of the accountants of the local government to produce the annual and other financial statements. It is ***not*** the responsibility of the auditors whose obligation is to report to the local elected council on the credibility and legality of the financial statements. The council may appoint an audit committee to review the audit reports on their behalf, or they may ask the finance committee to do this.

However, it is quite common, in many countries, for local government financial statements to be audited by properly authorized public officials. Auditors should be qualified, independent, experienced, and competent. Audits should be regular and comprehensive. It is unclear whether or not public official auditors always fulfill these conditions.

In the United Kingdom, for example, there is a Local Government Audit Commission which employs qualified accountants either on its own staff or from hired accountancy firms. Thus, it clearly follows high standards.

Q: How did the worldwide trend of devolution affect municipal finance?

A: Outside of the former Soviet Union and Eastern Europe, municipal finance was not significantly affected by devolution, though there has been a tendency for decentralization. Central governments hold the purse-strings and almost all local governments operate under legislation engendered by the national, or - in federal systems - state, governments. Local governments rarely have separate constitutional authority, although there are varying degrees of local autonomy.

In the former Soviet Empire, changes of systems and of attitudes were much more dramatic. Local government units, unlike under the former Soviet system, ***are not branches of the general government.*** They are separate corporate bodies, or legal persons. But in Russia, and in other former socialist countries, they have often been granted "de jure" (legal) independence but not full "de facto" (practical) autonomy.

There seems to be an unwillingness to accept that the two systems are intended to operate quite differently. What is good for a central government is ***not necessarily*** equally good for a local government unit. For example, the main purpose of local government is to provide public services, with only enough authority to perform them effectively. It is almost always the responsibility of a central or state government to enact and enforce the criminal and civil law. Local by-laws or ordinances are usually concerned only with minor matters and are subject to an enabling legislation. Moreover, they may prove to be "ultra vires" (beyond their powers) and, therefore, unconstitutional, or at least unenforceable.

It may be appropriate, under certain circumstances, for a central government to run budgetary deficits, whether caused by current or capital transactions. In ***local government units***, there is almost always a necessity to distinguish between such transactions. Moreover, in most countries, local government units are ***required by law to have balanced budgets*****,** without resort to borrowing to cover current deficits.

A corporate body (legal person), whether a private or a public sector entity, has a separate legal identity from the central government and from the members, shareholders, or electorate who own and manage it. It has its own corporate name. Typically, its formal decisions are by resolution of its managing body (board or council). Written documents are authenticated by its common seal. It may contract, sue and be sued in its own name. Indeed, unless specifically prevented by law, ***it may even sue the central government!*** It may also have legal relationships with its own individual members or with its staff. It is often said to have perpetual succession, meaning that it lives on, even though the individual members may die, resign or otherwise cease their membership.

While a corporation owes its existence to legislation, a local government unit is established, typically, under something like a "Local Government Organic Law". Corporate status differs ***fundamentally*** from that of (say) government departments in a system of de-concentration. Permanent closure or abolition of a municipal council, or indeed any change in its powers and duties, would almost always require formal legal action, typically national parliamentary legislation.

A local government unit makes its own policy decisions, some of which, especially the financial ones, often require approval by a central government authority. Still, the central government rarely runs, or manages, a local government unit on a daily basis. The relationship is at arms length and not hands on. A local government unit usually is empowered to own land and real estate. Sometimes, public assets - such as with roads or drainage systems - are deemed to be "vested in" the local authority because they cannot be owned in the same way as buildings are.

Q: Local authorities issue bonds, partake in joint ventures, lend to SME's - in short, encroach on turf previously exclusively occupied by banks, the capital markets, and business. Is this a good or a bad thing?

A: Local governments are established to provide services and perform activities required or allowed by law! Normally, they won't seek or be permitted to engage in commercial activities, best left to the private sector. However, there have always been natural monopolies (such as water supply), coping with negative economic externalities (such as sewerage and solid waste management), the provision of whole or partial public goods (such as street lighting, or roads) and merit goods (such as education, health, and welfare), and services that the community, for economic or social reasons, seeks to subsidize (such as urban transport). Left to the private marketplace, these services would be absent, or under-supplied, or over-charged for.

Such services are wholly or partially financed by local taxation, either imposed by local governments, or by central (or state) taxation, through a grant or revenue-sharing system. What has changed in recent years is that local governments have been encouraged and empowered to outsource these services to the private sector, or to "public-private" partnerships.

Charges for services, and revenues from taxation cover current operating expenditures with a small operating surplus used to partly fund capital expenditure or to service long, or medium term debt, such as bond issues secured against future revenues. Commercial banks, because of their tendency to lend only for relatively short periods of time, usually have a relatively minor role in such funding, except perhaps as fiscal agents or bond issue managers.

Other funding is obtained via direct - and dependence-forming - capital grants from the central or state government. Alternatively, the central government can establish a quasi-autonomous local government loans authority, which it may wholly or partially fund. The authority may also seek to raise additional funds from commercial sources and make loans on reasonable terms to the local governments.

Third, the central government may lend directly to local governments, or guarantee their borrowing. Finally, local governments are left to their own devices to raise loans as and when they can, on whatever terms are available. This usually leaves them in a precarious position, because the market for this kind of long and medium term credit is thin and costly.

Commercial banks make short term loans to local governments to cover temporary shortages of working capital. If not properly controlled, such short-term loans are rolled over and accumulate unsustainably. That is what happed in New York City, in the seventies.

Q: In the age of the Internet and the car, isn't the added layer of municipal bureaucracy superfluous or even counterproductive? Can't the center - at least in smallish countries - administer things at least as well?

A: I am quite sure that they can. There are many glaring examples of mismatches of sizes, shapes and responsibilities of local government units. For example, New York, Moscow and Bombay are each single local government units. Yet, they each have much bigger populations than many countries, such as New Zealand, the republics of former Yugoslavia, and the Baltic states.

On the other hand, the Greater Washington Metropolitan Area comprises a federal district, four counties and several small cities. The local government systems are under the jurisdictions of two states and the federal government. Each of the two states has a completely different traditions and systems of local governance, emanating from pre-independence times. Accordingly, the local government systems north and east of the Potomac

River (which flows through the Washington area) are substantially different from those to the south and west. Finally, the Boston area, a cradle of U.S. democracy, is governed by a conglomerate of over 40 local government jurisdictions. Even its most famous college, Harvard, is in Cambridge and not in Boston itself. Many of the jurisdictions are so small (Boston is not very big by U.S. standards) that common services are run by agencies of the State of Massachusetts.

The problem of centralizing financial records would, indeed, be relatively simple to solve. If credit card companies can maintain linkages world-wide, there is no ***practical*** reason why local government accounts for (say) a city in Macedonia could not be kept in China. The issue here is quite different. It revolves around democracy, tradition, living in community, service delivery at a local level, civil society, and the common wealth. It really has very little to do with accountancy, which is just one tool of management, albeit an important one.

Afghanistan, Economy of

I. The Poppy Fields

Conspiracy theorists in the Balkan have long speculated on the true nature of the Albanian uprising in Macedonia. According to them, Afghanistan was about to flood Europe with cheap opium through the traditional Balkan routes. The KLA - denounced by the State Department as late as 1998 as a drug trafficking organization - was, in the current insurrection, in its new guise as the NLA, simply establishing a lawless beachhead in Macedonia, went the rumours. The Taliban were known to stock c. 3000 tonnes of raw opium. The Afghanis - Arab fighters against the Soviet occupation of Afghanistan - another 2000 tonnes (their fee for providing military and security services to the Taliban). Even at the current, depressed, prices, this would fetch well over 2 billion US dollars in next door Pakistan. It also represents 5 years of total European consumption and a (current) street level value in excess of 100 billion US dollars. The Taliban intends to offload this quantity in the next few months and to convert it to weapons. Destabilizing the societies of the West is another welcome side effect.

It is ironic that the Taliban collaboration with the United Nations Office for Drug Control and Crime Prevention (UNODCCP) culminated this year in the virtual eradication of all opium poppies in Afghanistan. Only 18 months ago, Afghan opium production (c. 4600 tonnes a year) accounted for 70% of world consumption (in the form of heroin). The shift (partly forced on the Taliban by an unusual climate) from poppies to cereals (that started in 1997) was thus completed successfully.

II. Agriculture

Afghanistan is not a monolithic entity. It is a mountainous and desert territory (c. 251,000 sq. miles in size, less than 10% of it cultivated). Administratively and politically, it is reminiscent of Somalia. The Taliban government - now recognized only by Pakistan - rules the majority of the country as a series of tribal fiefdoms. The country - ruined by a decade of warfare between majority Pushtuns and minority Tajiks and Uzbeks in the north - lacks all institutions, or infrastructure. In an economy of subsistence agriculture and trading, millions (up to one third of a population of 27 million) have been internally displaced or rendered refugees. One third of all farms have been vacated. Close to 70% of all villages are demolished. Unemployment - in a mostly unskilled workforce of 11 million - may well exceed 50%. Poverty is rampant, food scarce, population growth unsustainable. The traditional social safety net - the family - has unraveled, leading to widespread and recurrent famine and malnutrition. The mainstays of grazing and cattle herding have been hampered by mines and deforestation.

The Taliban regime has been good to the economy. It restored the semblance of law and order. Agricultural production recovered to pre-Soviet invasion (1978) levels. Friendly Pakistan provided 80% of the shortfall in grain (international aid agencies provided the rest). The number of heads of livestock - the only form of savings in devastated Afghanistan - increased. Many refugees came back.

Urban workers - mostly rural labourers displaced by war - fared worse, though. As industries and services vanished and army recruitment stabilized with the Taliban's victories, salaries decreased by up to 40% while inflation picked up (to an annual average of 20-25%, as reflected in the devaluation of the currency and in the price of bread). More than 50% of the average $1 a day wage of the casual, unskilled, worker, are spent on bread alone!

But this discrepancy between a recovering agricultural sector and the dilapidated and depleted cities led to reverse migration back to the villages. In the long term it was a healthy trend.

Paradoxically, the collapse of the central state led to the emergence of a thriving and vibrant private sector engaged in both legal and criminal activities. Foreign exchange dealing is conducted in thousands of small, privately owned, exchange offices. Rich Afghani traders have invested heavily in small scale and home industries (mainly in textiles and agri-business).

III. Trade

In some respects, Afghanistan is an extension of Pakistan economically and, until recently, ideologically. Food prices in Afghanistan, for instance - the only reliable indicator of inflation - closely follow Pakistan's. The Afghan currency (there are two - one issued by the Taliban and another issued by the deposed government in Faizabad) is closely linked to Pakistan's currency, though unofficially so. The regions closest to Pakistan (Herat, Jalalabad, Kandahar) - where cross border trading, drug trafficking, weapons smuggling, illegal immigration (to Western Europe), and white slavery are brisk - are far more prosperous than the northern, war-torn, ones (Badakhshan, Bamyan). The Taliban uses economic sanctions in its on-going war against the Northern Alliance. In 1998-9, it has blockaded the populous provinces of Parwan and Kapisa.

Another increasingly important trade partner is Turkmenistan. It supplies Afghanistan with petrol, diesel, LNG, and jet fuel (thus reducing Afghani dependence on hostile Iranian supplies). Uzbekistan and Tajikistan, its two other neighbours, are considered by the Taliban to be enemies. This enmity results in much higher costs of transportation which price out many Afghan products.

With Pakistan, Afghanistan has an agreement (the Afghan Transit Trade) which provides the latter with access to the sea. Afghanistan imports consumer goods and durables through this duty free corridor (and promptly re-exports them illegally to Pakistan). Pakistani authorities periodically react by unilaterally dropping duty free items off the ATT list. The Afghans proceed to import the banned items (many of them manufactured in Pakistan's archrival, India) via the Gulf states, Russia, Ukraine (another important drug route) and into Pakistan.

IV. The Future

The current conflict can be a blessing in disguise. Western aid and investment can help resuscitate the Soviet era mining (Copper, Zinc) operations and finally tap Afghanistan's vast reserves of oil and natural gas. With a GDP per capita of less than $800, there is room for massive growth. Yet, such bright prospects are dimmed by inter-ethnic rivalry, a moribund social system, decades of war and natural disaster (such as the draught in 1998-9), and intense meddling and manipulation by near and far. One thing is certain: opium production is likely to increase dramatically. And Western users will be treated to ever cheaper heroin and Hasish.

Agent-Principal Problem

In the catechism of capitalism, shares represent the part-ownership of an economic enterprise, usually a firm. The value of shares is determined by the replacement value of the assets of the firm, including intangibles such as goodwill. The price of the share is determined by transactions among arm's length buyers and sellers in an efficient and liquid market. The price reflects expectations regarding the future value of the firm and the stock's future stream of income - i.e., dividends.

Alas, none of these oft-recited dogmas bears any resemblance to reality. Shares rarely represent ownership. The float - the number of shares available to the public - is frequently marginal. Shareholders meet once a year to vent and disperse. Boards of directors are appointed by management - as are auditors. Shareholders are not represented in any decision making process - small or big.

The dismal truth is that shares reify the expectation to find future buyers at a higher price and thus incur capital gains. In the Ponzi scheme known as the stock exchange, this expectation is proportional to liquidity - new suckers - and volatility. Thus, the price of any given stock reflects merely the consensus as to how easy it would be to offload one's holdings and at what price.

Another myth has to do with the role of managers. They are supposed to generate higher returns to shareholders by increasing the value of the firm's assets and, therefore, of the firm. If they fail to do so, goes the moral tale, they are booted out mercilessly. This is one manifestation of the "Principal-Agent Problem". It is defined thus by the Oxford Dictionary of Economics:

"The problem of how a person A can motivate person B to act for A's benefit rather than following (his) self-interest."

The obvious answer is that A can never motivate B not to follow B's self-interest - never mind what the incentives are. That economists pretend otherwise - in "optimal contracting theory" - just serves to demonstrate how divorced economics is from human psychology and, thus, from reality.

Managers will always rob blind the companies they run. They will always manipulate boards to collude in their shenanigans. They will always bribe auditors to bend the rules. In other words, they will always act in their self-interest. In their defense, they can say that the damage from such actions to each shareholder is minuscule while the benefits to the manager are enormous. In other words, this is the rational, self-interested, thing to do.

But why do shareholders cooperate with such corporate brigandage? In an important Chicago Law Review article whose preprint was posted to the Web a few weeks ago - titled "Managerial Power and Rent Extraction in the Design of Executive Compensation" - the authors demonstrate how the typical stock option granted to managers as part of their remuneration rewards mediocrity rather than encourages excellence.

But everything falls into place if we realize that shareholders and managers are allied against the firm - not pitted against each other. The paramount interest of both shareholders and managers is to increase the value of the stock - regardless of the true value of the firm. Both are concerned with the performance of the share - rather than the performance of the firm. Both are preoccupied with boosting the share's price - rather than the company's business.

Hence the inflationary executive pay packets. Shareholders hire stock manipulators - euphemistically known as "managers" - to generate expectations regarding the future prices of their shares. These snake oil salesmen and snake charmers - the corporate executives - are allowed by shareholders to loot the company providing they generate consistent capital gains to their masters by provoking persistent interest and excitement around the business. Shareholders, in other words, do not behave as owners of the firm - they behave as free-riders.

The Principal-Agent Problem arises in other social interactions and is equally misunderstood there. Consider taxpayers and their government. Contrary to conservative lore, the former want the government to tax them providing they share in the spoils. They tolerate corruption in high places, cronyism, nepotism, inaptitude and worse - on condition that the government and the legislature redistribute the wealth they confiscate. Such redistribution often comes in the form of pork barrel projects and benefits to the middle-class.

This is why the tax burden and the government's share of GDP have been soaring inexorably with the consent of the citizenry. People adore government spending precisely because it is inefficient and distorts the proper allocation of economic resources. The vast majority of people are rent-seekers. Witness the mass demonstrations that erupt whenever governments try to slash expenditures, privatize, and eliminate their gaping deficits. This is one reason the IMF with its austerity measures is universally unpopular.

Employers and employees, producers and consumers - these are all instances of the Principal-Agent Problem. Economists would do well to discard their models and go back to basics. They could start by asking:

Why do shareholders acquiesce with executive malfeasance as long as share prices are rising?

Why do citizens protest against a smaller government - even though it means lower taxes?

Could it mean that the interests of shareholders and managers are identical? Does it imply that people prefer tax-and-spend governments and pork barrel politics to the Thatcherite alternative?

Nothing happens by accident or by coercion. Shareholders aided and abetted the current crop of corporate executives enthusiastically. They knew well what was happening. They may not have been aware of the exact nature and extent of the rot - but they witnessed approvingly the public relations antics, insider trading, stock option resetting , unwinding, and unloading, share price manipulation, opaque transactions, and outlandish pay packages. Investors remained mum throughout the corruption of corporate America. It is time for the hangover.

AIDS

The region which brought you the Black Death, communism and all-pervasive kleptocracy now presents: AIDS. The process of enlargement to the east may, unwittingly, open the European Union's doors to the two scourges of inordinately brutal organized crime and exceptionally lethal disease. As Newsweek noted, the threat is greater and nearer than any hysterically conjured act of terrorism.

The effective measure of quarantining the HIV-positive inhabitants of the blighted region to prevent a calamity of medieval proportions is proscribed by the latest vintage of politically correct liberalism. The West can only help them improve detection and treatment. But this is a tall order.

East European medicine harbors fantastic pretensions to west European standards of quality and service. But it is encumbered with African financing, German bureaucracy and Vietnamese infrastructure. Since the implosion of communism in 1989, deteriorating incomes, widespread unemployment and social disintegration plunged people into abject poverty, making it impossible to maintain a healthy lifestyle.

A report published in September by the European regional office of the World Health Organization (WHO) pegs at 46 the percentage of the general population in the countries of the former communist bloc living on less than $4 a day - close to 170 million people. Crumbling and desperately underfunded healthcare systems, ridden by corruption and cronyism, ceased to provide even the appearance of rudimentary health services.

The number of women who die at - ever rarer - childbirth skyrocketed. Transition has trimmed Russian life expectancy by well over a decade to 59, lower than in India. People lead brutish and nasty lives only to expire in their prime, often inebriated. In the republics of former Yugoslavia, respiratory and digestive tract diseases run amok. Stress and pollution conspire to reap a grim harvest throughout the wastelands of eastern Europe. The rate of Tuberculosis in Romania exceeds that of sub-Saharan Africa.

UNAIDS and WHO have just published their AIDS Epidemic Update. It states unequivocally: "In Eastern Europe and Central Asia, the number of people living with Human Immunodeficiency Virus - HIV - in 2002 stood at 1.2 million. HIV/AIDS is expanding rapidly in the Baltic States, the Russian Federation and several Central Asian republics."

The figures are grossly understated - and distorting. The epidemic in eastern Europe and central Asia - virtually on the European Union's doorstep - is accelerating and its growth rate has surpassed sub-Saharan Africa's. One fifth of all people in this region infected by HIV contracted the virus in the preceding 12 months. UNAIDS says: "The unfortunate distinction of having the world’s fastest-growing HIV/AIDS epidemic still belongs to Eastern Europe and Central Asia."

In the past eight years, AIDS has been suddenly "discovered" in 30 large Russian cities and in 86 of its 89 regions. Four fifth of all infections in the Commonwealth of Independent States - the debris left by the collapse of the USSR - are among people younger than 29. By July this year, new HIV cases surged to 200,000 - up from 11,000 in December 1998.

In St. Petersburg, their numbers multiplied a staggering 250-fold since 1996 to 10,000 new instances diagnosed in 2001. Most of these cases are attributed to intravenous drug use. But, according to Radio Free Europe/Radio Liberty, 400 infected women gave birth in a single hospital in St. Petersburg in the first nine months of 2002 - compared to 149 throughout last year. About one third of the neonates test HIV-positive within 24 months. The disease has broken loose.

How misleading even these dire data are is revealed by an in-depth study of a single city in Russia, Togliatti. Fully 56 percent of all drug users proved to be HIV-positive, most of them infected in the last 2 years. Three quarters of them were unaware of their predicament. One quarter of all prostitutes did not require their customers to use condoms. Two fifths of all "female sex workers" then proceeded to have unsafe intercourse with their mates, husbands, or partners. Studies conducted in Donetsk, Moscow and St. Petersburg found that one seventh of all prostitutes are already infected.

An evidently shocked compiler of the results states: "The study lends further credence to concerns that the HIV/AIDS epidemic in Russian cities could be considerably more severe than the already-high official statistics indicate." The region's governments claim that 1 percent of the population of countries in transition - still a hefty 4 million people - use drugs. But this, too, is a wild underestimate. UNAIDS itself cites a study that concluded that "among Moscow secondary-school students ... 4% had injected drugs".

Quoted in Pravda.ru, The Director of the Federal Scientific Center for AIDS at Russia's Ministry of Health, Vadim Pokrovsky, warns that Russia is likely to follow the "African model" with up to an 80 percent infection rate in some parts. Kaliningrad, with a 4 percent prevalence of the syndrome, he muses, can serve as a blueprint for the short-term development of the AIDS epidemic in Russia.

Or, take Uzbekistan. New infections registered in the first six months of 2002 surpassed the entire caseload of the previous decade. Following the war in Afghanistan, heroin routes have shifted to central Asia, spreading its abuse among the destitute and despondent populations of Azerbaijan, Kazakhstan, Georgia, Kyrgyzstan, Tajikistan and Uzbekistan. In many of these countries and, to some extent, in Russia and Ukraine, some grades of heroine are cheaper than vodka.

Ominously, reports the European enter for the Epidemiological Monitoring of AIDS, as HIV cases among drug users decline, they increase exponentially among heterosexuals. This, for instance, is the case in Belarus and Ukraine. The prevalence of HIV among all Ukrainians is 1 percent.

Even relative prosperity and good governance can no longer stem the tide. Estonia's infection rate is 50 percent higher than Russia's, even if the AIDS cesspool that is the exclave of Kaliningrad is included in the statistics. Latvia is not far behind. One of every seven prisoners in Lithuania has fallen prey to the virus. All three countries will accede to the European Union in 2004. Pursuant to an agreement signed recently between Russia and the EU, Kaliningrad's denizens will travel to all European destinations unencumbered by a visa regime.

Very little is done to confront the looming plague. One third of young women in Azerbaijan and Uzbekistan never heard of AIDS. Over-crowded prisons provide no clean needles or condoms to their inmates. There are no early warning "sentinel" programs anywhere. Needle exchanges are unheard of. UNICEF warns, in its report titled "Social Monitor 2002", that HIV/AIDS imperils both future generations and the social order.

The political class is unmoved. President Vladimir Putin never as much as mentions AIDS in his litany of speeches. Even Macedonia's western-minded and western-propped president, Boris Trajkovski, dealt with the subject for the first time only yesterday. Belarus did not bother to apply to the United Nation's Global Fund to Fight AIDS, Tuberculosis, and Malaria or to draw approved resources from the World Bank's anti-TB/HIV/AIDS project.

In many backward, tribal countries - especially in the Balkan and in central Asia - the subjects of procreation, let alone contraception, are taboo. Vehicles belonging to Medecins du Monde, a French NGO running a pioneer needle exchange program in Russia, were torched. The Orthodox Church has strongly objected to cinema ads promoting safer sex. Sexual education is rare.

Even when education is on offer - like last year's media campaign in Ukraine - it rarely mitigates or alters high-risk conduct. According to Radio Free Europe/Radio Liberty, the St. Petersburg AIDS Center carried out a survey of 2000 people who came to be tested there and were consequently exposed to AIDS prevention training. "Neither the men nor the women had changed their high-risk behavior", is the unsettling conclusion.

Ignorance is compounded by a dismal level personal hygiene, not the least due to chronically malfunctioning water, sanitation and electricity grids and to the prohibitive costs of cleansing agents and medicines. Sexually transmitted diseases - the gateways to the virus - are rampant. Close to half a million new cases of syphilis are diagnosed annually only in Russia.

The first step in confronting the epidemic is proper diagnosis and acknowledgement of the magnitude of the problem. Macedonia, with 2 million citizens, implausibly claims to harbor only 18 carriers and 5 AIDS patients. A national strategy to confront the syndrome is not due until June next year. Though AIDS medication is theoretically provided free of charge to all patients, the country's health insurance fund, looted by its management, is unable to afford to import them.

In a year of buoyant tax revenues, the Russian government reduced spending on AIDS-related issues from $6 million to $5 million. By comparison, the U.S. Agency for International Development (USAID) alone allocated $4 million to Russia's HIV/AIDS activities last year. Another $1.5 were given to Ukraine. Russia blocked last year a $150 million World Bank loan for the treatment of tuberculosis and AIDS.

Money is a cardinal issue, though. Christof Ruehl, the World Bank's chief economist in Russia and Murray Feshbach, a senior scholar at the Woodrow Wilson International Center for Scholars in Washington, put the number of infected people in the Russian Federation at 1-1.2 million. Even this figure - five times the official guesstimate - may be irrationally exuberant. A report by the US National Intelligence Council forecasts 5-8 million HIV-positives in Russia by the end of the decade. Already one third of conscripts are deemed unfit for service due to HIV and hepatitis.

Medicines are scarce. Only 100 of St. Petersburg's 17,000 registered HIV carriers receive retroviral care of any kind. Most of them will die if not given access to free treatment. Yet, even a locally manufactured, generic version, of an annual dose of the least potent antiretroviral cocktail would cost hundreds of dollars - about half a year's wages. At market prices, free medicines for all AIDS sufferers in this vast country would amount to as much as four fifths of the entire federal budget, says Ruehl.

Some pharmaceutical multinationals - spearheaded by Merck - have offered the more impoverished countries of the region, such as Romania, AIDS prescriptions at 10 percent of the retail price in the United States. But this is still an unaffordable $1100 per year per patient. To this should be added the cost of repeated laboratory tests and antibiotics - c. $10,000 annually, according to the New York Times. The average monthly salary in Romania is $100, in Macedonia $160, in Ukraine $60. It is cheaper to die than to be treated for AIDS.

Indeed, society would rather let the tainted expire. People diagnosed with AIDS in eastern Europe are superstitiously shunned, sacked from their jobs and mistreated by health and law enforcement authorities. Municipal bureaucracies scuttle even the little initiative shown by reluctant governments. These self-defeating attitudes have changed only in central Europe, notably in Poland where an outbreak of AIDS was contained successfully.

And, thus, the bleak picture is unlikely to improve soon. UNAIDS, UNICEF and WHO publish country-specific "Epidemiological Factsheets on HIV/AIDS and Sexually Transmitted Infections". The latest edition, released this year, is disheartening. Under-reporting, shoddy, intermittent testing, increasing transmission through heterosexual contact, a rising number of infected children. This is part of the dowry east Europe brings to its long-delayed marriage with a commitment-phobic European Union.

Albania, Economy of

Blessed with Chinese GDP growth rates (7-8% annually in each of the last 3 years) and German inflation (4%, down from 32% in 1997, mostly attributable to increases in energy and housing costs), it is easy to forget Albania's Somali recent past.

In 1997, following the collapse of a series of politically-sanctioned pyramid schemes in which one third of the impoverished population lost its meager life savings, Albania imploded. The mob looted 700,000 guns from the armories of the army and the police and went on a rampage, in bloody scenes replete with warlords, crime, and 1500 dead. It took 5% of GDP to recapitalize Albania's tottering banks and overall GDP dropped by 7% that year. During the two preceding years, Albania has been the IMF's poster boy (as it is again nowadays). Since October 1991, the World Bank has approved 43 projects in the country, committed close to $570 million and disbursed two thirds of its commitments. This, excluding $100 million after the 1999 Kosovo crisis and $50 million for agricultural development.

The European Investment Bank (EIB), the EBRD, the EU, and the Stability Pact have committed billions to the region for infrastructure, crime fighting, and institution building projects. Albania stood to benefit from this infusion and from a future Stabilization and Association Agreement with the EU (similar to Macedonia's and Croatia's). Yet, as Chris Patten (the Commissioner in charge of aid) himself admitted to "The Economist": "The

EU'S capacity for making political promises is more impressive than our past record of delivering financial assistance". The aid was bungled and mired in pernicious bureaucratic infighting. The EU's delegation in Tirana was recently implicated in "serious financial irregularities".

The economic picture (if notoriously unreliable official statistics are to be trusted) has been mixed ever since.

The budget deficit hovers around 9% (similar to Macedonia's, Albania's war ravaged neighbor). The (very soft and very long term) external debt is at a nadir of 28% of GDP (though still 150% of exports) and foreign exchange reserves cover more than 4 months of imports. This is reflected in the (export averse) stable exchange rate of the lek. But the overall public debt is much higher (70%) and the domestic component may well be unsustainable. Money supply is still roaring (+12%), interest rates are punishingly high (8% p.a.) though in steep decline, and GDP per capita is less than $1000. It is still one of Europe's poorest countries (especially its rural north). Most of its GDP growth is in construction and trade. Health and education are decrepit and deteriorating. And people vote with their feet (emigrate in droves) and wallets (the economy is effectively dollarized).

Privatization receipts which were supposed to amortize public debt did not materialize (though there were some notable successes in 2000, including the completion of the privatization of land and of the important mining sector). Negative sentiment towards emerging economies, Albania's proximity to the Kosovo and Macedonia killing fields, and global recession make this prospect even more elusive. Had it not been for the $500 million in remittances from 20% of the workforce who are employed in Greece and Italy - Albania would have been in dire straits. Money from Albanian drug dealers, immigrant smugglers, and other unsavory characters still filters in from Prague, Zurich, and the USA. These illicit - but economically crucial - funds may explain the government's foot dragging on the privatization of the omnipresent Savings Bank (83% of all deposits, no loans, owns 85% of all treasury bills, 2% net return on equity) and its reluctance to overhaul the moribund banking system and enact anti money laundering measures. It took crushing pressure by IFI's to force the government to hive off the Savings Bank's pension plan business into Albapost, the local Post Office.

In the intervening years, Albania got its fiscal act together (though its tax base is still minimal) and made meaningful inroads into the informal economy (read: organized crime), not least by dramatically improving its hitherto venal and smuggler-infested customs service. A collateral registry has been introduced and much debated bankruptcy and mediation laws may be enacted next year. Everything, from the operations of the Central Bank to the executive branches is being revamped. Those who remained in Albania are much more invigorated than they have been in a long time.

But the problems are structural. Albania is among the few countries in our post-modern world which rely on agriculture (55%) rather than industry (24%), or services (21%). Only 40% of the population live in cities and female illiteracy is still at 24%. Tourism (especially of the archeological kind) is promising. But there are less than 6 computers and 40 phones per 1000 citizens and less than 40% of the roads are paved (Albanians were forbidden to own private cars until 1985). FDI amounts to a measly

$50 million a year and aid per capita has tripled to c. $160 since 1997. Pervasive electricity shortages (despite budget draining subsidies of imported energy) hamper economic activity. Albania was rated 100th (out of 174) in the UNDP's Human Development Index and 90th (out of 175) in UNICEF's Report on the State of the World's Children (under-five mortality). Its neighbors ranked 55-73.

The isolationist legacy of the demented and paranoid Enver Hoxha is only partly to blame. Mismanagement, corruption, the criminalization of society, and tribalism are equally at fault in post-Communist Albania. Everyone takes bribes - not surprising when a senior Minister earns less than $1000 a month (ten times the average salary). A well developed, though fast eroded, social (extended family, village, tribe) safety net ensures that only 20% of the population are under the official poverty line. But these extended ties are one of the reasons for local unemployment (almost 20% of the workforce) - immigrant workers (mostly family members) constitute more than 25% of those employed.

With a youthful (32) Prime Minister (Ilir Meta, overwhelmingly re-elected this year) who is an economist by profession, Albania is reaching out to its neighbours. As early as 1992 it joined the improbable (and hitherto ineffective) Black Sea Economic Cooperation Pact (with Greece, Turkey and ... Azerbaijan and Armenia!) - which currently lobbies for the re-opening of the Danube River. Albanian cheap exports are competitive only if transported via river. Albania signed recently a series of bilateral agreements with Montenegro regarding transportation on the Bojana river and the Skadar Lake, use of harbors, the extension of railways and roads, and the regulation of aviation rights. Despite the fact that

Macedonia is (abnormally for geographical neighbors) not an important trading partner, Albania has responded positively to all the Macedonian initiatives for economic and political integration of the region. It is here, in regional collaboration and synergy, that Albania's future rests. Should the region deteriorate once more into mayhem and worse, Albania would be amongst the first and foremost to suffer. Hence its surprisingly conciliatory stance in the recent crisis in Macedonia. It seems that Albanian politicians have wisely decided to move from a "Great Albania" to a prosperous one.

Albania, often accused in the past of harboring unemployed mujaheedin and al-Qaida cells, has offered to contribute 70-75 fighters to Bush's anti-Iraqi "coalition of the willing". Earlier this month, it co-signed the US-Adriatic Charter, enshrining closer cooperation with America, Croatia and Macedonia.

Albania, on the seam between the European Union and wilder territories, is in the frontline. Last week, it turned away at the border a notorious Albanian "troublemaker", now a Swiss resident, Albanian Liberation Army head Gafurr Adili. The British plan to transform it into a centre for asylum seekers - most of them Iraqis - while their claims are being processed. Italy asked Albania on Wednesday to fend off war refugees likely to try to cross over to Western Europe from the Balkan country's coast.

Yet, Albania is far from being an American satellite, the way Macedonia is.

Defying American pressures, it is promoting a free trade agreement with Kosovo, the erstwhile Yugoslav province, now populated almost entirely by Kosovars of Albanian origin. Albanian and Iranian officials on state visit to Tirana last month called for closer economic, trade and international collaboration. An agreement on double taxation was subsequently signed. Albania inked and ratified the statute of the International Criminal Court, much-opposed by the USA.

Albania's economy is no less conflicted. Is it really Europe's poorest, 52 percent agricultural, failed state - or a role model of economic revival and geopolitical responsibility, as some multilaterals would have it?

Tales of horror and lachrymosity abound. According to the CIA's 2002 Factbook, one third of the population is under the poverty line and official unemployment is 17 percent. The Irish charity Cradle has recently collected $90,000 in food and hygiene products from children in 19 primary schools in Waterford to be shipped to the destitute state.

People inhabit shanty towns precariously constructed over toxic dumps - such as the one in Porto Romana, south of Albania's second city, Durres. The United Nations pegged the cleanup costs of this single site at $10 million. A million Albanians fled their homeland to Greece, Italy, Switzerland and Central Europe.

Legislation to protect property rights and facilitate commerce is lacking, the courts are compromised, law enforcement agencies irreparably rotten. Add to this, says the International Crisis Group in a report it released last week, "weak infrastructure, old technology, the fiscal burden (income taxes, value added tax and customs duties), weak implementation of legislation and insufficient financial services for the private sector" - and the following observations of the United Nations Conference on Trade and Development (UNCTAD) make sense:

"Albania receives relatively low levels of FDI flows, even compared to other countries of the Central and Eastern Europe region. Such flows increased quite substantially in recent years however, from a US$ 60 million average in 1993-1999 to US$ 143 million in 2000 and about US$ 200 million in 2001. The 2000 increase in FDI flows has led to an increase in the share of such flows in gross fixed capital formation, from 7% in 1999 to about 20% in 2000. Still, the share of FDI inflows in gross fixed capital formation registered between 1994 and 2000 was 15% on average, far below its 42% peak level in 1993."

But the true situation - accounting for the enormous informal economy, much of it illicit - is substantially different. The International Monetary Fund provided, two weeks ago, a more balanced view, following the conclusion of an Article IV consultation with the authorities:

"Sound financial policies and market reforms during most of the 1990s have fostered growth and macroeconomic stability. Nonetheless, poverty remains pervasive, and the sustainability of growth is dependent on the expansion of tradables, in particular industry and mining. However, investment in these sectors is hindered by a deficient business climate including administrative barriers and electricity shortages."

Though annual economic growth has dwindled from a historic average of 7 percent to 4.7 percent last year, import demand was buttressed by rising foreign investment and $1 billion in private remittances. This, of course, led to a widening trade deficit in both 2001 and 2002 - though the exchange rate is eerily stable.

Tax collection is still sporadic but the fiscal deficit has remained restrained, though high, at 8.5 percent of gross domestic product in 2001 and about 7.5 percent the year after. Total public debt declined to c. 64 percent of GDP from about 72 percent at end-2000, mainly due to generous debt forgiveness by the West.

The trade deficit is an alarming 24 percent of GDP, the current account deficit at almost one tenth of Albania's puny $4.6 billion product. International reserves are at a healthy 5 months of imports, the outcome of unilateral transfers, especially aid, remittances and debt.

Inflation peaked at 7 percent in early 2002 despite some tightening of monetary policy. It has since subsided. The repo rate, though, soared since mid-2001 from 6.5 to 8 percent. But to no avail: currency in circulation continued its vertiginous climb due to sizable panicky deposit withdrawals from the largest two banks early last year. Deposits have been recovering but lackadaisically.

The IMF chastises Albania's government:

"Structural reforms have slowed since mid-2001, with delays in privatization and, since mid-2002, slippage in electricity sector reform. Political changes, together with the weakened global market, hindered the planned mid-2002 sale of the Savings Bank and Albtelekom. While the authorities have made significant progress in reforming the ailing energy sector, drought has caused severe electricity shortages in recent years. Moreover recent slippage in meeting targets for bill collection and losses could prolong the crisis."

Albania's economic Renaissance is evident even in the moribund energy sector. According to Balkan Times, the country's Power and Industry Ministry is poised to approve a $257 million project in the oil sector - on top of $350 million invested in the past 12 years. The country may well become an oil producer - though this will do little to ameliorate its chronic power shortages and blackouts.

The Patos-Marinez well has proven to be surprisingly bountiful. Another $85 million will be invested by the World Bank in a combined-cycle (thermal and fuel) power station at a six-hectare greenfield site north of Vlore adjacent to an offshore oil tanker terminal.

Nor are signs of revival confined to oil. In an ironic reversal of roles, Air Albania dished out c. $3 million on a plane it bought from the bankrupt Australian carrier, Ansett. The recent introduction of a deposit insurance scheme restored some confidence in the banking system. Though only one in ten has a bank account - more than 12 foreign financial institutions opened shop in this country of 3.5 million people.

Construction of everything - from hotels to apartment blocks - is booming, driven by laundered funds from thriving drugs, trafficking and smuggling operations. Albania is one of the fastest growing mobile telephony markets in the world and its transport infrastructure has improved dramatically.

Bank supervision was strengthened, anti money laundering measures introduced, arrears with foreign creditors were largely regularized and an anti-corruption program implemented (by the venal and crime-infested Socialists, thunder the no less tainted opposition). The European Union intends to sign a Stabilization and Association Agreement with Tirana next month.

How can such disparate visions - of penury and resurgence - be reconciled?

As the International Crisis Group has noted, Albania may be making progress economically - but not so socially. It is still politically volatile, permeated by corruption and crime, centered around the capital at the expense of other under-developed regions.

Religious intolerance is growing - the general secretary of the Muslim community was assassinated two months ago. The environment is hopelessly dilapidated, poverty is rampant, destabilizing small weapons ubiquitous and some minorities - notably the Roma - ill-treated.

Albania's neighborhood is equally disheartening. Post-Djindjic Serbia is under an increasingly onerous "emergency" military regime. Montenegro is secessionist. Bloody tensions inside Macedonia between ethnic groups and political camps are mounting. Kosovo is restless. The European Union preoccupied. the United States wants out of the benighted Balkans. Relations with both Greece and Italy are strained.

Albania cannot alter its geographical destiny - but it can reform itself. Its leadership makes all the right noises and, occasionally, the proper moves. But it is a far cry from the fervor of true converts, such as Romania, Croatia, Bulgaria, or even Serbia. Unless Albanians take their own future seriously - no one else will.

Analysis, Technical and Fundamental

The authors of a paper published by NBER on March 2000 and titled "The Foundations of Technical Analysis" - Andrew Lo, Harry Mamaysky, and Jiang Wang - claim that:

"Technical analysis, also known as 'charting', has been part of financial practice for many decades, but this discipline has not received the same level of academic scrutiny and acceptance as more traditional approaches such as fundamental analysis.

One of the main obstacles is the highly subjective nature of technical analysis - the presence of geometric shapes in historical price charts is often in the eyes of the beholder. In this paper we offer a systematic and automatic approach to technical pattern recognition ... and apply the method to a large number of US stocks from 1962 to 1996..."

And the conclusion:

" ... Over the 31-year sample period, several technical indicators do provide incremental information and may have some practical value."

These hopeful inferences are supported by the work of other scholars, such as Paul Weller of the Finance Department of the university of Iowa. While he admits the limitations of technical analysis - it is a-theoretic and data intensive, pattern over-fitting can be a problem, its rules are often difficult to interpret, and the statistical testing is cumbersome - he insists that "trading rules are picking up patterns in the data not accounted for by standard statistical models" and that the excess returns thus generated are not simply a risk premium.

Technical analysts have flourished and waned in line with the stock exchange bubble. They and their multi-colored charts regularly graced CNBC, the CNN and other market-driving channels. "The Economist" found that many successful fund managers have regularly resorted to technical analysis - including George Soros' Quantum Hedge fund and Fidelity's Magellan. Technical analysis may experience a revival now that corporate accounts - the fundament of fundamental analysis - have been rendered moot by seemingly inexhaustible scandals.

The field is the progeny of Charles Dow of Dow Jones fame and the founder of the "Wall Street Journal". He devised a method to discern cyclical patterns in share prices. Other sages - such as Elliott - put forth complex "wave theories". Technical analysts now regularly employ dozens of geometric configurations in their divinations.

Technical analysis is defined thus in "The Econometrics of Financial Markets", a 1997 textbook authored by John Campbell, Andrew Lo, and Craig MacKinlay:

"An approach to investment management based on the belief that historical price series, trading volume, and other market statistics exhibit regularities - often ... in the form of geometric patterns ... that can be profitably exploited to extrapolate future price movements."

A less fanciful definition may be the one offered by Edwards and Magee in "Technical Analysis of Stock Trends":

"The science of recording, usually in graphic form, the actual history of trading (price changes, volume of transactions, etc.) in a certain stock or in 'the averages' and then deducing from that pictured history the probable future trend."

Fundamental analysis is about the study of key statistics from the financial statements of firms as well as background information about the company's products, business plan, management, industry, the economy, and the marketplace.

Economists, since the 1960's, sought to rebuff technical analysis. Markets, they say, are efficient and "walk" randomly. Prices reflect all the information known to market players - including all the information pertaining to the future. Technical analysis has often been compared to voodoo, alchemy, and astrology - for instance by Burton Malkiel in his seminal work, "A Random Walk Down Wall Street".

The paradox is that technicians are more orthodox than the most devout academic. They adhere to the strong version of market efficiency. The market is so efficient, they say, that nothing can be gleaned from fundamental analysis. All fundamental insights, information, and analyses are already reflected in the price. This is why one can deduce future prices from past and present ones.

Jack Schwager, sums it up in his book "Schwager on Futures: Technical Analysis", quoted by Stockcharts.com:

"One way of viewing it is that markets may witness extended periods of random fluctuation, interspersed with shorter periods of nonrandom behavior. The goal of the chartist is to identify those periods (i.e. major trends)."

Not so, retort the fundamentalists. The fair value of a security or a market can be derived from available information using mathematical models - but is rarely reflected in prices. This is the weak version of the market efficiency hypothesis.

The mathematically convenient idealization of the efficient market, though, has been debunked in numerous studies. These are efficiently summarized in Craig McKinlay and Andrew Lo's tome "A Non-random Walk Down Wall Street" published in 1999.

Not all markets are strongly efficient. Most of them sport weak or "semi-strong" efficiency. In some markets, a filter model - one that dictates the timing of sales and purchases - could prove useful. This is especially true when the equilibrium price of a share - or of the market as a whole - changes as a result of externalities.

Substantive news, change in management, an oil shock, a terrorist attack, an accounting scandal, an FDA approval, a major contract, or a natural, or man-made disaster - all cause share prices and market indices to break the boundaries of the price band that they have occupied. Technical analysts identify these boundaries and trace breakthroughs and their outcomes in terms of prices.

Technical analysis may be nothing more than a self-fulfilling prophecy, though. The more devotees it has, the stronger it affects the shares or markets it analyses.

Investors move in herds and are inclined to seek patterns in the often bewildering marketplace. As opposed to the assumptions underlying the classic theory of portfolio analysis - investors do remember past prices. They hesitate before they cross certain numerical thresholds.

But this herd mentality is also the Achilles heel of technical analysis. If everyone were to follow its guidance - it would have been rendered useless. If everyone were to buy and sell at the same time - based on the same technical advice - price advantages would have been arbitraged away instantaneously. Technical analysis is about privileged information to the privileged few - though not too few, lest prices are not swayed.

Studies cited in Edwin Elton and Martin Gruber's "Modern Portfolio Theory and Investment Analysis" and elsewhere show that a filter model - trading with technical analysis - is preferable to a "buy and hold" strategy but inferior to trading at random. Trading against recommendations issued by a technical analysis model and with them - yielded the same results. Fama-Blum discovered that the advantage proffered by such models is identical to transaction costs.

The proponents of technical analysis claim that rather than forming investor psychology - it reflects their risk aversion at different price levels. Moreover, the borders between the two forms of analysis - technical and fundamental - are less sharply demarcated nowadays. "Fundamentalists" insert past prices and volume data in their models - and "technicians" incorporate arcana such as the dividend stream and past earnings in theirs.

It is not clear why should fundamental analysis be considered superior to its technical alternative. If prices incorporate all the information known and reflect it - predicting future prices would be impossible regardless of the method employed. Conversely, if prices do not reflect all the information available, then surely investor psychology is as important a factor as the firm's - now oft-discredited - financial statements?

Prices, after all, are the outcome of numerous interactions among market participants, their greed, fears, hopes, expectations, and risk aversion. Surely studying this emotional and cognitive landscape is as crucial as figuring the effects of cuts in interest rates or a change of CEO?

Still, even if we accept the rigorous version of market efficiency - i.e., as Aswath Damodaran of the Stern Business School at NYU puts it, that market prices are "unbiased estimates of the true value of investments" - prices do react to new information - and, more importantly, to anticipated information. It takes them time to do so. Their reaction constitutes a trend and identifying this trend at its inception can generate excess yields. On this both fundamental and technical analysis are agreed.

Moreover, markets often over-react: they undershoot or overshoot the "true and fair value". Fundamental analysis calls this oversold and overbought markets. The correction back to equilibrium prices sometimes takes years. A savvy trader can profit from such market failures and excesses.

As quality information becomes ubiquitous and instantaneous, research issued by investment banks discredited, privileged access to information by analysts prohibited, derivatives proliferate, individual participation in the stock market increases, and transaction costs turn negligible - a major rethink of our antiquated financial models is called for.

The maverick Andrew Lo, a professor of finance at the Sloan School of Management at MIT, summed up the lure of technical analysis in lyric terms in an interview he gave to Traders.com's "Technical Analysis of Stocks and Commodities", quoted by Arthur Hill in Stockcharts.com:

"The more creativity you bring to the investment process, the more rewarding it will be. The only way to maintain ongoing success, however, is to constantly innovate. That's much the same in all endeavors. The only way to continue making money, to continue growing and keeping your profit margins healthy, is to constantly come up with new ideas."

Anarchy (as Organizing Principle)

The recent spate of accounting fraud scandals signals the end of an era. Disillusionment and disenchantment with American capitalism may yet lead to a tectonic ideological shift from laissez faire and self regulation to state intervention and regulation. This would be the reversal of a trend dating back to Thatcher in Britain and Reagan in the USA. It would also cast some fundamental - and way more ancient - tenets of free-marketry in grave doubt.

Markets are perceived as self-organizing, self-assembling, exchanges of information, goods, and services. Adam Smith's "invisible hand" is the sum of all the mechanisms whose interaction gives rise to the optimal allocation of economic resources. The market's great advantages over central planning are precisely its randomness and its lack of self-awareness.

Market participants go about their egoistic business, trying to maximize their utility, oblivious of the interests and action of all, bar those they interact with directly. Somehow, out of the chaos and clamor, a structure emerges of order and efficiency unmatched. Man is incapable of intentionally producing better outcomes. Thus, any intervention and interference are deemed to be detrimental to the proper functioning of the economy.

It is a minor step from this idealized worldview back to the Physiocrats, who preceded Adam Smith, and who propounded the doctrine of "laissez faire, laissez passer" - the hands-off battle cry. Theirs was a natural religion. The market, as an agglomeration of individuals, they thundered, was surely entitled to enjoy the rights and freedoms accorded to each and every person. John Stuart Mill weighed against the state's involvement in the economy in his influential and exquisitely-timed "Principles of Political Economy", published in 1848.

Undaunted by mounting evidence of market failures - for instance to provide affordable and plentiful public goods - this flawed theory returned with a vengeance in the last two decades of the past century. Privatization, deregulation, and self-regulation became faddish buzzwords and part of a global consensus propagated by both commercial banks and multilateral lenders.

As applied to the professions - to accountants, stock brokers, lawyers, bankers, insurers, and so on - self-regulation was premised on the belief in long-term self-preservation. Rational economic players and moral agents are supposed to maximize their utility in the long-run by observing the rules and regulations of a level playing field.

This noble propensity seemed, alas, to have been tampered by avarice and narcissism and by the immature inability to postpone gratification. Self-regulation failed so spectacularly to conquer human nature that its demise gave rise to the most intrusive statal stratagems ever devised. In both the UK and the USA, the government is much more heavily and pervasively involved in the minutia of accountancy, stock dealing, and banking than it was only two years ago.

But the ethos and myth of "order out of chaos" - with its proponents in the exact sciences as well - ran deeper than that. The very culture of commerce was thoroughly permeated and transformed. It is not surprising that the Internet - a chaotic network with an anarchic modus operandi - flourished at these times.

The dotcom revolution was less about technology than about new ways of doing business - mixing umpteen irreconcilable ingredients, stirring well, and hoping for the best. No one, for instance, offered a linear revenue model of how to translate "eyeballs" - i.e., the number of visitors to a Web site - to money ("monetizing"). It was dogmatically held to be true that, miraculously, traffic - a chaotic phenomenon - will translate to profit - hitherto the outcome of painstaking labour.

Privatization itself was such a leap of faith. State owned assets - including utilities and suppliers of public goods such as health and education - were transferred wholesale to the hands of profit maximizers. The implicit belief was that the price mechanism will provide the missing planning and regulation. In other words, higher prices were supposed to guarantee an uninterrupted service. Predictably, failure ensued - from electricity utilities in California to railway operators in Britain.

The simultaneous crumbling of these urban legends - the liberating power of the Net, the self-regulating markets, the unbridled merits of privatization - inevitably gave rise to a backlash.

The state has acquired monstrous proportions in the decades since the Second world War. It is about to grow further and to digest the few sectors hitherto left untouched. To say the least, these are not good news. But we libertarians - proponents of both individual freedom and individual responsibility - have brought it on ourselves by thwarting the work of that invisible regulator - the market.

Arms Trade

In a desperate bid to fend off sanctions, the Bosnian government banned yesterday all trade in arms and munitions. A local, Serb-owned company was documented by the State Department selling spare parts and maintenance for military aircraft to Iraq via Yugoslav shell companies.

Heads rolled. In the Republika Srpska, the Serb component of the ramshackle Bosnian state, both the Defense Minister Slobodan Bilic and army Chief of Staff Novica Simic resigned. Another casualty was the general director of the Orao Aircraft Institute of Bijeljina - Milan

Prica. On the Yugoslav side, Jugoimport chief Gen Jovan Cekovic and federal Deputy Defense Minister Ivan Djokic stood down.

Bosnia's is only the latest in a series of embarrassing disclosures in practically every country of the former eastern bloc, including all the EU accession candidates. With the crumbling of the Warsaw pact and the economies of the region, millions of former military and secret service operators resorted to peddling weapons and martial expertise to rogue states, terrorist outfits, and organized crime. The confluence - and, lately, convergence - of these interests is threatening Europe's very stability.

Last week, the Polish "Rzeczpospolita" accused the Military Information services (WSI) of illicit arms sales between 1992-6 through both private and state-run entities. The weapons were plundered from the Polish army and sold at half price to Croatia and Somalia, both under UN arms embargo.

Deals were struck with the emerging international operations of the Russian mafia. Terrorist middlemen and Latvian state officials were involved. Breaching Poland's democratic veneer, the Polish Ministry of Defense threatened to sue the paper for disclosing state secrets.

Police in Lodz is still investigating the alarming disappearance of 4 Arrow anti-aircraft missiles from a train transporting arms from a factory to the port of Gdansk, to be exported. The private security escort claim innocence.

The Czech Military Intelligence Services (VZS) have long been embroiled in serial scandals. The Czech defense attaché to India, Miroslav Kvasnak, was recently fired for disobeying explicit orders from the minister of defense. According to Jane's, Kvasnak headed URNA - the elite anti-terrorist unit of the Czech National Police. He was sacked in 1995 for selling Semtex, the notorious Czech plastic explosive, as well as weapons and munitions to organized crime gangs.

In late August, the Czechs arrested arms traffickers, members of an international ring, for selling Russian weapons - including, incredibly, tanks, fighter planes, naval vessels, long range rockets, and missile platforms - to Iraq. The operation has lasted 3 years and was conducted from Prague.

According to the "Wall Street Journal", the Czech intelligence services halted the sale of $300 million worth of the Tamara radar systems to Iraq in 1997. Czech firms, such as Agroplast, a leading waste processing company, have often been openly accused of weapons smuggling. "The Guardian" tracked in February a delivery of missiles and guidance systems from the Czech Republic through Syria to Iraq.

German go-betweens operate in the Baltic countries. In May a sale of more than two pounds of the radioactive element cesium-137 was thwarted in Vilnius, the capital of Lithuania. The substance was sold to terrorist groups bent on producing a "dirty bomb", believe US officials quoted by "The Guardian". The Director of the CIA, John Deutsch, testified in Congress in 1996 about previous cases in Lithuania involving two tons of radioactive wolfram and 220 pounds of uranium-238.

Still, the epicenters of the illicit trade in weapons are in the Balkan, in Russia, and in the republics of the former Soviet Union. Here, domestic firms intermesh with Western intermediaries, criminals, terrorists, and state officials to engender a pernicious, ubiquitous and malignant web of smuggling and corruption.

According to the Center for Public Integrity and the Western media, over the last decade, renegade Russian army officers have sold weapons to every criminal and terrorist organization in the world - from the IRA to al-Qaida and to every failed state, from Liberia to Libya.

They are protected by well-connected, bribe-paying, arms dealers and high-level functionaries in every branch of government. They launder the proceeds through Russian oil multinationals, Cypriot, Balkan, and Lebanese banks, and Asian, Swiss, Austrian, and British trading conglomerates - all obscurely owned and managed.

The most serious breach of the united international front against Iraq may be the sale of the $100 million anti-stealth Ukrainian Kolchuga radar to the pariah state two years ago. Taped evidence suggests that president Leonid Kuchma himself instructed the General Director of the Ukrainian arms sales company, UkrSpetzExport, Valery Malev to conclude the deal. Malev died in a mysterious car accident on March 6, three days after his taped conversation with Kuchma surfaced.

The Ukrainians insist that they were preempted by Russian dealers who sold a similar radar system to Iraq - but this is highly unlikely as the Russian system was still in development at the time. the American and British are currently conducting a high-profile investigation in Kyiv.

In Russia, illegal arms are traded mainly by the Western Group of Forces in cahoots with private companies, both domestic and foreign. The Air Defense Army specializes in selling light arms. The army is the main source of weapons - plastic explosives, grenade launchers, munitions - of both Chechen rebels and Chechen criminals. Contrary to received opinion, volunteer-soldiers, not conscripts, control the arms trade. The state itself is involved in arms proliferation. Sales to China and Iran were long classified. From June, all sales of materiel enjoy "state secret" status.

There is little the US can do. The Bush administration has imposed in May sanctions on Armenian and Moldovan companies, among others, for aiding and abetting Iran's efforts to obtain weapons of mass destruction. Armenian president, Robert Kocharian, indignantly denied knowledge of such transactions and vowed to get to the bottom of the American allegations.

The Foreign Policy Research Institute, quoted by Radio Free Europe/Radio Liberty, described a "Department of Energy (DOE) initiative, underway since 1993, to improve 'material protection, control and accountability' at former Soviet nuclear enterprises. The program enjoys substantial bipartisan support in the United States and is considered the first line of defense against unwanted proliferation episodes."

"As of February 2000, more than 8 years after the collapse of the USSR, new security systems had been installed at 113 buildings, most of them in Russia; however, these sites contained only 7 percent of the estimated 650 tons of weapons-usable material considered at risk for theft or diversion. DOE plans call for safeguarding 60 percent of the material by 2006 and the rest in 10 to 15 years or longer."

Russian traders learned to circumvent official channels and work through Belarus. Major General Stsyapan Sukharenka, the first deputy chief of the Belarusian KGB, denied, in March, any criminal arms trading in his country. This vehement protest is gainsaid by the preponderance of Belarusian arms traders replete with fake end-user certificates in Croatia during the Yugoslav wars of secession (1992-5).

Deputy Assistant Secretary of State Steven Pifer said that UN inspectors unearthed Belarusian artillery in Iraq in 1996. Iraqis are also being trained in Belarus to operate various advanced weapons systems. The secret services and armies of Ukraine, Russia, and even Romania use Belarus to mask the true origin of weapons sold in contravention of UN sanctions.

Western arms manufacturers lobby their governments to enhance their sales. Legitimate Russian and Ukrainian sales are often thwarted by Western political arm-twisting. When Macedonia, in the throes of a civil war it was about to lose, purchased helicopter gunships from Ukraine, the American Embassy leaned on the government to annul the contracts and threatened to withhold aid and credits if it does not succumb.

The duopoly, enjoyed by the USA and Russia, forces competitors to go underground and to seek rogue or felonious customers. Yugoslav scientists, employed by Jugoimport and other firms run by former army officers, are developing cruise missiles for Iraq, alleges the American administration. The accusation, though, is dubious as Iraq has no access to satellites to guide such missiles.

Another Yugoslav firm, Brunner, constructed a Libyan rocket propellant manufacturing facility. In an interview to the "Washington Post", Yugoslavia's president Vojislav Kostunica brushed off the American complaints about, as he put it disdainfully, "overhauling older-generation aircraft engines".

Such exploits are not unique to Yugoslavia or Bosnia. The Croat security services are notorious for their collusion in drug and arms trafficking, mainly via Hungary. Macedonian construction companies collaborate with manufacturers of heavy machinery and purveyors of missile technology in an effort to recoup hundreds of millions of dollars in Iraqi debts. Albanian crime gangs collude with weapon smugglers based in Montenegro and Kosovo. The Balkan - from Greece to Hungary - is teeming with these penumbral figures.

Arms smuggling is a by-product of criminalized societies, destitution, and dysfunctional institutions. The prolonged period of failed transition in countries such as Yugoslavia, Macedonia, Bosnia, Moldova, Belarus, and Ukraine has entrenched organized crime. It now permeates every legitimate economic sphere and every organ of the state. Whether this situation is reversible is the subject of heated debate. But it is the West which pays the price in increased crime rates and, probably in Iraq, in added fatalities once it launches war against that murderous regime.

Asian Tigers

The first reaction of economies in transition is a sharp decline in their production, mainly in industrial production. In the countries which attained independence with the demise of the British Empire (where the sun never set) - industrial production fell by 20% on average. Even this was because these countries continued to maintain economic ties with the "mother" (the United Kingdom). They also continued to trade among themselves, with the rest of the British Empire, through the Commonwealth mechanism.

This was not the case when the second biggest empire of modern times collapsed, the Soviet empire. When the USSR and the Eastern Bloc disintegrated - the COMECON trading bloc was dismantled, never to be replaced by another. All the constituents of the former Eastern Bloc preferred to trade with the west rather than with one another. The Empire left in its wake mountains of trade debts, total lack of liquidity and money losing barter operations carried out in unrealistic prices.

Thus, industrial production plunged in the newly established countries (CIS and the countries which were part of Former Yugoslavia) as well as in other former members of the Eastern Bloc by 40-60% over a period of 5 years. A slow recovery is discernible only in the last two years and industrial production is picking up at an annual rate of 2% (Estonia) to 8% (the Czech Republic) - depending on the country.

This disastrous drop in the most important parameter of economic health was largely attributable to a few, cumulative factors:

a. The sudden evaporation of all the traditional export markets - simultaneously. Macedonia has lost 80% of its export markets with the bloody and siege-laden disintegration of the Former (federation of) Yugoslavia. Similar vicissitudes were experienced by other countries in transition.

b. A huge, unsustainable internal debt between the companies themselves (each acting in the dual role of supplier and of client) - and between the enterprises and the state. This burden was only very mildly ameliorated by bartering. Mostly, it led to severe cases of insolvency or lack of liquidity and to a reversion to pre-monetary economic systems.

c. This lack of liquidity also prevented the investment in capital assets (plant modernization, personnel training, data processing and decision making tools) necessary to sustain efficiency gains, increase productivity and maintain competitiveness.

d. Gross inefficiency of the industrial plants which was due to massive hidden unemployment, low maintenance standards and the aforementioned lack of capital.

e. Outmoded and outdated management techniques. The old guard of managers in industry were ill adapted to the rapid changes wrought about them by capitalism and wise industries. They continued "to fight the last (and lost) wars", to bemoan their fate and not to provide a sense of direction, a vision of the future and the management decisions which are derivatives of the above.

f. Faulty legislation, dysfunctioning law enforcement systems, crony capitalism and privateering (the sale of state assets to political allies or to family members of influential political and economic figures) - all led to fuzzy ownership structures and to a virtual abandonment of the protection of property rights. In the absence of clear ownership and under the threat ever - imminent loss of property, the profit motivation has degenerated into speculative binges and bouts and decision making was transformed into power contests.

g. These industries produced and manufactured goods in accordance with some central planning, an theoretical model of the marketplace, or rule-of-thumb thinking. The result was mountains of shoddy merchandise, of low quality and very little demand. Antiquated design and lack of responsiveness to market needs and consumers' wishes only exacerbated the situation.

h. This absence of market research, market analysis and, more generally, market awareness led to the almost complete absence of marketing, sales promotion, or advertising (in the modern sense). Paradoxically, the communist era industries demonstrate a deeper belief in "the invisible hand of the market" than do their capitalist brethren. They entrust the function of the dissemination of information and its influence upon the decisions made by consumers - entirely to the market. If the product is either needed or good enough, it will sell itself, was the thinking. Marketing and advertising were thought of as illegitimate cajoling, pushing consumers to make decisions that they would not have made otherwise.

i. Industry operated under all these crushing constraints in an environment of heavy to impossible regulation, trade protectionism (which denied them the benefits of competition), corrupt bureaucracy, rolls of red tape, heavy political involvement and a total distortion of economic considerations by "social" ones. This was further compounded by a decaying banking system (where the distinction between lender and borrower was rendered superfluous by the concept of "social capital" which belongs to everyone equally). It could not supply the industrial sector with capital replenishment and the total absence of capital markets did not help.

j. Last - but far from being least - was the non existence of a "Protestant" or "Asian values" work ethic. Low salaries, feigned "equality" and absent profit motivation - all led to a disincentived work environment. The norm in many of these countries is still: "come to work, open and close the door and get paid", as the saying goes. This is the benign case. Stealing from the workplace has become an acceptable way of complementing income and moonlighting was done at the expense of the official "primary" workplace.

But it seems that the worst is over and that the scene is fast changing.

However sloppy or criminal the process of privatization, still hundreds of thousands of new capitalists were brewed and introduced, willy nilly, to the profit motive. The spectre of capital gains, made most of them (except the most hardened) discover marketing, advertising, design, export, trade financing, public offerings, strategic partnerships, concessions and business plans.

Industries are much more focussed and market oriented. The new religion of capitalism, replete with entrepreneurship, free choice, personal profit and the invisible hand of the market has been successfully phased in.

Both the domestic markets and international trade are recovering nicely. Consumption is growing and with it exports. The political level is withdrawing from the scene through more or less successful privatization or transformation schemes and appropriate legislation to minimize the role of the state in the economy.

Some countries have opted to "skip" some of the industrial portion of the classic, evolutionary economic cycle - and go directly to investing in information and knowledge industries. They educate their workforce and retrain it accordingly. They invite multinationals - using a cocktail of tax incentives and direct grants and subsidies - to open back office operations (accounting, administration) and telemarketing operations in their countries. This calls for lower investment than in classic (or sunset) industries and has a high value added to the economy.

But the single largest driving force behind economic recovery is foreign capital. Foreign Direct Investment

(FDI) is pouring in and with it: new markets, technology transfers through joint ventures, new, attractive product mixes, new management, new ideas and new ownership - clear and decisive.

So, industrial production is picking up and will continue to grow briskly in all countries in transition that have the peaceful conditions necessary for long term development. If Macedonia will follow the examples of the Baltic countries, of Poland, the Czech Republic, Hungary, Slovenia, even Russia, Ireland, Egypt, Chile, Indonesia, Israel and the Philippines - it will double its industrial production within 10 years and redouble it again in 15 years.

Israel, Ireland and … France and Japan (!) are examples of poor, agricultural countries, which made the transition to thriving industrial countries successfully.

But was their secret? How come Hong Kong and Singapore are richer than Britain by some measures? Together with South Korea and Taiwan they have been growing at an average rate of 7.5% annually for the last 30 years. China, Indonesia, Malaysia, Thailand, The Philippines have joined the "Asian Tigers" club.

They all share some common features:

a. Massive injections of labour (by massive immigration from rural areas to the cities, urbanization). Massive injections of capital and technology. The above injections were financed by an exceedingly high level of savings and investments (savings amount to 35% of GDP, on average).

b. Wise government direction provided through a clear industrial policy. This, though, is a double edged sword: a less wise policy would have backfired with the same strength.

c. A capitalist, profit seeking mentality.

d. An annual increase of 2-3% in productivity which is the result of copying technology and other forms of technology transfers from the rich West.

e. Strong work, family and society ethics within a cohesive, conformist and supportive social environment (the "Asian Values" are the Eastern equivalent of the "Protestant Work Ethic").

f. Low taxation and small government budgets (less than 20% of GDP compared to twice as much in the West - and 3 times as much in France today).

g. Flexible and mobile labour and c (in certain countries) capital markets. When mobility or flexibility are restricted (Japan) it is the result of social treaty rather than of legislation, regulation, or other statist intervention.

h. A firm, long lasting commitment to education and to skill acquisition, even in hard circumstances. The number of educated people is low but growing rapidly, as a result.

i. Openness to trade, knowledge and to technology.

j. Imports are composed mostly of investment goods and capital assets. The culture of conspicuous, addictive (or even normal) consumption is less developed there.

Still, these countries started from a very low income base. It is common economic knowledge that low income countries always grow fast because they can increase their productivity simply by purchasing technology and management in the rich country. Purchasing technology is always much cheaper than developing it - while maintaining roughly the same economic benefits.

Thus, Hong Kong grew by 9% in the 60s. This growth coefficient was reduced to 7.5% in the 80s and to 5% in the 90s. But China, Malaysia, Thailand and Indonesia are likely to grow annually by 7-9% during the next decade.

Not that these countries are exempt from problems. The process of maturation creates many of them. There is the dependence on export markets and volatile exchange rates (which determine the terms of trade). When the West reduced its consumption of microchips and the Dollar appreciated by 50% against the Japanese Yen - all the tigers suffered a decline in economic growth rates, current account deficits of 5-8% of their GDP, strikes (South Korea) and Stock Market crashes (Thailand, to name but one of many). In Singapore and in Hong Kong, the industrial production plummeted by 5% last year (1996).

Years of easy money and cheap credits directed by the state at selected industries starved small businesses, created overinvestment and overcapacity in certain, state-supported, industries and destabilized the banking and the financial systems. It helped forge infrastructure bottlenecks and led to a shortage in skilled or educated manpower. In Thailand only 38% of those 14 years old attend school and in China, the situation is not much better.

Finally, the financial markets proved to be too regulated, the government proved to be too bureaucratic, corruption proved to be too rampant (Indonesia, Japan, almost everybody else). There were too many old conglomerate-type mega - companies which prevented competition (e., the Chaebol in South Korea or the Zaibatsu in Japan).

So, the emerging economies are looking to Hong Kong, Singapore and Taiwan to supply the ideal: truly flexible labour markets, no state involvement, lots of nimble, small businesses, deregulated markets, transigent industrial policies. These countries - and the rest of the Asian Tigers - are expected to beat the West at its own game: money. They have many more years of economic growth ahead:

Each Korean worker has only 40% of the capital goods, available to his Western comrade, at his disposal. Putting more technology at his fingertips will increase his productivity.

An industrial worker in the west has a minimum of 10 years of education. In Indonesia and Thailand he has 4 years and even in South Korea he has merely 9 years. On average, an industrial worker in one of the Asian Tigers countries carries 7 years of education in his satchel - hardly the stuff that generals are made of. Research demonstrated that the more educated the worker - the higher his productivity.

Finally, increasing wages and looming current account deficits - will force the tigers to move to higher value added (non labour intensive) industries (the services, information and knowledge industries).

Then, it will be the turn of countries like Macedonia to take their place in some labour intensive areas and to rise to tigerdom.

Asset Bubbles

The recent implosion of the global equity markets - from Hong Kong to New York - engendered yet another round of the semipternal debate: should central banks contemplate abrupt adjustments in the prices of assets - such as stocks or real estate - as they do changes in the consumer price indices? Are asset bubbles indeed inflationary and their bursting deflationary?

Central bankers counter that it is hard to tell a bubble until it bursts and that market intervention bring about that which it is intended to prevent. There is insufficient historical data, they reprimand errant scholars who insist otherwise. This is disingenuous. Ponzi and pyramid schemes have been a fixture of Western civilization at least since the middle Renaissance.

Assets tend to accumulate in "asset stocks". Residences built in the 19th century still serve their purpose today. The quantity of new assets created at any given period is, inevitably, negligible compared to the stock of the same class of assets accumulated over decades and, sometimes, centuries. This is why the prices of assets are not anchored - they are only loosely connected to their production costs or even to their replacement value.

Asset bubbles are not the exclusive domain of stock exchanges and shares. "Real" assets include land and the property built on it, machinery, and other tangibles. "Financial" assets include anything that stores value and can serve as means of exchange - from cash to securities. Even tulip bulbs will do.

In 1634, in what later came o be known as "tulipmania", tulip bulbs were traded in a special marketplace in Amsterdam, the scene of a rabid speculative frenzy. Some rare black tulip bulbs changed hands for the price of a big mansion house. For four feverish years it seemed like the craze would last forever. But the bubble burst in 1637. In a matter of a few days, the price of tulip bulbs was slashed by 96%!

Uniquely, tulipmania was not an organized scam with an identifiable group of movers and shakers, which controlled and directed it. Nor has anyone made explicit promises to investors regarding guaranteed future profits. The hysteria was evenly distributed and fed on itself. Subsequent investment fiddles were different, though.

Modern dodges entangle a large number of victims. Their size and all-pervasiveness sometimes threaten the national economy and the very fabric of society and incur grave political and social costs.

There are two types of bubbles.

Asset bubbles of the first type are run or fanned by financial intermediaries such as banks or brokerage houses. They consist of "pumping" the price of an asset or an asset class. The assets concerned can be shares, currencies, other securities and financial instruments - or even savings accounts. To promise unearthly yields on one's savings is to artificially inflate the "price", or the "value" of one's savings account.

More than one fifth of the population of 1983 Israel were involved in a banking scandal of Albanian proportions. It was a classic pyramid scheme. All the banks, bar one, promised to gullible investors ever increasing returns on the banks' own publicly-traded shares.

These explicit and incredible promises were included in prospectuses of the banks' public offerings and won the implicit acquiescence and collaboration of successive Israeli governments. The banks used deposits, their capital, retained earnings and funds illegally borrowed through shady offshore subsidiaries to try to keep their impossible and unhealthy promises. Everyone knew what was going on and everyone was involved. It lasted 7 years. The prices of some shares increased by 1-2 percent daily.

On October 6, 1983, the entire banking sector of Israel crumbled. Faced with ominously mounting civil unrest, the government was forced to compensate shareholders. It offered them an elaborate share buyback plan over 9 years. The cost of this plan was pegged at $6 billion - almost 15 percent of Israel's annual GDP. The indirect damage remains unknown.

Avaricious and susceptible investors are lured into investment swindles by the promise of impossibly high profits or interest payments. The organizers use the money entrusted to them by new investors to pay off the old ones and thus establish a credible reputation. Charles Ponzi perpetrated many such schemes in 1919-1925 in Boston and later the Florida real estate market in the USA. Hence a "Ponzi scheme".

In Macedonia, a savings bank named TAT collapsed in 1997, erasing the economy of an entire major city, Bitola. After much wrangling and recriminations - many politicians seem to have benefited from the scam - the government, faced with elections in September, has recently decided, in defiance of IMF diktats, to offer meager compensation to the afflicted savers. TAT was only one of a few similar cases. Similar scandals took place in Russia and Bulgaria in the 1990's.

One third of the impoverished population of Albania was cast into destitution by the collapse of a series of nation-wide leveraged investment plans in 1997. Inept political and financial crisis management led Albania to the verge of disintegration and a civil war. Rioters invaded police stations and army barracks and expropriated hundreds of thousands of weapons.

Islam forbids its adherents to charge interest on money lent - as does Judaism. To circumvent this onerous decree, entrepreneurs and religious figures in Egypt and in Pakistan established "Islamic banks". These institutions pay no interest on deposits, nor do they demand interest from borrowers. Instead, depositors are made partners in the banks' - largely fictitious - profits. Clients are charged for - no less fictitious - losses. A few Islamic banks were in the habit of offering vertiginously high "profits". They went the way of other, less pious, pyramid schemes. They melted down and dragged economies and political establishments with them.

By definition, pyramid schemes are doomed to failure. The number of new "investors" - and the new money they make available to the pyramid's organizers - is limited. When the funds run out and the old investors can no longer be paid, panic ensues. In a classic "run on the bank", everyone attempts to draw his money simultaneously. Even healthy banks - a distant relative of pyramid schemes - cannot cope with such stampedes. Some of the money is invested long-term, or lent. Few financial institutions keep more than 10 percent of their deposits in liquid on-call reserves.

Studies repeatedly demonstrated that investors in pyramid schemes realize their dubious nature and stand forewarned by the collapse of other contemporaneous scams. But they are swayed by recurrent promises that they could draw their money at will ("liquidity") and, in the meantime, receive alluring returns on it ("capital gains", "interest payments", "profits").

People know that they are likelier to lose all or part of their money as time passes. But they convince themselves that they can outwit the organizers of the pyramid, that their withdrawals of profits or interest payments prior to the inevitable collapse will more than amply compensate them for the loss of their money. Many believe that they will succeed to accurately time the extraction of their original investment based on - mostly useless and superstitious - "warning signs".

While the speculative rash lasts, a host of pundits, analysts, and scholars aim to justify it. The "new economy" is exempt from "old rules and archaic modes of thinking". Productivity has surged and established a steeper, but sustainable, trend line. Information technology is as revolutionary as electricity. No, more than electricity. Stock valuations are reasonable. The Dow is on its way to 33,000. People want to believe these "objective, disinterested analyses" from "experts".

Investments by households are only one of the engines of this first kind of asset bubbles. A lot of the money that pours into pyramid schemes and stock exchange booms is laundered, the fruits of illicit pursuits. The laundering of tax-evaded money or the proceeds of criminal activities, mainly drugs, is effected through regular banking channels. The money changes ownership a few times to obscure its trail and the identities of the true owners.

Many offshore banks manage shady investment ploys. They maintain two sets of books. The "public" or "cooked" set is made available to the authorities - the tax administration, bank supervision, deposit insurance, law enforcement agencies, and securities and exchange commission. The true record is kept in the second, inaccessible, set of files.

This second set of accounts reflects reality: who deposited how much, when and subject to which conditions - and who borrowed what, when and subject to what terms. These arrangements are so stealthy and convoluted that sometimes even the shareholders of the bank lose track of its activities and misapprehend its real situation. Unscrupulous management and staff sometimes take advantage of the situation. Embezzlement, abuse of authority, mysterious trades, misuse of funds are more widespread than acknowledged.

The thunderous disintegration of the Bank for Credit and Commerce International (BCCI) in London in 1991 revealed that, for the better part of a decade, the executives and employees of this penumbral institution were busy stealing and misappropriating $10 billion. The Bank of England's supervision department failed to spot the rot on time. Depositors were - partially - compensated by the main shareholder of the bank, an Arab sheikh. The story repeated itself with Nick Leeson and his unauthorized disastrous trades which brought down the venerable and veteran Barings Bank in 1995.

The combination of black money, shoddy financial controls, shady bank accounts and shredded documents renders a true account of the cash flows and damages in such cases all but impossible. There is no telling what were the contributions of drug barons, American off-shore corporations, or European and Japanese tax-evaders - channeled precisely through such institutions - to the stratospheric rise in Wall-Street in the last few years.

But there is another - potentially the most pernicious - type of asset bubble. When financial institutions lend to the unworthy but the politically well-connected, to cronies, and family members of influential politicians - they often end up fostering a bubble. South Korean chaebols, Japanese keiretsu, as well as American conglomerates frequently used these cheap funds to prop up their stock or to invest in real estate, driving prices up in both markets artificially.

Moreover, despite decades of bitter experiences - from Mexico in 1982 to Asia in 1997 and Russia in 1998 - financial institutions still bow to fads and fashions. They act herd-like in conformity with "lending trends". They shift assets to garner the highest yields in the shortest possible period of time. In this respect, they are not very different from investors in pyramid investment schemes.

Case Study - The Savings and Loans Associations Bailout

Asset bubbles - in the stock exchange, in the real estate or the commodity markets - invariably burst and often lead to banking crises. One such calamity struck the USA in 1986-1989. It is instructive to study the decisive reaction of the administration and Congress alike. They tackled both the ensuing liquidity crunch and the structural flaws exposed by the crisis with tenacity and skill. Compare this to the lackluster and hesitant tentativeness of the current lot. True, the crisis - the result of a speculative bubble - concerned the banking and real estate markets rather than the capital markets. But the similarities are there.

The savings and loans association, or the thrift, was a strange banking hybrid, very much akin to the building society in Britain. It was allowed to take in deposits but was really merely a mortgage bank. The Depository Institutions Deregulation and Monetary Control Act of 1980 forced S&L's to achieve interest parity with commercial banks, thus eliminating the interest ceiling on deposits which they enjoyed hitherto.

But it still allowed them only very limited entry into commercial and consumer lending and trust services. Thus, these institutions were heavily exposed to the vicissitudes of the residential real estate markets in their respective regions. Every normal cyclical slump in property values or regional economic shock - e.g., a plunge in commodity prices - affected them disproportionately.

Interest rate volatility created a mismatch between the assets of these associations and their liabilities. The negative spread between their cost of funds and the yield of their assets - eroded their operating margins. The 1982 Garn-St. Germain Depository Institutions Act encouraged thrifts to convert from mutual - i.e., depositor-owned - associations to stock companies, allowing them to tap the capital markets in order to enhance their faltering net worth.

But this was too little and too late. The S&L's were rendered unable to further support the price of real estate by rolling over old credits, refinancing residential equity, and underwriting development projects. Endemic corruption and mismanagement exacerbated the ruin. The bubble burst.

Hundreds of thousands of depositors scrambled to withdraw their funds and hundreds of savings and loans association (out of a total of more than 3,000) became insolvent instantly, unable to pay their depositors. They were besieged by angry - at times, violent - clients who lost their life savings.

The illiquidity spread like fire. As institutions closed their gates, one by one, they left in their wake major financial upheavals, wrecked businesses and homeowners, and devastated communities. At one point, the contagion threatened the stability of the entire banking system.

The Federal Savings and Loans Insurance Corporation (FSLIC) - which insured the deposits in the savings and loans associations - was no longer able to meet the claims and, effectively, went bankrupt. Though the obligations of the FSLIC were never guaranteed by the Treasury, it was widely perceived to be an arm of the federal government. The public was shocked. The crisis acquired a political dimension.

A hasty $300 billion bailout package was arranged to inject liquidity into the shriveling system through a special agency, the FHFB. The supervision of the banks was subtracted from the Federal Reserve. The role of the the Federal Deposit Insurance Corporation (FDIC) was greatly expanded.

Prior to 1989, savings and loans were insured by the now-defunct FSLIC. The FDIC insured only banks. Congress had to eliminate FSLIC and place the insurance of thrifts under FDIC. The FDIC kept the Bank Insurance Fund (BIF) separate from the Savings Associations Insurance Fund (SAIF), to confine the ripple effect of the meltdown.

The FDIC is designed to be independent. Its money comes from premiums and earnings of the two insurance funds, not from Congressional appropriations. Its board of directors has full authority to run the agency. The board obeys the law, not political masters. The FDIC has a preemptive role. It regulates banks and savings and loans with the aim of avoiding insurance claims by depositors.

When an institution becomes unsound, the FDIC can either shore it up with loans or take it over. If it does the latter, it can run it and then sell it as a going concern, or close it, pay off the depositors and try to collect the loans. At times, the FDIC ends up owning collateral and trying to sell it.

Another outcome of the scandal was the Resolution Trust Corporation (RTC). Many savings and loans were treated as "special risk" and placed under the jurisdiction of the RTC until August 1992. The RTC operated and sold these institutions - or paid off the depositors and closed them. A new government corporation (Resolution Fund Corporation, RefCorp) issued federally guaranteed bailout bonds whose proceeds were used to finance the RTC until 1996.

The Office of Thrift Supervision (OTS) was also established in 1989 to replace the dismantled Federal Home Loan Board (FHLB) in supervising savings and loans. OTS is a unit within the Treasury Department, but law and custom make it practically an independent agency.

The Federal Housing Finance Board (FHFB) regulates the savings establishments for liquidity. It provides lines of credit from twelve regional Federal Home Loan Banks (FHLB). Those banks and the thrifts make up the Federal Home Loan Bank System (FHLBS). FHFB gets its funds from the System and is independent of supervision by the executive branch.

Thus a clear, streamlined, and powerful regulatory mechanism was put in place. Banks and savings and loans abused the confusing overlaps in authority and regulation among numerous government agencies. Not one regulator possessed a full and truthful picture. Following the reforms, it all became clearer: insurance was the FDIC's job, the OTS provided supervision, and liquidity was monitored and imparted by the FHLB.

Healthy thrifts were coaxed and cajoled to purchase less sturdy ones. This weakened their balance sheets considerably and the government reneged on its promises to allow them to amortize the goodwill element of the purchase over 40 years. Still, there were 2,898 thrifts in 1989. Six years later, their number shrank to 1,612 and it stands now at less than 1,000. The consolidated institutions are bigger, stronger, and better capitalized.

Later on, Congress demanded that thrifts obtain a bank charter by 1998. This was not too onerous for most of them. At the height of the crisis the ratio of their combined equity to their combined assets was less than 1%. But in 1994 it reached almost 10% and remained there ever since.

This remarkable turnaround was the result of serendipity as much as careful planning. Interest rate spreads became highly positive. In a classic arbitrage, savings and loans paid low interest on deposits and invested the money in high yielding government and corporate bonds. The prolonged equity bull market allowed thrifts to float new stock at exorbitant prices.

As the juridical relics of the Great Depression - chiefly amongst them, the Glass-Steagall Act - were repealed, banks were liberated to enter new markets, offer new financial instruments, and spread throughout the USA. Product and geographical diversification led to enhanced financial health.

But the very fact that S&L's were poised to exploit these opportunities is a tribute to politicians and regulators alike - though except for setting the general tone of urgency and resolution, the relative absence of political intervention in the handling of the crisis is notable. It was managed by the autonomous, able, utterly professional, largely a-political Federal Reserve. The political class provided the professionals with the tools they needed to do the job. This mode of collaboration may well be the most important lesson of this crisis.

Case Study - Wall Street, October 1929

Claud Cockburn, writing for the "Times of London" from New-York, described the irrational exuberance that gripped the nation just prior to the Great Depression. As Europe wallowed in post-war malaise, America seemed to have discovered a new economy, the secret of uninterrupted growth and prosperity, the fount of transforming technology:

"The atmosphere of the great boom was savagely exciting, but there were times when a person with my European background felt alarmingly lonely. He would have liked to believe, as these people believed, in the eternal upswing of the big bull market or else to meet just one person with whom he might discuss some general doubts without being regarded as an imbecile or a person of deliberately evil intent - some kind of anarchist, perhaps."

The greatest analysts with the most impeccable credentials and track records failed to predict the forthcoming crash and the unprecedented economic depression that followed it. Irving Fisher, a preeminent economist, who, according to his biographer-son, Irving Norton Fisher, lost the equivalent of $140 million in today's money in the crash, made a series of soothing predictions. On October 22 he uttered these avuncular statements: "Quotations have not caught up with real values as yet ... (There is) no cause for a slump ... The market has not been inflated but merely readjusted..."

Even as the market convulsed on Black Thursday, October 24, 1929 and on Black Tuesday, October 29 - the New York Times wrote: "Rally at close cheers brokers, bankers optimistic".

In an editorial on October 26, it blasted rabid speculators and compliant analysts: "We shall hear considerably less in the future of those newly invented conceptions of finance which revised the principles of political economy with a view solely to fitting the stock market's vagaries." But it ended thus: "(The Federal Reserve has) insured the soundness of the business situation when the speculative markets went on the rocks."

Compare this to Alan Greenspan Congressional testimony this summer: "While bubbles that burst are scarcely benign, the consequences need not be catastrophic for the economy ... (The Depression was brought on by) ensuing failures of policy."

Investors, their equity leveraged with bank and broker loans, crowded into stocks of exciting "new technologies", such as the radio and mass electrification. The bull market - especially in issues of public utilities - was fueled by "mergers, new groupings, combinations and good earnings" and by corporate purchasing for "employee stock funds".

Cautionary voices - such as Paul Warburg, the influential banker, Roger Babson, the "Prophet of Loss" and Alexander Noyes, the eternal Cassandra from the New York Times - were derided. The number of brokerage accounts doubled between March 1927 and March 1929.

When the market corrected by 8 percent between March 18-27 - following a Fed induced credit crunch and a series of mysterious closed-door sessions of the Fed's board - bankers rushed in. The New York Times reported: "Responsible bankers agree that stocks should now be supported, having reached a level that makes them attractive." By August, the market was up 35 percent on its March lows. But it reached a peak on September 3 and it was downhill since then.

On October 19, five days before "Black Thursday", Business Week published this sanguine prognosis:

"Now, of course, the crucial weaknesses of such periods - price inflation, heavy inventories, over-extension of commercial credit - are totally absent. The security market seems to be suffering only an attack of stock indigestion... There is additional reassurance in the fact that, should business show any further signs of fatigue, the banking system is in a good position now to administer any needed credit tonic from its excellent Reserve supply."

The crash unfolded gradually. Black Thursday actually ended with an inspiring rally. Friday and Saturday - trading ceased only on Sundays - witnessed an upswing followed by mild profit taking. The market dropped 12.8 percent on Monday, with Winston Churchill watching from the visitors' gallery - incurring a loss of $10-14 billion.

The Wall Street Journal warned naive investors:

"Many are looking for technical corrective reactions from time to time, but do not expect these to disturb the upward trend for any prolonged period."

The market plummeted another 11.7 percent the next day - though trading ended with an impressive rally from the lows. October 31 was a good day with a "vigorous, buoyant rally from bell to bell". Even Rockefeller joined the myriad buyers. Shares soared. It seemed that the worst was over.

The New York Times was optimistic:

"It is thought that stocks will become stabilized at their actual worth levels, some higher and some lower than the present ones, and that the selling prices will be guided in the immediate future by the worth of each particular security, based on its dividend record, earnings ability and prospects. Little is heard in Wall Street these days about 'putting stocks up."

But it was not long before irate customers began blaming their stupendous losses on advice they received from their brokers. Alec Wilder, a songwriter in New York in 1929, interviewed by Stud Terkel in "Hard Times" four decades later, described this typical exchange with his money manager:

"I knew something was terribly wrong because I heard bellboys, everybody, talking about the stock market. About six weeks before the Wall Street Crash, I persuaded my mother in Rochester to let me talk to our family adviser. I wanted to sell stock which had been left me by my father. He got very sentimental: 'Oh your father wouldn't have liked you to do that.' He was so persuasive, I said O.K. I could have sold it for $160,000. Four years later, I sold it for $4,000."

Exhausted and numb from days of hectic trading and back office operations, the brokerage houses pressured the stock exchange to declare a two day trading holiday. Exchanges around North America followed suit.

At first, the Fed refused to reduce the discount rate. "(There) was no change in financial conditions which the board thought called for its action." - though it did inject liquidity into the money market by purchasing government bonds. Then, it partially succumbed and reduced the New York discount rate, which, curiously, was 1 percent above the other Fed districts - by 1 percent. This was too little and too late. The market never recovered after November 1. Despite further reductions in the discount rate to 4 percent, it shed a whopping 89 percent in nominal terms when it hit bottom three years later.

Everyone was duped. The rich were impoverished overnight. Small time margin traders - the forerunners of today's day traders - lost their shirts and much else besides. The New York Times:

"Yesterday's market crash was one which largely affected rich men, institutions, investment trusts and others who participate in the market on a broad and intelligent scale. It was not the margin traders who were caught in the rush to sell, but the rich men of the country who are able to swing blocks of 5,000, 10,000, up to 100,000 shares of high-priced stocks. They went overboard with no more consideration than the little trader who was swept out on the first day of the market's upheaval, whose prices, even at their lowest of last Thursday, now look high by comparison ... To most of those who have been in the market it is all the more awe-inspiring because their financial history is limited to bull markets."

Overseas - mainly European - selling was an important factor. Some conspiracy theorists, such as Webster Tarpley in his "British Financial Warfare", supported by contemporary reporting by the likes of "The Economist", went as far as writing:

"When this Wall Street Bubble had reached gargantuan proportions in the autumn of 1929, (Lord) Montagu Norman (governor of the Bank of England 1920-1944) sharply (upped) the British bank rate, repatriating British hot money, and pulling the rug out from under the Wall Street speculators, thus deliberately and consciously imploding the US markets. This caused a violent depression in the United States and some other countries, with the collapse of financial markets and the contraction of production and employment. In 1929, Norman engineered a collapse by puncturing the bubble."

The crash was, in large part, a reaction to a sharp reversal, starting in 1928, of the reflationary, "cheap money", policies of the Fed intended, as Adolph Miller of the Fed's Board of Governors told a Senate committee, "to bring down money rates, the call rate among them, because of the international importance the call rate had come to acquire. The purpose was to start an outflow of gold - to reverse the previous inflow of gold into this country (back to Britain)." But the Fed had already lost control of the speculative rush.

The crash of 1929 was not without its Enrons and World.com's. Clarence Hatry and his associates admitted to forging the accounts of their investment group to show a fake net worth of $24 million British pounds - rather than the true picture of 19 billion in liabilities. This led to forced liquidation of Wall Street positions by harried British financiers.

The collapse of Middle West Utilities, run by the energy tycoon, Samuel Insull, exposed a web of offshore holding companies whose only purpose was to hide losses and disguise leverage. The former president of NYSE, Richard Whitney was arrested for larceny.

Analysts and commentators thought of the stock exchange as decoupled from the real economy. Only one tenth of the population was invested - compared to 40 percent today. "The World" wrote, with more than a bit of Schadenfreude: "The country has not suffered a catastrophe ... The American people ... has been gambling largely with the surplus of its astonishing prosperity."

"The Daily News" concurred: "The sagging of the stocks has not destroyed a single factory, wiped out a single farm or city lot or real estate development, decreased the productive powers of a single workman or machine in the United States." In Louisville, the "Herald Post" commented sagely: "While Wall Street was getting rid of its weak holder to their own most drastic punishment, grain was stronger. That will go to the credit side of the national prosperity and help replace that buying power which some fear has been gravely impaired."

During the Coolidge presidency, according to the Encyclopedia Britannica, "stock dividends rose by 108 percent, corporate profits by 76 percent, and wages by 33 percent. In 1929, 4,455,100 passenger cars were sold by American factories, one for every 27 members of the population, a record that was not broken until 1950. Productivity was the key to America's economic growth. Because of improvements in technology, overall labour costs declined by nearly 10 percent, even though the wages of individual workers rose."

Jude Waninski adds in his tome "The Way the World Works" that "between 1921 and 1929, GNP grew to $103.1 billion from $69.6 billion. And because prices were falling, real output increased even faster." Tax rates were sharply reduced.

John Kenneth Galbraith noted these data in his seminal "The Great Crash":

"Between 1925 and 1929, the number of manufacturing establishments increased from 183,900 to 206,700; the value of their output rose from $60.8 billions to $68 billions. The Federal Reserve index of industrial production which had averaged only 67 in 1921 ... had risen to 110 by July 1928, and it reached 126 in June 1929 ... (but the American people) were also displaying an inordinate desire to get rich quickly with a minimum of physical effort."

Personal borrowing for consumption peaked in 1928 - though the administration, unlike today, maintained twin fiscal and current account surpluses and the USA was a large net creditor. Charles Kettering, head of the research division of General Motors described consumeritis thus, just days before the crash: "The key to economic prosperity is the organized creation of dissatisfaction."

Inequality skyrocketed. While output per man-hour shot up by 32 percent between 1923 and 1929, wages crept up only 8 percent. In 1929, the top 0.1 percent of the population earned as much as the bottom 42 percent. Business-friendly administrations reduced by 70 percent the exorbitant taxes paid by those with an income of more than $1 million. But in the summer of 1929, businesses reported sharp increases in inventories. It was the beginning of the end.

Were stocks overvalued prior to the crash? Did all stocks collapse indiscriminately? Not so. Even at the height of the panic, investors remained conscious of real values. On November 3, 1929 the shares of American Can, General Electric, Westinghouse and Anaconda Copper were still substantially higher than on March 3, 1928.

John Campbell and Robert Shiller, author of "Irrational Exuberance", calculated, in a joint paper titled "Valuation Ratios and the Lon-Run Market Outlook: An Update" posted on Yale University' s Web Site, that share prices divided by a moving average of 10 years worth of earnings reached 28 just prior to the crash. Contrast this with 45 on March 2000.

In an NBER working paper published December 2001 and tellingly titled "The Stock Market Crash of 1929 - Irving Fisher was Right", Ellen McGrattan and Edward Prescott boldly claim: "We find that the stock market in 1929 did not crash because the market was overvalued. In fact, the evidence strongly suggests that stocks were undervalued, even at their 1929 peak."

According to their detailed paper, stocks were trading at 19 times after-tax corporate earning at the peak in 1929, a fraction of today's valuations even after the recent correction. A March 1999 "Economic Letter" published by the Federal Reserve Bank of San-Francisco wholeheartedly concurs. It notes that at the peak, prices stood at 30.5 times the dividend yield, only slightly above the long term average.

Contrast this with an article published in June 1990 issue of the "Journal of Economic History" by Robert Barsky and Bradford De Long and titled "Bull and Bear Markets in the Twentieth Century":

"Major bull and bear markets were driven by shifts in assessments of fundamentals: investors had little knowledge of crucial factors, in particular the long run dividend growth rate, and their changing expectations of average dividend growth plausibly lie behind the major swings of this century."

Jude Waninski attributes the crash to the disintegration of the pro-free-trade coalition in the Senate which later led to the notorious Smoot-Hawley Tariff Act of 1930. He traces all the important moves in the market between March 1929 and June 1930 to the intricate protectionist danse macabre in Congress.

This argument may never be decided. Is a similar crash on the cards? This cannot be ruled out. The 1990's resembled the 1920's in more than one way. Are we ready for a recurrence of 1929? About as we were prepared in 1928. Human nature - the prime mover behind market meltdowns - seemed not to have changed that much in these intervening seven decades.

Will a stock market crash, should it happen, be followed by another "Great Depression"? It depends which kind of crash. The short term puncturing of a temporary bubble -

e.g., in 1962 and 1987 - is usually divorced from other economic fundamentals. But a major correction to a lasting bull market invariably leads to recession or worse.

As the economist Hernan Cortes Douglas reminds us in "The Collapse of Wall Street and the Lessons of History" published by the Friedberg Mercantile Group, this was the sequence in London in 1720 (the infamous "South Sea Bubble"), and in the USA in 1835-40 and 1929-32.

Britain's Asset Bubble

The five ghastly "Jack the Ripper" murders took place in an area less than a quarter square mile in size. Houses in this haunting and decrepit no man's land straddling the City and metropolitan London could be had for 25-50,000 British pounds as late as a decade ago. How things change!

The general buoyancy in real estate prices in the capital coupled with the adjacent Spitalfields urban renewal project have lifted prices. A house not 50 yards from the scene of the Ripper's last - and most ghoulish - slaying now sells for over 1 million pounds. In central London, one bedroom apartments retail for an outlandish half a million.

According to research published in September 2002 by Halifax, the UK's largest mortgage lender, the number of 1 million pound homes sold has doubled in 1999-2002 to 2600. By 2002, it has increased elevenfold since 1995. According to The Economist's house price index, prices rose by a further 15.6% in 2003, 10.2% in 2004 and a whopping 147% in total since 1997. In Greater London, one in every 90 homes fetches even a higher price. The average UK house now costs 100,000 pounds. In the USA, the ratios of house prices to rents and to median income are at historic highs.

One is reminded of the Japanese boast, at the height of their realty bubble, that the grounds of the royal palace in Tokyo are worth more than the entire real estate of Manhattan. Is Britain headed the same way?

A house - much like a Big Mac - is a basket of raw materials, goods, and services. But, unlike the Big Mac - and the purchasing power index it spawned - houses are also investment vehicles and stores of value. They yield often tax exempt capital gains, rental income, or benefits from occupying them (rent payments saved). Real estate is used to hedge against inflation, save for old age, and speculate. Prices of residential and commercial property reflect scarcity, investment fads, and changing moods.

Homeowners in both the UK and the USA - spurred on by aggressive marketing and the lowest interest rates in 30 years - have been refinancing old, more expensive, mortgages and heavily borrowing against their "equity" - i.e., against the meteoric rise in the market prices of their abodes.

According to the Milken Institute in Los Angeles, asset bubbles tend to both enhance and cannibalize each other. Profits from surging tradable securities are used to buy property and drive up its values. Borrowing against residential equity fuels overvaluations in fervid stock exchanges. When one bubble bursts - the other initially benefits from an influx of funds withdrawn in panic from the shriveling alternative.

Quantitatively, a considerably larger share of the nation's wealth is tied in real estate than in the capital markets. Yet, the infamous wealth effect - an alleged fluctuation in the will to consume as a result of changing fortunes in the stock exchange - is equally inconspicuous in the realty markets. It seems that consumption is correlated with lifelong projected earnings rather than with the state of one's savings and investments.

This is not the only counter-intuitive finding. Asset inflation - no matter how vertiginous - rarely spills into consumer prices. The recent bubbles in Japan and the USA, for instance, coincided with a protracted period of disinflation. The bursting of bubbles does have a deflationary effect, though.

In a late 2002 survey of global house price movements, "The Economist" concluded that real estate inflation is a global phenomenon. Though Britain far outpaces the United States and Italy (65% rise since 1997), it falls behind Ireland (179%) and South Africa (195%). It is in league with Australia (with 113%) and Spain (132%).

The paper notes wryly:

"Just as with equities in the late 1990s, property bulls are now coming up with bogus arguments for why rampant house-price inflation is sure to continue. Demographic change ... Physical restrictions and tough planning laws ... Similar arguments were heard in Japan in the late 1980s and Germany in the early 1990s - and yet in recent years house prices in these two countries have been falling. British house prices also tumbled in the late 1980s."

They are bound to do so again. In the long run, the rise in house prices cannot exceed the increase in disposable income. The effects of the bursting of a property bubble are invariably more pernicious and prolonged than the outcomes of a bear market in stocks. Real estate is much more leveraged. Debt levels can well exceed home equity ("negative equity") in a downturn. Nowadays, loans are not eroded by high inflation. Adjustable rate mortgages - one third of the annual total in the USA - will make sure that the burden of real indebtedness mushrooms as interest rates rise.

The Economist (April 2005):

"An IMF study on asset bubbles estimates that 40% of housing booms are followed by housing busts, which last for an average of four years and see an average decline of roughly 30% in home values. But given how many homebuyers in booming markets seem to be basing their purchasing decisions on expectations of outsized returns—a recent survey of buyers in Los Angeles indicated that they expected their homes to increase in value by a whopping 22% a year over the next decade—nasty downturns in at least some markets seem likely."

With both the equity and realty markets in gloom, people revert to cash and bonds and save more - leading to deflation or recession or both. Japan is a prime example of such a shift of investment preferences. When prices collapse sufficiently to become attractive, investors pile back into both the capital and real estate markets. This cycle is as old and as inevitable as human greed and fear.

Post Script

In 2007, a collapse in the subprime mortgage market in the United States precipitated a sharp global decline in housing starts and prices - as predicted. The year after, this led to a global credit crunch, the destabilization of the banking system, the demise of all the major investment banks in the USA, and recession throughout the industrialized world. The resultant drop in commodity and energy prices caused the slowdown to spread to developing countries as well.

Asset Confiscation and Asset Forfeiture

The abuse of asset confiscation and forfeiture statutes by governments, law enforcement agencies, and political appointees and cronies throughout the world is well-documented. In many developing countries and countries in transition, assets confiscated from real and alleged criminals and tax evaders are sold in fake auctions to party hacks, cronies, police officers, tax inspectors, and relatives of prominent politicians at bargain basement prices.

That the assets of suspects in grave crimes and corruption should be frozen or "disrupted" until they are convicted or exonerated by the courts - having exhausted their appeals - is understandable and in accordance with the Vienna Convention. But there is no justification for the seizure and sale of property otherwise.

In Switzerland, financial institutions are obliged to automatically freeze suspect transactions for a period of five days, subject to the review of an investigative judge. In France, the Financial Intelligence Unit can freeze funds involved in a reported suspicious transaction by administrative fiat. In both jurisdictions, the fast track freezing of assets has proven to be a more than adequate measure to cope with organized crime and venality.

The presumption of innocence must fully apply and due process upheld to prevent self-enrichment and corrupt dealings with confiscated property, including the unethical and unseemly use of the proceeds from the sale of forfeited assets to close gaping holes in strained state and municipal budgets.

In the United States, according to The Civil Asset Forfeiture Reform Act of 2000 (HR 1658), the assets of suspects under investigation and of criminals convicted of a variety of more than 400 minor and major offenses (from soliciting a prostitute to gambling and from narcotics charges to corruption and tax evasion) are often confiscated and forfeited ("in personam, or value-based confiscation").

Technically and theoretically, assets can be impounded or forfeited and disposed of even in hitherto minor Federal civil offenses (mistakes in fulfilling Medicare or tax return forms)

The UK's Assets Recovery Agency (ARA) that is in charge of enforcing the Proceeds of Crime Act 2002, had this chilling statement to make on May 24, 2007:

“We are pursuing the assets of those involved in a wide range of crime including drug dealing, people trafficking, fraud, extortion, smuggling, control of prostitution, counterfeiting, benefit fraud, tax evasion and environmental crimes such as illegal dumping of waste and illegal fishing." (!)

Drug dealing and illegal fishing in the same sentence.

The British firm Bentley-Jennison, who provide Forensic Accounting Services, add:

"In some cases the defendants will even have their assets seized at the start of an investigation, before any charges have been considered. In many cases the authorities will assume that all of the assets held by the defendant are illegally obtained as he has a "criminal lifestyle". It is then down to the defendant to prove otherwise. If the defendant is judged to have a criminal lifestyle then it will be assumed that physical assets, such as properties and motor vehicles, have been acquired through the use of criminal funds and it will be necessary to present evidence to contradict this.

The defendant's bank accounts will also be scanned for evidence of spending and any expenditure on unidentified assets (and in some cases identified assets) is also likely to be included as alleged criminal benefit. This often leads to the inclusion of sums from legitimate sources and double counting both of which need to be eliminated."

Under the influence of the post-September 11 United States and the FATF (Financial Action Task Force on Money Laundering), Canada, Australia, the United Kingdom, Greece, South Korea, and Russia have similar asset recovery and money laundering laws in place.

International treaties (for instance, the 1959 European Convention on Mutual Legal Assistance in Criminal Matters, the 1990 Convention of the Council of Europe on Laundering, Search, Seizure and Confiscation of the

Proceeds from Crime (ETS 141), and The U.N. Convention against Corruption 2003- UNCAC) and European Union Directives (e.g., 2001/97/EC) allow the seizure and confiscation of the assets and "unexplained wealth" of criminals and suspects globally, even if their alleged or proven crime does not constitute an offense where they own property or have bank accounts.

This abrogation of the principle of dual criminality sometimes leads to serious violations of human and civil rights. Hitler could have used it to ask the United Kingdom's Assets Recovery Agency (ARA) to confiscate the property of refugee Jews who committed "crimes" by infringing on the infamous Nuremberg race laws.

Only offshore tax havens, such as Andorra, Antigua, Aruba, the British Virgin Islands, Guernsey, Monaco, the Netherlands Antilles, Samoa, St. Vincent, the US Virgin Islands, and Vanuatu still resist the pressure to join in the efforts to trace and seize suspects' assets and bank accounts in the absence of a conviction or even charges.

Even worse, unlike in other criminal proceedings, the burden of proof is on the defendant who has to demonstrate that the source of the funds used to purchase the confiscated or forfeited assets is legal. When the defendant fails to furnish such evidence conclusively and convincingly, or if he has left the United States or had died, the assets are sold at an auction and the proceeds usually revert to various law enforcement agencies, to the government's budget, or to good social causes and programs. This is the case in many countries, including United Kingdom, United States, Germany, France, Hong Kong, Italy, Denmark, Belgium, Austria, Greece, Ireland, New Zealand, Singapore and Switzerland.

According to a brief written by Jack Smith, Mark Pieth, and Guillermo Jorge at the Basel Institute on Governance, International Centre for Asset Recovery:

"Article 54(1)(c) of the UNCAC recommends that states parties establish non-criminal systems of confiscation, which have several advantages for recovery actions: the standard of evidence is lower ("preponderance of the evidence" rather than "beyond a reasonable doubt"); they are not subject to some of the more restrictive traditional safeguards of international cooperation such as the offense for which the defendant is accused has to be a crime in the receiving state (dual criminality); and it opens more formal avenues for negotiation and settlements. This is already the practice in some jurisdictions such as the US, Ireland, the UK, Italy, Colombia, Slovenia, and South Africa, as well as some Australian and Canadian States."

In most countries, including the United Kingdom, the United States, Austria, Germany, Indonesia, Macedonia, and Ireland, assets can be impounded, confiscated, frozen, forfeited, and even sold prior to and without any criminal conviction.

In Australia, Austria, Ireland, Hong-Kong, New Zealand, Singapore, United Kingdom, South Africa, United States and the Netherlands alleged and suspected criminals, their family members, friends, employees, and partners can be stripped of their assets even for crimes they have committed in other countries and even if they have merely made use of revenues obtained from illicit activities (this is called "in rem, or property-based confiscation"). This often gives rise to cases of double jeopardy.

Typically, the defendant is notified of the impending forfeiture or confiscation of his or her assets and has recourse to a hearing within the relevant law enforcement agency and also to the courts. If he or she can prove "substantial harm" to life and business, the property may be released to be used, though ownership is rarely restored.

When the process of asset confiscation or asset forfeiture is initiated, banking secrecy is automatically lifted and the government indemnifies the banks for any damage they may suffer for disclosing confidential information about their clients' accounts.

In many countries from South Korea to Greece, lawyer-client privilege is largely waived. The same requirements of monitoring of clients' activities and reporting to the authorities apply to credit and financial institutions, venture capital firms, tax advisers, accountants, and notaries.

Elsewhere, there are some other worrying developments:

In Bulgaria, the assets of tax evaders have recently begun to be confiscated and turned over to the National Revenue Agency and the State Receivables Collection Agency. Property is confiscated even when the tax assessment is disputed in the courts. The Agency cannot, however, confiscate single-dwelling houses, bank accounts up to 250 leva of one member of the family, salary or pension up to 250 leva a month, social care, and alimony, support money or allowances.

Venezuela has recently reformed its Organic Tax Code to allow for:

" (P)re-judgment enforcement measures (to) include closure of premises for up to ten days and confiscation of merchandise. These measures will be applied in addition to the attachment or sequestration of personal property and the prohibition against alienation or encumbrance of realty. During closure of premises, the employer must continue to pay workers, thereby avoiding an appeal for constitutional protection."

Finally, in many states in the United States, "community responsibility" statutes require of owners of legal businesses to "abate crime" by openly fighting it themselves. If they fail to tackle the criminals in their neighborhood, the police can seize and sell their property, including their apartments and cars. The proceeds from such sales accrue to the local municipality.

In New-York City, the police confiscated a restaurant because one of its regular patrons was an alleged drug dealer. In Alabama, police seized the home of a senior citizen because her yard was used, without her consent, for drug dealing. In Maryland, the police confiscated a family's home and converted it into a retreat for its officers, having mailed one of the occupants a package of marijuana.

Auction

Months of procrastination and righteous protestations to the contrary led to the inevitable: the European Commission assented last week to a joint venture between Germany's T-mobile and Britain's mmO2 to share the mammoth costs of erecting third generation - 3G in the parlance - mobile phone networks in both countries. The two companies were among the accursed winners of a series of spectrum auctions in the late 1990's. Altogether telecom firms shelled well over $100 billion to secure 3G licences in markets as diverse as Germany, Italy, the UK, and the Netherlands.

There is little doubt that governments - and, through them, the public - have made a killing in these auctions. But paying the fees left the winners' coffers depleted. They are now unable to comply with the licence terms and provide the service that is supposed to revolutionize wireless communications and data retrieval.

Judged narrowly, from the sellers' point of view, these auctions have been an astounding success. But the outcomes of the best auctions encompass the widest possible utility - including the buyers' and the public's. From this wider angle, go the critics, spectrum auctions have been an abysmal failure.

This is surprising. Auctions are nothing new. The notorious slave fairs of the 18th and 19th century were auction markets. Similar bazaars existed in ancient Greece. Many commodities, such as US loose leaf tobacco, are exclusively sold in such tenders as are government bonds, second hand goods, used machinery, artworks, antiques, stamps, old coins, rare books, jewelry, and property foreclosed by financial institutions or expropriated by the government. Several stock and commodity exchanges the world over are auction-based. A branch of game theory - auction theory - deals with the intricacies of auctions and how they can be frustrated by collusion implicit or explicit.

All auctions are managed by an auctioneer who rewards the desired article to the highest bidder and charges the seller - and sometimes the bidder a fee, a percentage of the realized price. In almost all auctions, the seller sets a - published or undisclosed - "reserve" price - the lowest bid it is willing to accept and below which the item is "reserved", i.e., goes unsold.

In an English "open outcry" auction, bids are made public, allowing other bidders to up the ante. In a first-price - or discriminatory - sealed bid auction, bids remain secret until the auctioneer opens the sealed envelopes at a pre-determined time. In the Vickrey - or uniform second price - auction the winner pays an amount equal to the second highest bid. In a Dutch auction, the auctioneer announces a series of decreasing prices and awards the article to the first bidder. These epithets are used in financial markets to designate other types of auctions.

Auctions are no longer considered the most efficient method in markets with imperfect competition - as most markets are.

Steve Kaplan and Mohanbir Sawhney noted in an article published by the Harvard Business Review two years ago that the advent of the Internet removed two handicaps. It allows an unlimited number of potential bidders and sellers to congregate virtually on Web sites such as eBay. It also eliminated the substantial costs of traditional, physical, auctions. The process of matching buyers with sellers - i.e., finding equilibrium prices which clear supply and demand efficiently - was also simplified in e-hubs.

Yet, as Paul Milgrom of Stanford University pointed out to "The Economist":

"Arguments that online exchanges will produce big increases in efficiency ... implicitly assume that the Internet will make markets perfectly competitive - with homogeneous products and competition on price alone ... (ignore the fact that) markets for most goods and services in fact have 'imperfect competition' - similar but slightly differentiated products competing on many things besides price."

Moreover, as Paul Klemperer of Oxford University observes, bidders sometimes collude - explicitly, in "rings", or implicitly, by signaling each other - to rig the process or deter "outsider" entrants. New participants often underbid, expecting incumbents to overbid.

An FCC auction of wireless data transmission frequencies in April 1997 raised only $14 million - rather than the $1.8 billion expected. This was apparently achieved by signals to warn off competitors embedded in the bids themselves. Salomon Brothers admitted, in August 1991, to manipulating US treasury auctions - by submitting fake bids - and paid a fine of $290 million.

Another problem is the "winner's curse" - the tendency to bid too high to ensure winning. Wary of this propensity, bidders often bid too low - especially in sealed bid auctions or in auctions with many bidders, says Jeremy Bulow of Stanford University in a paper he co-authored with Klemperer. And, as opposed to fixed prices, preparing for an auction consumes resources while the risk of losing is high.

So, are the critics right? Have the 3G auctions - due to their inherent imperfections or erroneous design - brought the winners to their pecuniary knees? will the sunk costs of the licence fees be passed on to reluctant consumers? Should the European Commission and governments in Europe allow winners to co-invest, co-own, co-operate, and co-maintain their networks?

This, at best, is debatable.

Frequencies are a commodity in perfect competition - though their price (their "common value") is unknown. Theoretically, auctioning the spectrum is the most efficient way to make bidders pay for their "monopoly rent" - i.e., their excess profits. Bidders know best where their interests lie and how much they can pay and the auction process extracts this information from them in the form of a bid. They may misread the market and go bust - but this is a risk every business takes.

Economic theory decouples the size of the bids from the marginal return on investment. But, in the real world, the higher the "commitment fees" in the shape of costs sunk into obtaining the licenes - the more motivated the winners are to recoup them by investing in infrastructure, providing innovative services competitively, and aggressively marketing their offerings. The licences are fully tradable assets whose value depends on added investment in networks and customers.

Too late, telcoms are realizing the magnitude of their mistake. Consumers are ill-prepared for the wireless Internet. Clashing standards, incompatible devices, reluctant hardware manufacturers, the spread of broadband, the recession - all conspire to undermine the sanguine business plans of yesteryear. Yet, getting it wrong does not justify a bail-out. On the very contrary, the losers should be purged by that famous invisible hand.

Inexorable and merciless as it may be, the market - unencumbered by state intervention - always ends up delivering commercial, non-public, goods cheaply and efficiently.

Austria, Economy of

Harry Potter would have surely enrolled. A school for wizardry has just opened in Austria in the forbidding mountains around Klagenfurt. The apprentices will be granted a sorcerer's diploma upon completion of their studies. This is a wise move. Austria may need all the witchcraft it can master in the next few years.

Chancellor's Wolfgang Schoessel's conservative People's Party convincingly won the elections on Sunday with more than 42 percent of all votes cast. In the process, it trounced Jorg Haider's much decried far right outfit, the misnamed Freedom Party, which lost a staggering two thirds of all its supporters. Schoessel may now feel that, thus humbled, the Freedom Party may constitute a more reliable and less erratic partner in a future coalition government.

The first signs are not encouraging, though. Haider resigned from the governorship of the province of Carinthia and then retracted his resignation, all in the space of 24 hours. In yet another xenophobic outpouring, he accused the European Union (EU) for his political near death experience. This contrasts sharply with Schoessel's staunch pro-European stance. Austria is the most avid proponent of EU enlargement.

Austria is uneasily located at the heart of Europe, flanked by Italy and Germany on the one side and by Slovakia, the

Czech Republic, Hungary and Slovenia on the other. It is a natural bridge between prosperous Brussels and impoverished Tirana, between a towering Germany and a cowering Serbia, between the Balkan and the central Europe. In its former incarnation as the Habsburg Empire, Austria ruled all these regions.

It still virtually controls the critical Danube route - the riparian exit for many of the landlocked countries of southeastern Europe. Its neutrality, its EU membership, banking secrecy, business tradition, affluence (average annual income per capita is c. $26,000), multilingualism, plurality of cultures and stable currency made it the natural hub for multinationals eyeing the territories of the former Soviet bloc. Novartis Generics, for instance, is a subsidiary of the Swiss pharmaceuticals giant Novartis. But it is headquartered in Austria. It has just concluded the purchase of the Slovenian generic drugs company, Lek.

Vienna hosts many international organizations, such as the Organization for Security and Cooperation in Europe (OSCE), the International Atomic Agency and OPEC - the Organization of Petroleum exporting Countries. It is also the pivot of Europe's organized crime and espionage. Albanian drug dealers mix well with Ukrainian and Moldovan human traffickers and Russian KGB agents turned weapons smugglers.

Austria is schizophrenic - staid and inertial at home, it is an aggressive risk-taker abroad. For four decades, everything - from wage increases to the most inconsequential governmental sinecure - was determined by the two big parties in the infamous "Proporz" system.

A carefully balanced arrangement of partisan monopolies and cartels stifled the economy. Local commercial radio was first introduced only 6 years ago and a private national television channel - only in 2000. The banks set rates and fees in the monthly meetings of the Lombard Club, castigated by the European Union as a pernicious trust. Disgruntled citizens blamed this cozy, bureaucracy-laden, atmosphere of greed and cronyism for the signal failure to cope with the floods that ravaged the country a few months ago.

The Schoessel government pursued privatization, deregulation and budget discipline. This business-friendly attitude sustained the economy in a difficult global recessionary environment. Companies in virtually all sectors of the economy - from Telekom Austria to Erste Bank - beat analyst expectations and disclosed robust profit figures, rising equity and declining debts.

Gross domestic product (GDP) is expected, by the Economist Intelligence Unit, to grow by more than 2 percent next year. Inflation averages less than 2 percent and the budget deficit - 0.1 percent of GDP last year - is likely to reach a manageable 1.5 percent. Imports will grow by 1 percent and exports by double that. When much postponed tax reforms kick in in 2004, the economy is expected to revive.

The bulk of Austria's $400 million in overseas development aid goes to eastern Europe. It is a founding and funding member of the $33 million Southeast Europe Enterprise Development (SEED) initiative, led by the World Bank's International Finance Corporation (IFC) and intended to foster the formation of small and medium size enterprises in the region.

Austrian companies make it a point to participate in every trade fair and talk shop in the Balkan and in Mitteleuropa alongside firms from Macedonia, Bulgaria, Albania, Croatia, Bosnia-Herzegovina, Hungary, Slovenia and Romania. Austria initiated the Central European Initiative - the largest regional cooperation effort involving Austria, Italy, Hungary, Yugoslavia, the Czech Republic, Poland, Bosnia-Herzegovina, Croatia, Slovenia, Slovakia, Macedonia, Belarus, Bulgaria, Ukraine, Romania, Albania, and Moldova. A flurry of memoranda of understanding, pledges, contracts, and programs usually follows these encounters.

In a 1998 study titled "Austria's Foreign Direct Investment in Central and Eastern Europe: 'Supply Based' or 'Market Driven'?", written by Wilfried Altzinger of Vienna University of Economics and Business Administration, the author concludes:

"Since 1989 Austria's investment activities in Central and Eastern Europe has intensified. Investments are concentrated in adjacent countries. Geographical proximity and close historical and cultural ties have enabled even small and medium-sized Austrian enterprises to achieve a 'first mover advantage'. Investments have been performed to a large extent in industries that are typically not connected with outsourcing activities (trade, finance and insurance, construction).

Market-driven factors and strategic considerations are the ultimate objective of these investments. Only a few sectors, in particular a so-called 'core' industrial sector (metal products, mechanical products, electrical and electronic equipment), indicate that low labour costs are of importance. Trade and sales data of the affiliates support the dominance of the local market. Whilst on average 66% of the affiliates output was sold locally this share was only 39% for the 'core' industrial sector. This sector indicates particular patterns of relocation. Nevertheless, until now this part of Austria's FDI has only been of minor importance."

Austria recently signed with the governments of the region a memorandum of understanding on co-operation in the field of renewable energy resources. It is involved in the E75 motorway project which links the country to Greece through Macedonia. Despite the fact that Russia's debt to Austria of more than $3.5 billion is long overdue, bilateral trade is expanding briskly. Austria is a member of the Danube Cooperation Process centered around the economic and environmental issues of the 13 riparian signatories.

Croatia opened last June a trade chamber in Graz. The Croatian banking sector is completely Austrianized. Austria's energy company, OMV, is bidding for Croatia's energy behemoth, INA. Even destitute Albania signed a trade cooperation agreement with Austria, replete with specific projects of infrastructure, telecommunications, food and tourism.

Austrian exports amount to half of its GDP. Around 50 percent of Austria's trade is still with Germany, Italy and the United States. But Hungary has overtaken Switzerland with 4 percent of all of Austria's exports. Trade with central and eastern Europe is growing by leaps and bounds while lethargic Germany's share declines, though, at this stage, imperceptibly.

Many Austrian companies - especially in the financial sector - are actually central European. Erste Bank - Austria's largest network of savings houses - retains 3 people outside Austria, in places like the Czech Republic and Croatia, for every 1 employed at home. It also derives most of its net operating profit from its central and southeastern European subsidiaries. Margins in over-branched Austria are razor-thin.

Austrian banks act as both retail outlets and investment banks. Bank Austria, for instance, purchased stakes in Croatia's Splitska Banka and Bulgaria's fourth largest financial institution, Biochim. It is bidding for Romanian and Albanian banks. But it also lent aggressively to Bulgaria's second mobile phone operator, GloBul. Meinl Bank will advise the Macedonian government in its privatization of the debt-laden and inefficient electricity utility. Raifeissen Zentralbank Austria is heavily involved in lending related to fossil fuels in Romania and elsewhere.

It is here that the danger lies. Austria's financial sector is over-exposed to central, eastern and southeastern Europe in the same way that American banks were exposed to Latin America in the 1980's. The hype of EU enlargement coupled with the almost-religious belief in the process of transition from communist drabness to middle class riches have blinded Austrian banks to serious cultural obstacles, reactionary social forces and corrupt vested interests in the region. Tellingly, Austria is not a member of GRECO - the Council of Europe's Group of States against Corruption.

Should eastern Europe implode, mutual guarantee pacts among Austrian financial institutions ensure that a run on a single member or the bankruptcy of a single bank will cascade throughout the financial system. Austrian banks maintain inadequate tier 1 capital ratios - 6 percent compared to 8-12 percent in other countries in the West. Their domestic businesses are often loss leaders. They are ill-equipped for a meltdown.

High financial gearing in the banking sector means that any government intervention is likely to result in a nationalization of the banks. Industrial cross-shareholding within financial-industrial complexes might entangle the government in a process of reverse privatization. Austria would do well to sprint less vigorously where others fear to tread.

B

Balkans, Economies of the

Macedonia is a useful microcosm of the post-communist countries of the Balkan (self-importantly renamed by its denizens "Southeast Europe"). Prodded by its pro-Western president, Boris Trajkovski, it vocally - though implausibly - aspires to NATO and European Union membership. Its socialist prime minister - newly-elected in a remarkably smooth transfer of power - has just inked a landmark "social contract" with the trade unions.

Macedonia boasts of being an island of modernity and stability in an otherwise volatile (and backward) region. Indeed, in a sign of the times, Macedonian cellphones were rendered Internet-enabled this month Mobimak, one of the two providers of wireless communications services.

Yet, Macedonia's nationalist opposition boycotts both parliament and the peace process launched by the Ohrid Framework Agreement in August last year. Macedonia's biggest minority, the Albanians - at least 30 percent of its population, as a recently concluded census should reveal, unless blatantly tampered with - are again restless. Though an erstwhile group of terrorists (or "freedom fighters") made it to the legislature and the government, splinter factions threaten to reignite last year's civil war. Inter-ethnic hostilities are in the cards.

The country's new government, egged on by a worried international community, has embarked on an unprecedented spree of arrests intended to visibly combat a paralyzing wave of corruption and crime. Several privatization deals were annulled as well. Regrettably, though quite predictably, this newfound righteous zeal is aimed only at the functionaries and politicians of the opposition which constituted the former government.

In the meantime, Macedonia's economy is in tatters. At least one quarter of its population is below the poverty line. Unemployment is an unsustainable 31 percent. The trade deficit - c. $800 million - is a shocking 28 percent of its puny gross domestic product. Macedonia survives largely on charity, aid and loans doled out by weary donors, multilateral financing institutions and friendly countries. It is slated to sign yet another IMF standby agreement this coming February.

And this is the situation throughout most of the region. Macedonia is no forlorn exception - it is the poignant rule. Flurries of grandiose meetings, self-congratulatory conferences and interminable conventions between the desperate leaders of this benighted corner of Europe fail to disguise this hopeless prognosis.

Decrepit infrastructure, a debilitating brain drain, venal and obstructive bureaucracies, all-pervasive kleptocracies, dysfunctional institutions, reviving enmities, shoddy treatment of minorities and a reigning sense of fatalistic resignation - are cross-border phenomena.

International commitment to the entire region is dwindling. The British, German and American contingents within NATO intend to withdraw forces from Bosnia and Kosovo next year. Aid to refugees in Kosovo and Croatia may cease altogether as cash allotted to the United Nation's for this purpose has dried up.

Both Serbia and Montenegro have endured botched presidential elections. Disenchantment with much-derided politics and much-decried politicians is evident in the abysmally low turnout in all the recent rounds of voting. Tensions are growing as Yugoslavia is again slipping into a constitutional crisis. The new union of Serbia and Montenegro is a recipe for instability and constant friction. A lackluster economy doesn't help - industrial production has nudged up by an imperceptible 2.5 percent from a vanishingly low basis.

Political and economic transformations are likely to stall in Yugoslavia as nationalism reasserts itself and the reform camp disintegrates. Solemn mutual declarations of peace and prosperity notwithstanding, tension with neighboring countries - notably Croatia and Bosnia-Herzegovina - will flare up.

Despite some private sector dynamism and the appearance of law and order, Kosovo's unemployment rate is an impossible 57 percent and more than half of its destitute inhabitants survive beneath the poverty line. Its status unresolved and with diminishing international profile, it fails to attract the massive flows of foreign investment needed merely to maintain its utilities and mines. It is a veritable powder keg adjacent to a precariously balanced Macedonia.

Bosnians of all designations are rearming as well. The country has become a center of human trafficking, illicit weapons trading, smuggling and worse. The IMF, the World Bank and the European Bank for Reconstruction and Development (EBRD) are doing their best to resuscitate the moribund economy, but hitherto to little avail. The World Bank alone is expected to plough $102 million into the ailing economy. A dearth of foreign investment and decreasing foreign aid leave the ramshackle country exposed to a soaring balance of payments deficit.

Albanians are busy putting their crumbling house in order. The customs service is revamped in collaboration with concerned neighbors such as Italy. Transport infrastructure will connect Albania to Greece, Bulgaria, Macedonia and even Yugoslavia. Albania's air control system will be modernized next year. Still, a sapping budget deficit of almost 7 percent of GDP ties the government's hands.

Indeed, infrastructural projects represent the Balkan's Great White Hope. Transport corridors will crisscross the region and connect Bulgaria to Macedonia, Greece, Albania, Yugoslavia and Hungary. A Balkan-wide electricity grid is in the works and might even solve the chronic shortages in countries such as Albania.

Yet, not all is grim.

The Balkan is clearly segmented. On the one hand, countries like Macedonia, Albania, Yugoslavia and Bosnia seem to be cruelly doomed to a Sisyphean repetition of their conflicts and the destitution they entail. Slovenia, Croatia, Bulgaria and Romania, on the other hand, are either EU candidates or would be members. Slovenia - though it vehemently denies its regional affiliation - would be the first Balkan country to join the European Union in May 2004. Romania and Bulgaria are slated to follow it in 2007.

So much of Croatia's economy - especially its banking system - is in European hands that it is a de facto EU member, if far from being a de jure one. It, too, relies on IMF financing, though - the latest $140 million standby arrangement was just initialed.

Croatia's external debt is out of control and it needs all the foreign exchange it can lay its hands on. Labor unrest is growing and likely to mushroom in the dark winter months ahead - despite impressive strides in industrial production, up 10 percent year on year in November. Additionally, Croatia is intimately linked to the German market. It is an important export market for its goods and services (such as construction). Should the German economy stagnate, the Croats may suffer a recession.

Relationships with Slovenia are not too improved either. Several rounds of incendiary verbiage were exchanged between these uneasy neighbors over the fate of money owed to Croats by Slovenian banks and a co-owned nuclear facility. These - and trade issues - will be satisfactorily resolved next year.

Bulgaria has descended from euphoria, upon the success of the Simeon II National Movement in the June 2001 elections, to unmitigated gloom. It is besieged by scandals, skyrocketing energy prices, a totteringly balanced - albeit IMF sanctioned - budget, a growing current account deficit, surging unemployment and a privatization process in suspended animation.

Next year will be better, though: the telecoms, the electricity utility and its regional branches, the State Savings Bank and tobacco firms are likely to be disposed of, sold to consortia of foreign - mainly Greek - and domestic investors. GDP is already growing at a respectable annual clip of 4.5 percent.

Public debt declined by 15 percent in the last 4 years. Households' real income and consumption will both continue their double digit takeoff. Moody's recently upgraded the country's credit rating to "positive" and Standard and Poor followed suit and elevated the rank of four local banks.

Next year's big positive surprises - and erstwhile miscarriages - share a common language: Romanian.

Romania's NATO membership in 2003 will seal the astounding turnaround of this bleak country. Almost two thirds of its burgeoning trade is already with the EU. Unemployment dropped by a significant 2.4 percent this year. Some commentators foresee a snap election in the first half of the year to capitalize on these achievements, but this is unlikely.

Recently, the IMF has unblocked funds, though reluctantly. This time, though, Romania will keep its promises to the Fund and implement a rigorous austerity and enterprise reform package despite the vigorous opposition of unionized labor and assorted virulent nationalists assembled in the Greater Romania Party.

The tax system is already rationalized - corporate tax is down to 25 percent and a value added tax was introduced. The government currently consumes merely 6 percent of GDP. Privatization proceeds have shot up - admittedly from a dismal starting point. The Ministry of Tourism alone enjoyed an influx of $40 million of foreign direct investment. Some major properties - such as Romtelecom - will go on the block next year.

Both Moody's and the Japan Credit Rating Agency have upgraded the credit ratings of the country and its banks. GDP is predicted by the Economist Intelligence Unit to grow by 4.6 percent next year and by a hefty 5 percent in 2004. In purchasing power parity terms, it is already up 20 percent on 1998. Foreign exchange reserves have doubled since 1998 to c. $6 billion.

Even Moldova is affected by the positive spill-over and has considerably improved its ties with the IMF. It is pursuing restructuring and market-orientated reforms. It may succeed to reschedule its Paris Club debts next year. The United States - the country's largest donor - will likely increase its contribution from the current $44 million. The Moldovan president met United States President George Bush last week and came out assured of American support.

The Balkan in 2003 will be an immeasurably better place than it was in 1993, both politically and economically. Still, progress has been patchy and unevenly divided. Some countries have actually regressed. Others seem to be stuck in a time warp. A few have authentically broken with their past. While only five years ago it would have been safe to lump together as basket cases all the post-communist Balkan countries, with the exception of Slovenia - this is no longer true. It is cause for guarded optimism.

The denizens of the Balkans have always accused the Western media of ignorance, bias and worse. Reports from east Europe are often authored by fly-by-night freelancers with little or no acquaintance with the region. Even The Economist - usually a fount of objective erudition - blundered last week. It made a distinction between "wily" Albanian "rebels" and "moderate" Albanian "nationalists" in the ruling coalition. Alas, these two groups are one and the same: the "wily rebels" simply established a party and joined the government.

The European Commission - which maintains bloated and exorbitant missions in all the capitals of the Balkan - should be held to higher standards of reporting, though. Last month it published the second issue of "The West Balkan in Transition". Alas, it is informed not by facts but by the official party line of Brussels: all is well in the Balkan and it is largely thanks to us, the international community.

The report's numerical analyses are heavily warped by the curious inclusion of Croatia whose GDP per capita is three times the other countries'. Even with this distorting statistical influence, the regional picture is mixed. Inflation has undoubtedly been tamed - down from 36 percent in 2000 to 6 percent last year. But the trade deficit, up 25 percent on last year, is an ominous $10 billion, or an unsustainable one fifth of the region's combined gross domestic product.

About 70 percent of the shortfall is with the European Union and it has grown by a whopping 40 percent in the last 12 months. This gap is the outcome of the EU's protectionist policies. The Balkan's economic mainstays are agriculture, mining and textiles. The EU has erected an elaborate edifice of non-tariff barriers and production and export subsidies that make it inordinately difficult to penetrate its markets and render the prices of its own produce irresistible.

This debilitating and destabilizing trade discrimination is, of course, not mentioned anywhere in the report, though it sings the praises of utterly inadequate trade measures unilaterally adopted by the EU in 2000. The sad - and terrifying truth - is that the region survives on private remittances and handouts. The EU has done very little to alleviate this dependence by tackling its structural roots.

As assets depreciated in the dilapidated region, foreign direct investment (FDI) - mainly by Greeks, Germans, Slovenes and Austrians - has inevitably picked up, though surprisingly little. At $100 per capita, it is one of the lowest in the world.

The region's GDP is still well below 1991. The "growth" recorded since 1999 merely reflects a very gradual recovery from the devastation wrought on the region by the Unites States and its European allies in the Kosovo crisis. This, needless to add, also goes unmentioned.

The report's data are sometimes questionable. Consider Macedonia, for instance: its trade deficit last year was $800 million, or 24 percent of GDP - not 11.4 percent, as the report curiously stipulates. Foreign direct investment in 2001 was heavily skewed by the proceeds from the sale of the national telecom, most of which may not qualify as FDI at all. The figures for the inflation and budget deficits in 2002 are, in all probability, wrong. One could do better by simply surfing the Internet.

The report relies clubbily on information provided by the IMF - and openly espouses the controversial "Washington Consensus". Thus, it attributes "economic stability" (what is this?) and "price stability" to the use of "external anchors", namely exchange rate pegs.

Yet, there is a good reason to believe that rigid, multi-annual pegs have contributed to burgeoning trade deficits, the crumbling of the manufacturing sector, double digit unemployment (one third of the workforce in hapless Macedonia and twice that in Kosovo) and the region's dependence on foreign aid and credits. Macedonia's last devaluation was in 1997. Cumulative inflation since then has amounted to almost 20 percent, rendering the currency overvalued and the terms of trade hopelessly unfavorable.

At times, the report reads like outright propaganda. Trade ministers in the region would be astounded to learn that the numerous bilateral free trade agreements they have signed were sponsored by the much derided Stability Pact. The Stabilization and Association process, crow the authors, "considerably improved the political outlook in the region". Tell that to the Macedonians whose country was torn by a vicious civil war in 2001, after it has signed just such a agreement with the EU.

To say that donor funding "finances investments and supports reform" is to be unusually economical with the truth. Most of it is sucked by the recipient countries' insatiable balance of payments deficits and gaping budgetary chasms. Donor money encourages inefficiency and corruption, conspicuous consumption and imports. Luckily, international financial institutions, such as the IMF, are increasingly replacing such charity with credits conditioned on structural reforms.

The section of the report which deals with "fiscal consolidation" astonishingly ignores the informal sector of the region's economies. With the exception of Croatia, the "gray economy" is thought to equal at least one half the formal part. More than one tenth of the workforce are employed by underground enterprises.

International trade, tax revenues, internal investments and even FDI are all affected by the penumbral entrepreneurship of the black economy, comprised of both illicit businesses and tax evading but legitimate ones. It renders fiscal policy less potent than in other European countries.

Predictably, the report also fails to note the contradictory nature of Western economic prescriptions.

Thus, wage compression in the public sector - touted by the IMF and the World Bank - leads to a decrease in the remuneration of civil servants and, thus, encourages corruption. Yet, the very same multilateral institutions also exhort the countries of the Balkan to battle venality and cronyism. These goals are manifestly incompatible.

Contractionary austerity measures and enhanced tax collection reduce the purchasing power of the population and its ability to save and to invest. This is not conducive to the emergence of a private sector. It also hampers counter-cyclical intervention - whether planned or through automatic stabilizers - by the government. This demonetization is further aggravated by restrictive monetary policies, absence of foreign financing and investment and the pervasive dysfunction of all financial intermediaries and monetary transmission mechanisms.

The report ignores completely - at least on the regional level - crucial issues such as banking reform, inter-enterprise debt, competition policy, liberalization, deregulation, protection of minority shareholders and foreign investments, openness to foreign trade, research and development outlays, higher education, brain drain, intellectual property rights, or the quality of infrastructure. These matters determine the economic fate of emerging economies far more than their budget deficits. Yet, shockingly, they are nowhere to be found in the 62 pages of "The West Balkan in Transition".

It is disappointing that an organization of the caliber of the European Commission is unable to offer anything better than regurgitated formulas and half-baked observations lifted off IMF draft reports. The narrow focus on a few structural reforms and the analysis of a limited set of economic aspects is intellectually lazy and detrimental to a full-bodied comprehension of the region. Little wonder that more than a decade of such "insightful expertise" led to only mass poverty, rampant unemployment and inter-ethnic strife.

Banking, Austrian

In the second half of 2005, Erste Bank, Austria's second largest, took over yet another East and Central European financial institution: Romania's BCR (Romanian Commercial Bank). This acquisition threw into sharp relief the post-Communist Mittel-European strategy of Austrian banks, big and small.

In a report published in December 2001, Moody's captured the predicament of Austrian banking thus: "Austrian banks face a slowing domestic economy and continued growth as well as challenges in Central and Eastern Europe." Confronted with domestic near-vanishing margins and over-branching, Austrian banks established banking franchises in the growth markets of central and eastern Europe - from Croatia to the Czech Republic.

This rapid expansion strained management and capital resources. Austrian banks maintain a low tier 1 capital ration of c. 6 percent and less than stellar returns on equity of c. 11 percent. the cost to income ratio is a staggering 69 percent. Austria's banks have the lowest average financial strength in Western Europe. Why the robust ratings?

Moody's: "Debt and deposit ratings of the majority of Austrian banks are enhanced or underpinned by external or sector support ... the increasing cohesion within the larger banking groups should improve the competitiveness of the banking system in the medium to longer term ... (regardless of) the slowing economy and to some high-profile bankruptcies."

Moreover, the sector is consolidating. The five largest banking groups control well over half the sector. Operational costs are being cut and there are hesitant steps towards e-banking.

Wolfgang Christl is an investment banker with Euroinvestbank in Austria. Together with Dr. Robert Schneider of Wolf Theiss & Partner, attorneys at law, they attempted to shed light on Austrian banking. This interview was conducted with him in August 2002.

Q: What are the advantages and disadvantages of Austria as far as banking goes?

A: Austria has adopted the EU banking laws. Austrian banks within the European Union have no no special advantages or disadvantages.

Q: How does Austrian tax treatment of banking operations compare with other countries?

A: In Austria we have a capital gains tax of 25 percent applicable to individuals and trusts. Banks cannot deduct VAT on their transactions. The state levies stamp duties on credits and loans. Otherwise, the tax treatment of banks is comparable to other EU members.

Q: Austria's banks were renowned - or notorious - for their strict anonymity. Can you describe the history of Austrian bank anonymity and how it came to be abolished? What, in your view, was the effect on the banking system, the composition of bank clientele, and the volume of foreign savings and deposits?

A: Anonymity on savings accounts and equity investments, introduced after World War II, was abolished gradually after 1995, in accordance with EU regulations. Banking secrecy can be lifted in case of criminal and fiscal investigations. The effect of abolishing bank anonymity was minimal since there are not many substitutes for these financial institutions. Some foreign deposits may have been moved elsewhere, but that's just about it.

Q: The European Union has recently fined Austrian banks, members of the Lombard Club, for fixing the prices of deposits in a cartel-like arrangement. Could you give us the Austrian angle of this affair?

A: The Lombard Club was eventually historically justified in the post-war economy. The arguments presented by the Austrian banks were very weak because there was no awareness of wrongdoing. We think that the fines are rather high since the effect of the cartel was minimal and bank margins in Austria were much lower than in other EU countries. Mr. Haider wrongly claims his involvement in the EU-Lombard Club decision. He is a populist and a free-rider on the poor and small folks.

Q: Many Austrian banks have aggressively spread to Central Europe - notably the Czech Republic, Slovakia, Poland, Croatia, and Slovenia. Do you think it is a wise long term strategy? The region is in transition and its fortunes change daily. Poland has switched from prosperity to depression in less than 7 years. Aren't you concerned that Austrian banks are actually importing instability into their balance sheets?

A: The move by the Austrian banks into central and eastern Europe is a very good niche market growth strategy. Austrian banks lost a lot of money in the UK, the USA, and in other parts of the world - but were very risk-conscious in central and eastern Europe, where, today, they generate high margins. In the years to come, this will be a strongly growing region. Entering these markets was a very positive decision.

Q: Austria's banks are small by international standards. Do you foresee additional consolidation or purchases by foreign banks, possibly German?

A: I am convinced that there will be additional domestic consolidation coupled with some foreign purchases. The three big German banks - HVB, Bayerische Landesbank, and Deutsche Bank - are already present in Austria.

Q: In 1931, the collapse of Creditanstalt in Vienna triggered a global depression. The markets are again in turmoil, the global economy is stagnant, and trade protectionism is increasing. Can you compare the two periods?

A: Thank you or the honor of triggering a global recession, but Creditanstalt was too small to do so. In my view, you cannot compare the markets today and in 1931. Financial skills and organizations are much more developed today. Social systems are much more secure than in the 1930's.

Q: Could you tell us about bank supervision in Austria?

A: Since April 1, 2002, Austria has an independent financial markets supervisor for banks, insurance companies, and the capital markets.

Q: Does Austria have non-bank financial institutions such as thrifts (i.e., savings and loans, or building societies), credit cooperatives, microfinance lending, sectoral credit institutions, etc.?

A: Yes, we do have this kind of nonbank financial institutions but they play a minor role, maybe less than 1 percent of the market.

Q: Does Austria have a federal deposit insurance?

A: Yes, it does. Individuals are covered for a maximum of 20,000 euros in all their accounts in any single bank.

Companies are covered up to 90 percent of this amount. There is a centralized claims institution for the banking sector.

Postscript October 2008

In the wake of the financial crisis of 2007-9, car repossessions are up 25% in Romania, as the members of a newly-minted class of consumers are unable to meet their obligations. Austrian, Greek, Swedish, and German banks are exposed to default risks throughout Central and Eastern Europe. Consumers and businesses in Serbia, Ukraine, Hungary, and other teetering economies owe Austrian financial institutions $290 billion - almost the entire GDP of this country!

As local currencies depreciate, debts, denominated in foreign exchange, grow more expensive to service. As the real economy contracts, in the first phase of what appears to be a prolonged recession, bad loans mushroom and reserves are exhausted. This requires cash-strapped governments to recapitalize major banks. Faced with current account and budget deficits, some of these sovereigns are scrambling for outside infusions from the likes of the IMF.

Banking, German

Denial is a ubiquitous psychological defense mechanism. It involves the repression of bad news, unpleasant information, and anxiety-inducing experiences. Judging by the German press, the country is in a state of denial regarding the faltering health of its economy and the dwindling fortunes of its financial system.

Things are so bad now (June 2005) that Italy's UniCredit Bank is bidding to absorb the second largest German financial institution, HVB, for a mere 15 billion euros in an all-shares deal. UniCreit expects to shell out another 4.2 billion euros to buy out minority shareholders in HVB subsidiaries in Austria (Bank Austria) and Poland (BPH).

This will create a super-bank with more than 28 million customers served by a network of well over 7000 branches. Forty percent of this clientele (11 million) live in Central and Eastern Europe. The merged bank will control one fifth of the banking market in countries as disparate as Bulgaria, Croatia, and Poland.

UniCredit promises cost cutting to be achieved through the prompt sacking of 7% of HVB's bloated workforce of well over 120,000 employees. Alarmed, Handelsblatt, Germany's leading financial paper, urged more "ambition and patriotism" to avoid further encroachments of foreign banks into German turf. The aim, trumpeted the paper, somewhat incongruously, should be "global champions in the financial sector".

How are these xenophobic defenses to be erected? By mergers and acquisitions among German banks in the fragmented domestic market. Consolidation would lead to higher profits and less digestible takeover targets, goes the logic.

HVB itself disproves these self-deluding recipes. It is the sad outcome of a merger between Bayerische Vereinsbank and Hypo-Bank. Weighed down by an under-performing property portfolio in a waning German construction market, it is a dispiriting contrast to the dynamic (and profitable) UniCredit.

The decline and fall of German banking reached its nadir in 2002.

Three years ago, Commerzbank, Germany's fourth largest lender, saw its shares decimated by more than 80 percent to a 19-year low, having increased its loan-loss provisions to cover flood-submerged east German debts. Faced with a precipitous drop in net profit, it reacted reflexively by sacking yet more staff. The shares of many other German banks still trade below book value, after an impressive recovery from lows reached in 2001-2.

By end-2002, Dresdner Bank - Germany's third largest private establishment - had already trimmed an unprecedented one fifth of its workforce. Other leading German banks - such as Deutsche Bank and Hypovereinsbank - resorted to panic selling of equity portfolios, real-estate, non-core activities, and securitized assets to patch up their ailing income statements. Deutsche Bank, for instance, unloaded its US leasing and custody businesses.

On September 19, 2002 Moody's changed its outlook for Germany's largest banks from "stable" to "negative". In a scathing remark, it said:

"The rating agency stated several times already that current difficult economic conditions that are hurting the banking business in Germany come on top of the legacy of past strategies that were less focused on strengthening the banks' recurring earning power. Indeed, the German private-sector banks, as a group, remain among the lowest-performing large European banks."

In October 2002, Fitch Ratings, the international agency, followed suit and downgraded the long-term , short- term, and individual ratings of Dresdner Bank and of Bayerische Hypo- und Vereinsbank (HVB).

These were only the last in a series of negative outlooks pertaining to German insurers and banks. It is ironic that Fitch cited the "bear equity markets (that) have taken their toll not only on trading results but also on sales to private customers, the fund management business and on corporate finance."

Germans used to be immune to the stock exchange and its lures until they were caught in the frenzied global equities bubble. Moody's observed wryly that "a material and stable retail franchise in its home market, even if more modestly profitable, can and does represent a reliable line of defence against temporary difficulties in financial and wholesale markets."

The technology-laden and scandal-ridden Neuer Markt - Europe's answer to America's NASDAQ - as well as the SMAX exchange for small-caps were shut down in October 2002, the former having lost a staggering 96 percent of its value since March 2000. This compared to Britain's AIM, which lost "only" half its worth at that point. Even Britain's infamous FTSE-TechMARK faded by a "mere" 88 percent.

Only 1 company floated on the Neuer Markt in all of 2002 - compared to more than 130 two years before. In an unprecedented show of "no-confidence", more than 40 companies withdrew their listings in 2001. The Duetsche Boerse promised to create two new classes of shares on the Frankfurt Stock Exchange. It belatedly vowed to introduce more transparency and openness to foreign investors.

It's been downhill ever since.

Banks have been accused by irate customers of helping to list inappropriate firms and providing fraudulent advisory services. Court cases are pending against the likes of Commerzbank. These proceedings may dash the bank's hopes to move from retail into private banking.

To further compound matters, Germany is in the throes of a tsunami of corporate insolvencies. This long-overdue restructuring, though beneficial in the long run, couldn't have transpired at a worse time, as far as the banks go. Massive provisions and write-downs have voraciously consumed their capital base even as operating profits have plummeted. This double whammy more than eroded the benefits of their painful cost-cutting measures.

German banks - not unlike Japanese ones - maintain incestuous relationships with their clients. When it finally collapsed in April 2002, Philip Holzmann AG owed billions to Deutsche Bank with whom it had a cordial working relationship for more than a century. But the bank also owned 19.6 percent of the ailing construction behemoth and chaired its supervisory board - the relics of previous shambolic rescue packages.

Germany competes with Austria in over-branching, with Japan in souring assets, and with Russia in overhead. According to the German daily, Frankfurter Allgemeine Zeitung, the cost to income ratio of German banks is 90 percent. Mass bankruptcies and consolidation - voluntary or enforced - are unavoidable, especially in the cooperative, mortgage, and savings banks sectors, concludes the paper. The process is a decade-old. More than 1500 banks vanished from the German landscape in this period. Another 2500 remain making Germany still one of the most over-banked countries in the world.

Moody's don't put much stock in the cost-cutting measures of the German banks. Added competition and a "more realistic pricing" of loans and services are far more important to their shriveling bottom line. But "that light is not yet visible at the end of the tunnel ... and challenging market conditions are likely to persist for the time being."

The woeful state of Germany's financial system reflects not only Germany's economic malaise - "The Economist" repeatedly calls it the "sick man" of Europe - but its failed attempt to imitate and emulate the inimitable financial centers of London and New-York. It is a rebuke to the misguided belief that capitalistic models - and institutions - can be transplanted in their entirety across cultural barriers. It is incontrovertible proof that history - and the core competencies it spawns - still matter.

When German insurers and banks, for instance, branched into faddish businesses - such as the Internet and mobile telephony - they did so in vacuum. Germany has few venture capitalists and American-style entrepreneurs. This misguided strategy resulted in a frightening erosion of the strength and capital base of the intrepid investors.

In a sense, Germany - and definitely its eastern Lander - is a country in transition. Risk-aversion is giving way to risk-seeking in the forms of investments in equities and derivatives and venture capital. Family ownership is gradually supplanted by stock exchange listings, imported management, and mergers, acquisitions, and takeovers - both friendly and hostile. The social contracts regarding employment, pensions, the role of the trade unions, the balance between human and pecuniary capital, and the carving up of monopoly market niches - are being re-written.

Global integration means that, as sovereignty is transferred to supranational entities, the cozy relationship between the banks and the German government on all levels is over. In October 2001, Hans Eichel, the perennial German finance minister, announced OECD-inspired anti-money laundering measures that are likely to compromise bank secrecy and client anonymity and, thus, hurt the German - sometimes murky - banking business. Erstwhile rampant government intervention is now mitigated or outright prohibited by the European Union.

Thus, German Laender were forced, by the European Commission, to partly abolish, between 2002-5, their guarantees to the Landesbanken (regional development banks) and Sparkassen (thrifts). German diversification to Austria and central and east Europe provided only temporary respite. As the EU enlarged and digested the Czech Republic, Hungary, and Poland in May 2004 - German franchises there came under the uncompromising remit of the Commission once more.

In general, Germans fared worse than Austrians in their extraterritorial banking ventures. Less cosmopolitan, with less exposure to the parts of the former Habsburg Empire, and struggling with a stagnant domestic economy - German banks found it difficult to turn central European banks around as successfully as the likes of the Austrian Erste Bank did. They did make inroads into niche structured financing markets in north Europe and the USA - but these seem to be random excursions rather a studied shift of business emphasis.

On the bright side, Moody's - though it maintained a negative outlook on German banking until recently - noted, as early as November 2001, that the banks' "intrinsic financial strength and diversified operating base". Tax reform and the hesitant introduction of private pensions are also cause for restrained optimism.

Pursuant to the purchase of Drsedner Bank by Allianz, Moody's welcomed the emergence of bancassurance and Allfinanz models - financial services one stop shops. German banks are also positioned to reap the benefits of their considerable investments in e-commerce, technology, and the restructuring of their branch networks.

The Depression on 1929-1936 may have started with the meltdown of capital markets, especially that of Wall Street - but it was exacerbated by the collapse of the concatenated international banking system. The world today is even more integrated. The collapse of one or more major German banks can result in dire consequences and not only in the euro zone. The IMF says as much in its "World Economic Outlook" published on September 25, 2002.

The Germans deny this prognosis - and the diagnosis - vehemently. Bundesbank President Ernst Welteke - a board member of the European Central Bank - spent the better part of October 2002 implausibly denying any crisis in German banking. These are mere "structural problems in the weak phase", he told a press conference. Nothing consolidation can't solve.

It is this consistent refusal to confront reality that is the most worrisome. In the short to medium term, German banks are likely to outlive the storm. In the process, they will lose their iron grip on the domestic market as customer loyalty dissipates and foreign competition increases. If they do not confront their plight with honesty and open-mindedness, they may well be reduced to glorified back-office extensions of the global giants.

Bankruptcy and Liquidation

Close to 1.6 million Americans filed for personal bankruptcy (mostly under chapter 7) in 2004 - nine times as many (per capita) as did the denizens of the United Kingdom (with 35,898 insolvencies). The figure in the USA 25 years ago was 300,000. Bankruptcy has no doubt become a growth industry. This surge was prompted by both promiscuous legislation (in 1978) and concurrent pro-debtor (anti-usury) decisions in the Supreme Court.

Under chapter 7, for instance, cars and homes are exempt assets, untouchable by indignant creditors. Even under chapter 13, debt repayments are rescheduled and spread over 5 years to cover only a fraction of the original credit.

A new reform bill, passed in both the Senate and the House of Representatives in April 2005 seeks to reverse the trend by making going financial belly up a bit less easy. The Economist noted that:

"While consumers do carry more debt than they used to, the amount of income devoted to servicing that debt has

not gone up that much, thanks to falling interest rates and longer maturities. Other factors must be at work; plausible candidates include greater income volatility, legalised gambling, bigger medical bills, increased advertising by lawyers offering to help people in debt, and a cultural shift that has destigmatised bankruptcy."

Personal bankruptcies are rare outside the United States. Besides being stigmatized, such debtors surrender most of their income and virtually all their assets to their creditors. If the money they borrowed was spent frivolously or recklessly - or if they have a tainted credit history - borrowers are unlikely to be granted bankruptcy protection to start with.

Still, personal bankruptcies are dwarfed by corporate ones. In the plutocracy that the United States is fast becoming, corporations and their directors remain largely shielded from the consequences of the profligacy and malfeasance of their management.

The new bill merely curtails bonus schemes to executives and key personnel in firms under reorganization and introduces bankruptcy trustees where the management is suspected of fraud. Compare this to Britain where managers are responsible for corporate debts they knowingly incurred while the firm was insolvent.

Moreover, debts owed by individuals to firms take precedence over all other forms of personal financial obligations. In other words, as The Economist notes: "The new treatment of secured car loans could put child-support and alimony payments behind GM’s finance arm in the queue."

It all starts by defaulting on an obligation. Money owed to creditors or to suppliers is not paid on time, interest payments due on bank loans or on corporate bonds issued to the public are withheld. It may be a temporary problem - or a permanent one.

As time goes by, the creditors gear up and litigate in a court of law or in a court of arbitration. This leads to a "***technical or equity insolvency"*** status.

But this is not the only way a company can be rendered insolvent. It could also run liabilities which outweigh its assets. This is called ***"bankruptcy insolvency"***. True, there is a debate raging as to what is the best method to appraise the firm's assets and its liabilities. Should these appraisals be based on market prices - or on book value?

There is no one decisive answer. In most cases, there is strong reliance on the figures in the balance sheet.

If the negotiations with the creditors of the company (as to how to settle the dispute arising from the company's default) fails, the company itself can file (ask the court) for bankruptcy in a "v***oluntary bankruptcy filing"***.

Enter the court. It is only one player (albeit, the most important one) in this unfolding, complex drama. The court does not participate directly in the script.

Court officials are appointed. They work hand in hand with the representatives of the creditors (mostly lawyers) and with the management and the owners of the defunct company.

They face a tough decision: should they liquidate the company? In other words, should they terminate its business life by (among other acts) selling its assets?

The proceeds of the sale of the assets are divided (as "bankruptcy dividend") among the creditors. It makes sense to choose this route only if the (money) value yielded by liquidation exceeds the money the company, as a going concern, as a living, functioning, entity, can generate.

The company can, thus, go into "***straight bankruptcy"***. The secured creditors then receive the value of the property which was used to secure their debt (the "collateral", or the "mortgage, lien"). Sometimes, they receive the property itself - if it is not easy to liquidate (sell) it.

Once the assets of the company are sold, the first to be fully paid off are the secured creditors. Only then are the priority creditors paid (wholly or partially).

The priority creditors include administrative debts, unpaid wages (up to a given limit per worker), uninsured pension claims, taxes, rents, etc.

And only if any money is left after all these payments it is proportionally doled out to the unsecured creditors.

The USA had many versions of bankruptcy laws. There was the 1938 Bankruptcy Act, which was followed by amended versions in 1978, 1984, 1994, and, lately, in 2005.

Each state has modified the Federal Law to fit its special, local conditions.

Still, a few things - the spirit of the law and its philosophy - are common to all the versions. Arguably, the most famous procedure is named after the chapter in the law in which it is described, Chapter 11. Following is a brief discussion of chapter 11 intended to demonstrate this spirit and this philosophy.

This chapter allows for a mechanism called "reorganization". It must be approved by two thirds of all classes of creditors and then, again, it could be voluntary (initiated by the company) or involuntary (initiated by one to three of its creditors).

The American legislator set the following goals in the bankruptcy laws:

a. To provide a fair and equitable treatment to the holders of various classes of securities of the firm (shares of different kinds and bonds of different types).

b. To eliminate burdensome debt obligations, which obstruct the proper functioning of the firm and hinder its chances to recover and ever repay its debts to its creditors.

c. To make sure that the new claims received by the creditors (instead of the old, discredited, ones) equal, at least, what they would have received in liquidation.

Examples of such new claims: owners of debentures of the firm can receive, instead, new, long term bonds (known as reorganization bonds, whose interest is payable only from profits).

Owners of subordinated debentures will, probably, become shareholders and shareholders in the insolvent firm usually receive no new claims.

The chapter dealing with reorganization (the famous "Chapter 11") allows for ***"arrangements"*** to be made between debtor and creditors: an extension or reduction of the debts.

If the company is traded in a stock exchange, the Securities and Exchange Commission (SEC) of the USA advises the court as to the best procedure to adopt in case of reorganization.

What chapter 11 teaches us is that:

American Law leans in favor of maintaining the company as an ongoing concern. A whole is larger than the sum of its parts - and a living business is sometimes worth more than the sum of its assets, sold separately.

A more in-depth study of the bankruptcy laws shows that they prescribe three ways to tackle a state of malignant insolvency which threatens the well being and the continued functioning of the firm:

Chapter 7 (1978 Act) - **Liquidation**

A District court appoints an "interim trustee" with broad powers. Such a trustee can also be appointed at the request of the creditors and by them. The debtor is required to file detailed documentation and budget projections.

The Interim Trustee is empowered to do the following:

- Liquidate property and make distribution of liquidating dividends to creditors;
- Make management changes;
- Arrange unsecured financing for the firm;
- Operate the debtor business to prevent further losses.

By filing a bond, the debtor (really, the owners of the debtor) is able to regain possession of the business from the trustee.

Chapter 11 - Reorganization

Unless the court rules otherwise, the debtor remains in possession and in control of the business and the debtor and the creditors are allowed to work together flexibly. They are encouraged to reach a settlement by compromise and agreement rather than by court adjudication.

Maybe the biggest legal revolution embedded in chapter 11 is the relaxation of the age old ***ABSOLUTE PRIORITY*** rule, that says that the claims of creditors have categorical precedence over ownership claims. Rather, under chapter 11, the interests of the creditors have to be balanced with the interests of the owners and even with the larger good of the community and society at large.

And so, chapter 11 allows the debtor and creditors to be in direct touch, to negotiate payment schedules, the restructuring of old debts, even the granting of new loans by the same disaffected creditors to the same irresponsible debtor.

Chapter 10

Is sort of a legal hybrid, the offspring of chapters 7 and 11:

It allows for reorganization under a court appointed independent manager (trustee) who is responsible mainly for the filing of reorganization plans with the court - and for verifying strict adherence to them by both debtor and creditors.

Chapter 15

Adopts the United Nations model code on cross-border bankruptcy of multinationals.

Despite its clarity and business orientation, many countries found it difficult to adapt to the pragmatic, non sentimental approach which led to the virtual elimination of the absolute priority rule.

In England, for instance, the court appoints an official "receiver" to manage the business and to realize the debtor's assets on behalf of the creditors (and also of the owners). His main task is to maximize the proceeds of the liquidation and he continues to function until a court settlement is decreed (or a creditor settlement is reached, prior to adjudication). When this happens, the receivership ends and the receiver loses his status.

The receiver takes possession (but not title) of the assets and the affairs of a business in a receivership. He collects rents and other income on behalf of the firm.

So, British Law is much more in favor of the creditors. It recognizes the supremacy of their claims over the property claims of the owners. Honoring obligations - in the eyes of the British legislator and their courts - is the cornerstone of efficient, thriving markets. The courts are entrusted with the protection of this moral pillar of the economy.

And what about developing countries and economies in transition (themselves often heavily indebted to the rest of the world)?

Economies in transition are in transition not only economically - but also legally. Thus, each one adopted its own version of the bankruptcy laws.

In Hungary, Bankruptcy is automatically triggered. Debt for equity swaps are disallowed. Moreover, the law provides for a very short time to reach agreement with creditors about a reorganization of the debtor. These features led to 4000 bankruptcies in the wake of the new law - a number which mushroomed to 30,000 by May 1997.

In the Czech Republic, the insolvency law comprises special cases (over-indebtedness, for instance). It delineates two rescue programs:

a. A debt to equity swap (an alternative to bankruptcy) supervised by the Ministry of Privatization.

b. The Consolidation Bank (founded by the State) can buy a firm's obligations, if it went bankrupt, at 60% of par.

But the law itself is toothless and lackadaisically applied by the incestuous web of institutions in the country. Between March 1993 and September 1993 there were 1000 filings for insolvency, which resulted in only 30 commenced bankruptcy procedures. There hasn't been a single major bankruptcy in the Czech Republic since then - and not for lack of candidates.

Poland is a special case. The ***pre-war (1934) law*** declares bankruptcy in a state of lasting illiquidity and excessive indebtedness. Each creditor can apply to declare a company bankrupt. An insolvent company is obliged to file a maximum of 2 weeks following cessation of debt payments. There is a separate liquidation law which allows for voluntary procedures.

Bad debts are transferred to base portfolios and have one of three fates:

1. Reorganization, debt-consolidation (a reduction of the debts, new terms, debt for equity swaps) and a program of rehabilitation.
2. Sale of the corporate liabilities in auctions.
3. Classic bankruptcy (happens in 23% of the cases of insolvency).

No one is certain what is the best model. The reason is that no one knows the answers to the questions: are the rights of the creditors superior to the rights of the owners? Is it better to rehabilitate than to liquidate?

The effects of strict, liquidation-prone laws are not wholly pernicious or wholly beneficial. Consumers borrow less and interest rates fall - but entrepreneurs are deterred and firms become more risk-averse.

Until such time as these questions are settled and as long as the corporate debt crisis deepens - we will witness a flowering of disparate versions of bankruptcy laws all over the world.

It is when the going gets better, that the going gets tough. This enigmatic sentence bears explanation: when a firm is in dire straits, in the throes of a crisis, or is a loss maker – conflicts between the shareholders (partners) are rare. When a company is in the start-up phase, conducting research and development and fighting for its continued, profitable survival in the midst of a massive investment cycle – rarely will internal strife arise and threaten its existence. It is when the company turns a profit, when there is cash in the till – that, typically, all manner of grievances, complaints and demands arise. The internecine conflicts are especially acute where the ownership is divided equally. It is more accentuated when one of the partners feels that he is contributing more to the business, either because of his unique talents or because of his professional experience, contacts or due to the size of his initial investments (and the other partner does not share his views).

The typical grievances relate to the equitable, proportional, division of the company's income between the partners. In many firms partners serve in various management functions and draw a salary plus expenses. This is considered by other partners to be a dividend drawn in disguise. They want to draw the same amounts from the company's coffers (or to maintain some kind of symbolic monetary difference in favour of the position holder). Most minority partners are afraid of a tyranny of the majority and of the company being robbed blind (legally and less legally) by the partners in management positions. Others are plainly jealous, poisoned by rumours and bad advisors, pressurized by a spouse. A myriad of reasons can lead to internal strife, detrimental to the future of the operation.

This leads to a paralysis of the work of the company. Management and ownership resources are dedicated to taking sides in the raging battle and to thinking up new strategies and tactics of attacking "the enemy". Indeed, animosity, even enmity, arise together with bitterness and air of paranoia and impending implosion. The business itself is neglected, then derailed. Directors argue for hours regarding their perks and benefits – and deal with the main issues in a matter of a few minutes. The company car gets more attention than the company's main clients, the expense accounts are more closely scrutinized than the marketing strategies of the firm's competitors. This is disastrous and before long the company begins to lose clients, its marketing position degenerates, its performance and customer satisfaction deteriorate. This is mortal danger and it should be nipped in the bud.

Frankly, I do not believe much in introducing rational solutions to this highly charged EMOTIVE-PSYCHOLOGICAL problem. Logic cannot eliminate envy, ratio cannot cope with jealousy and bad mouthing will not stop if certain visible disparities are addressed. Still, dealing with the situation openly is better than relegating it to obscurity.

We must, first, make a distinction between a division of the company's assets and liabilities upon a dissolution of the partnership for whatever reason – and the distribution of its on-going revenues or profits.

In the first case (dissolution), the best solution I know of, is practised by the Bedouins in the Sinai Peninsula. For simplification's sake, let us discuss a collaboration between two equal partners that is coming to its end. One of the partners is then charged with dividing the partnership's assets and liabilities into two lots (that he deems equal). The other partner is then given the right of being the FIRST to choose one of the lots to himself. This is an ingenious scheme: the partner in charge of allocating the lots will do his utmost to ensure that they are indeed identical. Each lot will, probably, contain values of assets and liabilities identical to the other lot. This is because the partner in charge of the division does not know WHICH lot the other partner will choose. If he divides the lots unevenly – he runs the risk of his partner choosing the better lot and leaving him with the lesser one.

Life is not that simple when it comes to dividing a stream of income or of profits. Income can be distributed to the shareholders in many ways: wages, perks and benefits, expense accounts, and dividends. It is difficult to disentangle what money is paid to a shareholder against a real contribution – and what money is a camouflaged dividend. Moreover, shareholders are supposed to contribute to their firm (this is why they own shares) – so why should they be especially compensated when they do so? The latter question is particularly acute when the shareholder is not a full time employee of the firm – but allocates only a portion of his time and resources to it.

Solutions do exist, however. One category of solutions involves coming up with a clear definition of the functions of a shareholder (a job description). This is a prerequisite. Without such clarity, it would be close to impossible to quantify the respective contributions of the shareholders.

Following this detailed analysis, a pecuniary assessment of the contribution should be made. This is a tricky part. How to value the importance to the company of this or that shareholder?

One way is to publish a public tender for the shareholder's job, based on the aforementioned job description. The shareholder will accept, in advance, to match the lowest bid in the tender. Example: if the shareholder is the Active Chairman of the Board, his job will be minutely described in writing. Then, a tender will be published by the company for the job, including a job description. A committee, whose odd number of members will be appointed by the Board of Directors, will select the winner whose bid (cost) was the lowest. The shareholder will match these low end terms. In other words: the shareholder will accept the market's verdict. To perfect this technique, the CURRENT functionaries should also submit their bids under assumed names. This way, not only the issue of their compensation will be determined – but also the more basic question of whether they are the fittest for the job.

Another way is to consult executive search agencies and personnel placement agencies (also known as "Headhunters"). Such organizations can save the prolonged hassle of a public tender, on the one hand. On the other hand, their figures are likely to be skewed up. Because they are getting a commission equal to one monthly wage of the successfully placed executive – they will tend to quote a level of compensation higher than the market's. An approach should, therefore, be made to at least three such agencies and the resulting average figure should be adjusted down by 10% (approximately the commission payable to these agencies).

A closely similar method is to follow what other, comparable, firms, are offering their position-holders. This can be done by studying the classified ads and by directly asking the companies (if such direct enquiry is at all possible).

Yet another approach is to appoint a management consultancy to do the job: are the shareholders the best positioned people in their respective functions? Is their compensation realistic? Should alternative management methods be implemented (rotation, co-management, management by committee)?

All the above mentioned are FORMAL techniques in which arbitration is carried out to determine the remuneration level befitting the shareholder's position. Any compensation that he receives above this level is evidently a hidden dividend. The arbitration can be carried out directly by the market or by select specialists.

There are, however, more direct approaches. Some solutions are performance related. A base compensation (salary) is agreed between the parties: each shareholder, regardless of his position, dedication to the job, or contribution to the firm – will take home an amount of monthly fee reflecting his shareholding proportion or an amount equal to the one received by other shareholders. This, really, is the hidden dividend, disguised as a salary.

The remaining part of the compensation package will be proportional to some performance criteria.

Let us take the simplest case: two equal partners. One is in charge of activity A, which yields to the company AA in income and AAA in profits (gross or net). The second partner supervises and manages activity B, which yields to the company BB in revenues and BBB in profits. Both will receive an equal "base salary". Then, an additional total amount available to both partners will be decided ("incentive base"). The first partner will receive an additional amount, which will be one of the ratios {AA/(AA+BB)} or {AAA/(AAA+BBB)} multiplied by the incentive base.

The second partner will receive an additional amount, which will be one of the ratios {BB/(AA+BB)} or {BBB/(AAA+BBB)} multiplied by the same incentive base. A recalculation of the compensation packages will be done quarterly to reflect changes in revenues and in profits. In case the activity yields losses – it is better to use the revenues for calculation purposes. The profits should be used only when the firm is divided to clear profit and loss centres, which could be completely disentangled from each other.

All the above methods deal with partners whose contributions are NOT equal (one is more experienced, the other has more contacts, or a formal technological education, etc.). These solutions are also applicable when the partners DISAGREE concerning the valuation of their respective contributions. When the partners agree that they contribute equally, some basis can be agreed for calculating a fair compensation. For instance: the number of hours dedicated to the business, or even some arbitrary coefficient.

But whatever the method employed, when there is no such agreement between the partners, they should recognize each other's skills, talents and specific contributions. The compensation packages should never exceed what the shareholders can reasonably expect to get by way of dividends. Even the most envious person, if he knows that his partner can bring him in dividends more than he can ever hope for in compensation – will succumb to greed and award his partner what he needs in order to produce those dividends.

Banks, Financial Statements of

Banks are institutions where miracles happen regularly. We rarely entrust our money to anyone but ourselves – and our banks. Despite a very chequered history of mismanagement, corruption, false promises and representations, delusions and behavioural inconsistency – banks still succeed to motivate us to give them our money. Partly it is the feeling that there is safety in numbers. The fashionable term today is "moral hazard". The implicit guarantees of the state and of other financial institutions move us to take risks which we would, otherwise, have avoided. Partly it is the sophistication of the banks in marketing and promoting themselves and their products. Glossy brochures, professional computer and video presentations and vast, shrine-like, real estate complexes all serve to enhance the image of the banks as the temples of the new religion of money.

But what is behind all this? How can we judge the soundness of our banks? In other words, how can we tell if our money is safely tucked away in a safe haven?

The reflex is to go to the bank's balance sheets. Banks and balance sheets have been both invented in their modern form in the 15th century. A balance sheet, coupled with other financial statements is supposed to provide us with a true and full picture of the health of the bank, its past and its long-term prospects. The surprising thing is that – despite common opinion – it does.

But it is rather useless unless you know how to read it.

Financial statements (Income – or Profit and Loss - Statement, Cash Flow Statement and Balance Sheet) come in many forms. Sometimes they conform to Western accounting standards (the Generally Accepted Accounting Principles, GAAP, or the less rigorous and more fuzzily worded International Accounting Standards, IAS). Otherwise, they conform to local accounting standards, which often leave a lot to be desired. Still, you should look for banks, which make their updated financial reports available to you. The best choice would be a bank that is audited by one of the Big Four Western accounting firms and makes its audit reports publicly available. Such audited financial statements should consolidate the financial results of the bank with the financial results of its subsidiaries or associated companies. A lot often hides in those corners of corporate holdings.

Banks are rated by independent agencies. The most famous and most reliable of the lot is Fitch Ratings. Another one is Moody's. These agencies assign letter and number combinations to the banks that reflect their stability. Most agencies differentiate the short term from the long term prospects of the banking institution rated. Some of them even study (and rate) issues, such as the legality of the operations of the bank (legal rating). Ostensibly, all a concerned person has to do, therefore, is to step up to the bank manager, muster courage and ask for the bank's rating. Unfortunately, life is more complicated than rating agencies would have us believe.

They base themselves mostly on the financial results of the bank rated as a reliable gauge of its financial strength or financial profile. Nothing is further from the truth.

Admittedly, the financial results do contain a few important facts. But one has to look beyond the naked figures to get the real – often much less encouraging – picture.

Consider the thorny issue of exchange rates. Financial statements are calculated (sometimes stated in USD in addition to the local currency) using the exchange rate prevailing on the 31st of December of the fiscal year (to which the statements refer). In a country with a volatile domestic currency this would tend to completely distort the true picture. This is especially true if a big chunk of the activity preceded this arbitrary date. The same applies to financial statements, which were not inflation-adjusted in high inflation countries. The statements will look inflated and even reflect profits where heavy losses were incurred. "Average amounts" accounting (which makes use of average exchange rates throughout the year) is even more misleading. The only way to truly reflect reality is if the bank were to keep two sets of accounts: one in the local currency and one in USD (or in some other currency of reference). Otherwise, fictitious growth in the asset base (due to inflation or currency fluctuations) could result.

Another example: in many countries, changes in regulations can greatly effect the financial statements of a bank. In 1996, in Russia, for example, the Bank of Russia changed the algorithm for calculating an important banking ratio (the capital to risk weighted assets ratio).

Unless a Russian bank restated its previous financial statements accordingly, a sharp change in profitability appeared from nowhere.

The net assets themselves are always misstated: the figure refers to the situation on 31/12. A 48-hour loan given to a collaborating client can inflate the asset base on the crucial date. This misrepresentation is only mildly ameliorated by the introduction of an "average assets" calculus. Moreover, some of the assets can be interest earning and performing – others, non-performing. The maturity distribution of the assets is also of prime importance. If most of the bank's assets can be withdrawn by its clients on a very short notice (on demand) – it can swiftly find itself in trouble with a run on its assets leading to insolvency.

Another oft-used figure is the net income of the bank. It is important to distinguish interest income from non-interest income. In an open, sophisticated credit market, the income from interest differentials should be minimal and reflect the risk plus a reasonable component of income to the bank. But in many countries (Japan, Russia) the government subsidizes banks by lending to them money cheaply (through the Central Bank or through bonds). The banks then proceed to lend the cheap funds at exorbitant rates to their customers, thus reaping enormous interest income. In many countries the income from government securities is tax free, which represents another form of subsidy. A high income from interest is a sign of weakness, not of health, here today, gone tomorrow. The preferred indicator should be income from operations (fees, commissions and other charges).

There are a few key ratios to observe. A relevant question is whether the bank is accredited with international banking agencies. These issue regulatory capital requirements and other mandatory ratios. Compliance with these demands is a minimum in the absence of which, the bank should be regarded as positively dangerous.

The return on the bank's equity (ROE) is the net income divided by its average equity. The return on the bank's assets (ROA) is its net income divided by its average assets. The (tier 1 or total) capital divided by the bank's risk weighted assets – a measure of the bank's capital adequacy. Most banks follow the provisions of the Basel Accord as set by the Basel Committee of Bank Supervision (also known as the G10). This could be misleading because the Accord is ill equipped to deal with risks associated with emerging markets, where default rates of 33% and more are the norm. Finally, there is the common stock to total assets ratio. But ratios are not cure-alls. Inasmuch as the quantities that comprise them can be toyed with – they can be subject to manipulation and distortion. It is true that it is better to have high ratios than low ones. High ratios are indicative of a bank's underlying strength, reserves, and provisions and, therefore, of its ability to expand its business. A strong bank can also participate in various programs, offerings and auctions of the Central Bank or of the Ministry of Finance. The larger the share of the bank's earnings that is retained in the bank and not distributed as profits to its shareholders – the better these ratios and the bank's resilience to credit risks.

Still, these ratios should be taken with more than a grain of salt. Not even the bank's profit margin (the ratio of net income to total income) or its asset utilization coefficient (the ratio of income to average assets) should be relied upon. They could be the result of hidden subsidies by the government and management misjudgement or understatement of credit risks.

To elaborate on the last two points:

A bank can borrow cheap money from the Central Bank (or pay low interest to its depositors and savers) and invest it in secure government bonds, earning a much higher interest income from the bonds' coupon payments. The end result: a rise in the bank's income and profitability due to a non-productive, non-lasting arbitrage operation. Otherwise, the bank's management can understate the amounts of bad loans carried on the bank's books, thus decreasing the necessary set-asides and increasing profitability. The financial statements of banks largely reflect the management's appraisal of the business. This has proven to be a poor guide.

In the main financial results page of a bank's books, special attention should be paid to provisions for the devaluation of securities and to the unrealized difference in the currency position. This is especially true if the bank is holding a major part of the assets (in the form of financial investments or of loans) and the equity is invested in securities or in foreign exchange denominated instruments.

Separately, a bank can be trading for its own position (the Nostro), either as a market maker or as a trader. The profit (or loss) on securities trading has to be discounted because it is conjectural and incidental to the bank's main activities: deposit taking and loan making.

Most banks deposit some of their assets with other banks. This is normally considered to be a way of spreading the risk. But in highly volatile economies with sickly, underdeveloped financial sectors, all the institutions in the sector are likely to move in tandem (a highly correlated market). Cross deposits among banks only serve to increase the risk of the depositing bank (as the recent affair with Toko Bank in Russia and the banking crisis in South Korea have demonstrated).

Further closer to the bottom line are the bank's operating expenses: salaries, depreciation, fixed or capital assets (real estate and equipment) and administrative expenses. The rule of thumb is: the higher these expenses, the weaker the bank. The great historian Toynbee once said that great civilizations collapse immediately after they bequeath to us the most impressive buildings. This is doubly true with banks. If you see a bank fervently engaged in the construction of palatial branches – stay away from it.

Banks are risk arbitrageurs. They live off the mismatch between assets and liabilities. To the best of their ability, they try to second guess the markets and reduce such a mismatch by assuming part of the risks and by engaging in portfolio management. For this they charge fees and commissions, interest and profits – which constitute their sources of income.

If any expertise is imputed to the banking system, it is risk management. Banks are supposed to adequately assess, control and minimize credit risks. They are required to implement credit rating mechanisms (credit analysis and value at risk – VAR - models), efficient and exclusive information-gathering systems, and to put in place the right lending policies and procedures.

Just in case they misread the market risks and these turned into credit risks (which happens only too often), banks are supposed to put aside amounts of money which could realistically offset loans gone sour or future non-performing assets. These are the loan loss reserves and provisions. Loans are supposed to be constantly monitored, reclassified and charges made against them as applicable. If you see a bank with zero reclassifications, charge offs and recoveries – either the bank is lying through its teeth, or it is not taking the business of banking too seriously, or its management is no less than divine in its prescience. What is important to look at is the rate of provision for loan losses as a percentage of the loans outstanding. Then it should be compared to the percentage of non-performing loans out of the loans outstanding. If the two figures are out of kilter, either someone is pulling your leg – or the management is incompetent or lying to you. The first thing new owners of a bank do is, usually, improve the placed asset quality (a polite way of saying that they get rid of bad, non-performing loans, whether declared as such or not). They do this by classifying the loans. Most central banks in the world have in place regulations for loan classification and if acted upon, these yield rather more reliable results than any management's "appraisal", no matter how well intentioned.

In some countries the Central Bank (or the Supervision of the Banks) forces banks to set aside provisions against loans at the highest risk categories, even if they are performing. This, by far, should be the preferable method.

Of the two sides of the balance sheet, the assets side is the more critical. Within it, the interest earning assets deserve the greatest attention. What percentage of the loans is commercial and what percentage given to individuals? How many borrowers are there (risk diversification is inversely proportional to exposure to single or large borrowers)? How many of the transactions are with "related parties"? How much is in local currency and how much in foreign currencies (and in which)? A large exposure to foreign currency lending is not necessarily healthy. A sharp, unexpected devaluation could move a lot of the borrowers into non-performance and default and, thus, adversely affect the quality of the asset base. In which financial vehicles and instruments is the bank invested? How risky are they? And so on.

No less important is the maturity structure of the assets. It is an integral part of the liquidity (risk) management of the bank. The crucial question is: what are the cash flows projected from the maturity dates of the different assets and liabilities – and how likely are they to materialize. A rough matching has to exist between the various maturities of the assets and the liabilities. The cash flows generated by the assets of the bank must be used to finance the cash flows resulting from the banks' liabilities. A distinction has to be made between stable and hot funds (the latter in constant pursuit of higher yields). Liquidity indicators and alerts have to be set in place and calculated a few times daily.

Gaps (especially in the short term category) between the bank's assets and its liabilities are a very worrisome sign. But the bank's macroeconomic environment is as important to the determination of its financial health and of its creditworthiness as any ratio or micro-analysis. The state of the financial markets sometimes has a larger bearing on the bank's soundness than other factors. A fine example is the effect that interest rates or a devaluation have on a bank's profitability and capitalization. The implied (not to mention the explicit) support of the authorities, of other banks and of investors (domestic as well as international) sets the psychological background to any future developments. This is only too logical. In an unstable financial environment, knock-on effects are more likely. Banks deposit money with other banks on a security basis. Still, the value of securities and collaterals is as good as their liquidity and as the market itself. The very ability to do business (for instance, in the syndicated loan market) is influenced by the larger picture. Falling equity markets herald trading losses and loss of income from trading operations and so on.

Perhaps the single most important factor is the general level of interest rates in the economy. It determines the present value of foreign exchange and local currency denominated government debt. It influences the balance between realized and unrealized losses on longer-term (commercial or other) paper. One of the most important liquidity generation instruments is the repurchase agreement (repo). Banks sell their portfolios of government debt with an obligation to buy it back at a later date. If interest rates shoot up – the losses on these repos can trigger margin calls (demands to immediately pay the losses or else materialize them by buying the securities back).

Margin calls are a drain on liquidity. Thus, in an environment of rising interest rates, repos could absorb liquidity from the banks, deflate rather than inflate. The same principle applies to leverage investment vehicles used by the bank to improve the returns of its securities trading operations. High interest rates here can have an even more painful outcome. As liquidity is crunched, the banks are forced to materialize their trading losses. This is bound to put added pressure on the prices of financial assets, trigger more margin calls and squeeze liquidity further. It is a vicious circle of a monstrous momentum once commenced.

But high interest rates, as we mentioned, also strain the asset side of the balance sheet by applying pressure to borrowers. The same goes for a devaluation. Liabilities connected to foreign exchange grow with a devaluation with no (immediate) corresponding increase in local prices to compensate the borrower. Market risk is thus rapidly transformed to credit risk. Borrowers default on their obligations. Loan loss provisions need to be increased, eating into the bank's liquidity (and profitability) even further. Banks are then tempted to play with their reserve coverage levels in order to increase their reported profits and this, in turn, raises a real concern regarding the adequacy of the levels of loan loss reserves. Only an increase in the equity base can then assuage the (justified) fears of the market but such an increase can come only through foreign investment, in most cases. And foreign investment is usually a last resort, pariah, solution (see Southeast Asia and the Czech Republic for fresh examples in an endless supply of them. Japan and China are, probably, next).

In the past, the thinking was that some of the risk could be ameliorated by hedging in forward markets (=by selling it to willing risk buyers). But a hedge is only as good as the counterparty that provides it and in a market besieged by knock-on insolvencies, the comfort is dubious. In most emerging markets, for instance, there are no natural sellers of foreign exchange (companies prefer to hoard the stuff). So forwards are considered to be a variety of gambling with a default in case of substantial losses a very plausible way out.

Banks depend on lending for their survival. The lending base, in turn, depends on the quality of lending opportunities. In high-risk markets, this depends on the possibility of connected lending and on the quality of the collaterals offered by the borrowers. Whether the borrowers have qualitative collaterals to offer is a direct outcome of the liquidity of the market and on how they use the proceeds of the lending. These two elements are intimately linked with the banking system. Hence the penultimate vicious circle: where no functioning and professional banking system exists – no good borrowers will emerge.

Banks, German

Denial is a ubiquitous psychological defense mechanism. It involves the repression of bad news, unpleasant information, and anxiety-inducing experiences. Judging by the German press, the country is in a state of denial regarding the waning health of its economy and the dwindling fortunes of its financial system.

Commerzbank, Germany's fourth largest lender, saw its shares decimated by more than 80 percent to a 19-year low, having increased its loan-loss provisions to cover flood-submerged east German debts. Faced with a precipitous drop in net profit, it reacted reflexively by sacking yet more staff. The shares of many other German banks trade below book value.

Dresdner Bank - Germany's third largest private establishment - already trimmed an unprecedented one fifth of its workforce this year alone. Other leading German banks - such as Deutsche Bank and Hypovereinsbank - resorted to panic selling of equity portfolios, real-estate, non-core activities, and securitized assets to patch up their ailing income statements. Deutsche Bank, for instance, unloaded its US leasing and custody businesses.

On September 19, Moody's changed its outlook for Germany's largest banks from "stable" to "negative". In a scathing remark, it said:

"The rating agency stated several times already that current difficult economic conditions that are hurting the banking business in Germany come on top of the legacy of past strategies that were less focused on strengthening the banks' recurring earning power. Indeed, the German private-sector banks, as a group, remain among the lowest-performing large European banks."

Last week, Fitch Ratings, the international agency, followed suit and downgraded the long-term , short- term, and individual ratings of Dresdner Bank and of Bayerische Hypo- und Vereinsbank (HVB).

These were only the last in a series of negative outlooks pertaining to German insurers and banks. It is ironic that Fitch cited the "bear equity markets (that) have taken their toll not only on trading results but also on sales to private customers, the fund management business and on corporate finance."

Germans used to be immune to the stock exchange and its lures until they were caught in the frenzied global equities bubble. Moody's observes wryly that "a material and stable retail franchise in its home market, even if more modestly profitable, can and does represent a reliable line of defence against temporary difficulties in financial and wholesale markets."

The technology-laden and scandal-ridden Neuer Markt - Europe's answer to America's NASDAQ - as well as the SMAX exchange for small-caps were shut down last week, the former having lost a staggering 96 percent of its value since March 2000. This compared to Britain's AIM, which lost "only" half its worth. Even Britain's infamous FTSE-TechMARK faded by a "mere" 88 percent.

Only 1 company floated on the Neuer Markt this year - compared to more than 130 two years ago. In an unprecedented show of "no-confidence", more than 40 companies withdrew their listings last year. The Duetsche Boerse promised to create two new classes of shares on the Frankfurt Stock Exchange. It belatedly vowed to introduce more transparency and openness to foreign investors.

Banks have been accused by irate customers of helping to list inappropriate firms and providing fraudulent advisory services. Court cases are pending against the likes of

Commerzbank. These proceedings may dash the bank's hopes to move from retail into private banking.

To further compound matters, Germany is in the throes of a tsunami of corporate insolvencies. This long-overdue restructuring, though beneficial in the long run, couldn't have transpired at a worse time, as far as the banks go. Massive provisions and write-downs have voraciously consumed their capital base even as operating profits have plummeted. This double whammy more than eroded the benefits of their painful cost-cutting measures.

German banks - not unlike Japanese ones - maintain incestuous relationships with their clients. When it finally collapsed in April, Philip Holzmann AG owed billions to Deutsche Bank with whom it had a cordial working relationship for more than a century. But the bank also owned 19.6 percent of the ailing construction behemoth and chaired its supervisory board - the relics of previous shambolic rescue packages.

Germany competes with Austria in over-branching, with Japan in souring assets, and with Russia in overhead. According to the German daily, Frankfurter Allgemeine Zeitung, the cost to income ratio of German banks is 90 percent. Mass bankruptcies and consolidation - voluntary or enforced - are unavoidable, especially in the cooperative, mortgage, and savings banks sectors, concludes the paper. The process is a decade-old. More than 1500 banks vanished from the German landscape in this period. Another 2500 remain making Germany still one of the most over-banked countries in the world.

Moody's don't put much stock in the cost-cutting measures of the German banks. Added competition and a "more realistic pricing" of loans and services are far more important to their shriveling bottom line. But "that light is not yet visible at the end of the tunnel ... and challenging market conditions are likely to persist for the time being."

The woeful state of Germany's financial system reflects not only Germany's economic malaise - "The Economist" called it the "sick man" of Europe - but its failed attempt to imitate and emulate the inimitable financial centers of London and New-York. It is a rebuke to the misguided belief that capitalistic models - and institutions - can be transplanted in their entirety across cultural barriers. It is incontrovertible proof that history - and the core competencies it spawns - still matter.

When German insurers and banks, for instance, branched into faddish businesses - such as the Internet and mobile telephony - they did so in vacuum. Germany has few venture capitalists and American-style entrepreneurs. This misguided strategy resulted in a frightening erosion of the strength and capital base of the intrepid investors.

In a sense, Germany - and definitely its eastern Lander - is a country in transition. Risk-aversion is giving way to risk-seeking in the forms of investments in equities and derivatives and venture capital. Family ownership is gradually supplanted by stock exchange listings, imported management, and mergers, acquisitions, and takeovers - both friendly and hostile. The social contracts regarding employment, pensions, the role of the trade unions, the balance between human and pecuniary capital, and the carving up of monopoly market niches - are being re-written.

Global integration means that, as sovereignty is transferred to supranational entities, the cozy relationship between the banks and the German government on all levels is over. Last October, Hans Eichel, the German finance minister, announced OECD-inspired anti-money laundering measures that are likely to compromise bank secrecy and client anonymity and, thus, hurt the German - sometimes murky - banking business. Erstwhile rampant government intervention is now mitigated or outright prohibited by the European Union.

Thus, German Laender are forced, by the European Commission, to partly abolish, three years hence, their guarantees to the Landesbanken (regional development banks) and Sparkassen (thrifts). German diversification to Austria and central and east Europe will provide only temporary respite. As the EU enlarges and digests, at the very least, the Czech Republic, Hungary, and Poland in 2004-5 - German franchises there will come under the uncompromising remit of the Commission once more.

In general, Germans fared worse than Austrians in their extraterritorial banking ventures. Less cosmopolitan, with less exposure to the parts of the former Habsburg Empire, and struggling with a stagnant domestic economy - German banks found it difficult to turn central European banks around as successfully as the likes of the Austrian Erste Bank did. They did make inroads into niche structured financing markets in north Europe and the USA - but these seem to be random excursions rather a studied shift of business emphasis.

On the bright side, Moody's - though it maintains a negative outlook on German banking - noted, in November 2001, the banks' "intrinsic financial strength and diversified operating base". Tax reform and the hesitant introduction of private pensions are also cause for restrained optimism.

Pursuant to the purchase of Drsedner Bank by Allianz, Moody's welcome the emergence of bancassurance and Allfinanz models - financial services one stop shops. German banks are also positioned to reap the benefits of their considerable investments in e-commerce, technology, and the restructuring of their branch networks.

The Depression on 1929-1936 may have started with the meltdown of capital markets, especially that of Wall Street - but it was exacerbated by the collapse of the concatenated international banking system. The world today is even more integrated. The collapse of one or more major German banks can result in dire consequences and not only in the euro zone. The IMF says as much in its "World Economic Outlook" published on September 25.

The Germans deny this prognosis - and the diagnosis - vehemently. Bundesbank President Ernst Welteke - a board member of the European Central Bank - spent the better part of last week implausibly denying any crisis in German banking. These are mere "structural problems in the weak phase", he told a press conference. Nothing consolidation can't solve.

It is this consistent refusal to confront reality that is the most worrisome. In the short to medium term, German banks are likely to outlive the storm. In the process, they will lose their iron grip on the domestic market as customer loyalty dissipates and foreign competition increases. If they do not confront their plight with honesty and open-mindedness, they may well be reduced to glorified back-office extensions of the global giants.

Banks, Stability of

Banks are the most unsafe institutions in the world. Worldwide, hundreds of them crash every few years. Two decades ago, the US Government was forced to invest hundreds of billions of Dollars in the Savings and Loans industry. Multi-billion dollar embezzlement schemes were unearthed in the much feted BCCI - wiping both equity capital and deposits. Barings bank - having weathered 330 years of tumultuous European history - succumbed to a bout of untrammeled speculation by a rogue trader. In 1890 it faced the very same predicament only to be salvaged by other British banks, including the Bank of England. The list is interminable. There were more than 30 major banking crises this century alone.

That banks are very risky - is proven by the inordinate number of regulatory institutions which supervise banks and their activities. The USA sports a few organizations which insure depositors against the seemingly inevitable vicissitudes of the banking system.

The FDIC (Federal Deposit Insurance Corporations) insures against the loss of every deposit of less than 100,000 USD. The HLSIC insures depositors in saving houses in a similar manner. Other regulatory agencies supervise banks, audit them, or regulate them. It seems that you cannot be too cautious where banks are concerned.

The word "BANK" is derived from the old Italian word "BANCA" - bench or counter. Italian bankers used to conduct their business on benches. Nothing much changed ever since - maybe with the exception of the scenery. Banks hide their fragility and vulnerability - or worse - behinds marble walls. The American President, Andrew Jackson, was so set against banks - that he dismantled the nascent central bank - the Second Bank of the United States.

A series of bank scandals is sweeping through much of the developing world - Eastern and Central Europe to the fore. "Alfa S.", "Makedonija Reklam" and TAT have become notorious household names.

What is wrong with the banking systems in Central Eastern Europe (CEE) in general - and in Macedonia in particular? In a nutshell, almost everything. It is mainly a crisis of trust and adverse psychology. Financial experts know that Markets work on expectations and evaluations, fear and greed. The fuel of the financial markets is emotional - not rational.

Banks operate through credit multipliers. When Depositor A places 100,000 USD with Bank A, the Bank puts aside about 20% of the money. This is labelled a reserve and is intended to serve as an insurance policy cum a liquidity cushion. The implicit assumption is that no more than 20% of the total number of depositors will claim their money at any given moment.

In times of panic, when ALL the depositors want their money back - the bank is rendered illiquid having locked away in its reserves only 20% of the funds. Commercial banks hold their reserves with the Central Bank or with a third party institution, explicitly and exclusively set up for this purpose.

What does the bank do with the other 80% of Depositor A's money ($80,000)? It lends it to Borrower B. The Borrower pays Bank A interest on the loan. The difference between the interest that Bank A pays to Depositor A on his deposit - and the interest that he charges Borrower B - is the bank's income from these operations.

In the meantime, Borrower B deposits the money that he received from Bank A (as a loan) in his own bank, Bank B. Bank B puts aside, as a reserve, 20% of this money - and lends 80% (=$64,000) to Borrower C, who promptly deposits it in Bank C.

At this stage, Depositor A's money ($100,000) has multiplied and become $244,000. Depositor A has $100,000 in his account with Bank A, Borrower B has $80,000 in his account in Bank B, and Borrower C has $64,000 in his account in Bank C. This process is called credit multiplication. The Western Credit multiplier is 9. This means that every $100,000 deposited with Bank A could, theoretically, become $900,000: $400,000 in credits and $500,000 in deposits.

For every $900,000 in the banks' books - there are only 100,000 in physical dollars. Banks are the most heavily leveraged businesses in the world.

But this is only part of the problem. Another part is that the profit margins of banks are limited. The hemorrhaging consumers of bank services would probably beg to differ - but banking profits are mostly optical illusions. We can safely say that banks are losing money throughout most of their existence.

The SPREAD is the difference between interest paid to depositors and interest collected on credits. The spread in Macedonia is 8 to 10%. This spread is supposed to cover all the bank's expenses and leave its shareholders with a profit. But this is a shakey proposition. To understand why, we have to analyse the very concept of interest rates.

Virtually every major religion forbids the charging of interest on credits and loans. To charge interest is considered to be part usury and part blackmail. People who lent money and charged interest for it were ill-regarded - remember Shakespeare's "The Merchant of Venice"?

Originally, interest was charged on money lent was meant to compensate for the risks associated with the provision of credit in a specific market. There were four such hazards:

First, there are the operational costs of money lending itself. Money lenders are engaged in arbitrage and the brokering of funds. In other words, they borrow the money that they then lend on. There are costs of transportation and communications as well as business overhead.

The second risk is that of inflation. It erodes the value of money used to repay credits. In quotidian terms: as time passes, the Lender can buy progressively less with the money repaid by the Borrower. The purchasing power of the money diminishes. The measure of this erosion is called inflation.

And there is a risk of scarcity. Money is a rare and valued object. Once lent it is out of the Lender's hands, exchanged for mere promises and oft-illiquid collateral. If, for instance, a Bank lends money at a fixed interest rate - it gives up the opportunity to lend it anew, at higher rates.

The last - and most obvious risk is default: when the Borrower cannot or would not pay back the credit that he has taken.

All these risks have to be offset by the bank's relatively minor profit margin. Hence the bank's much decried propensity to pay their depositors as symbolically as they can - and charge their borrowers the highest interest rates they can get away with.

But banks face a few problems in adopting this seemingly straightforward business strategy.

Interest rates are an instrument of monetary policy. As such, they are centrally dictated. They are used to control the money supply and the monetary aggregates and through them to fine tune economic activity.

Governors of Central Banks (where central banks are autonomous) and Ministers of Finance (where central banks are more subservient) raise interest rates in order to contain economic activity and its inflationary effects. They cut interest rates to prevent an economic slowdown and to facilitate the soft landing of a booming economy. Despite the fact that banks (and credit card companies, which are really banks) print their own money (remember the multiplier) - they do not control the money supply or the interest rates that they charge their clients.

This creates paradoxes.

The higher the interest rates - the higher the costs of financing payable by businesses and households. They, in turn, increase the prices of their products and services to reflect the new cost of money. We can say that, to some extent, rather than prevent it, higher interest rates contribute to inflation - i.e., to the readjustment of the general price level.

Also, the higher the interest rates, the more money earned by the banks. They lend this extra money to Borrowers and multiply it through the credit multiplier.

High interest rates encourage inflation from another angle altogether:

They sustain an unrealistic exchange rate between the domestic and foreign currencies. People would rather hold the currency which yields higher interest (=the domestic one). They buy it and sell all other currencies.

Conversions of foreign exchange into local currency are net contributors to inflation. On the other hand, a high exchange rate also increases the prices of imported products. Still, all in all, higher interest rates contribute to the very inflation that are intended to suppress.

Another interesting phenomenon:

High interest rates are supposed to ameliorate the effects of soaring default rates. In a country like Macedonia - where the payments morale is low and default rates are stratospheric - the banks charge incredibly high interest rates to compensate for this specific risk.

But high interest rates make it difficult to repay one's loans and may tip certain obligations from performing to non-performing. Even debtors who pay small amounts of interest in a timely fashion - often find it impossible to defray larger interest charges.

Thus, high interest rates increase the risk of default rather than reduce it. Not only are interest rates a blunt and inefficient instrument - but they are also not set by the banks, nor do they reflect the micro-economic realities with which they are forced to cope.

Should interest rates be determined by each bank separately (perhaps according to the composition and risk profile of its portfolio)? Should banks have the authority to print money notes (as they did throughout the 18th and 19th centuries)? The advent of virtual cash and electronic banking may bring about these outcomes even without the complicity of the state.

Barbie

Barbie was invented by Ruth Handler in 1959. It was modelled on a minuscule German sex doll called "Lilli". Barbie was the nickname of Ruth's daughter, Barbara. Ruth proceeded to found Mattel with her husband, Elliott. It is now one of the world's largest toy manufacturers (revenues - c. $5 billion annually, a third of which in Barbie sales). More than 1 billion Barbies were sold by 1996. Mattel commemorated this event by manufacturing a "Dream Barbie".

Belarus, Economy of

Most of the post-communist countries in transition are ruled either by reformed communists or by authoritarian anti-communists. It is ironic that the West - recently led more by the European Union than by the USA - helps the former to get elected even as it demonizes and vilifies the latter. The "regime change" fad, one must recall, started in the Balkans with Slobodan Milosevic, not in Afghanistan, or Iraq.

Aleksander Kwasniewski, a former communist minister and the current president of Poland is feted by the likes of George Bush. Vladimir Putin, a former KGB officer and Russia's president, is a strategic ally of the USA. Branko Crvnkovski - an active "socialist" and the president of Macedonia - is the darling of the international community.

Vaclav Klaus (former prime minister of the Czech Republic), Vladimir Meciar (former strongman and prime minister of Slovakia), Ljubco Georgievski (until 2002 the outspoken prime minister of Macedonia), Viktor Orban (voted out as prime minister of Hungary in late 2002) - all strident anti-communists - are shunned by the great democracies.

The West contributed to the electoral downfall of some of these leaders. When it failed, it engineered their ostracism. Meciar, for instance, won the popular vote twice but was unable to form a government because both NATO and the European Union made clear that a Slovakia headed by Meciar will be barred from membership and accession.

But nowhere is European and American discomfiture and condemnation more evident than in Ukraine and Belarus.

Leonid Kuchma, Ukraine's former president, has been accused by the opposition and by the international media of every transgression - from selling radar systems to Iraq to ordering the murder of a journalist. He hadn't visited a single European leader - with the exception of Romano Prodi, the chief of the European Commission - in the last five years of his much-maligned reign.

Kuchma was not allowed to attend NATO's Prague summit in November 2002 due to opposition by NATO and a few European governments. It was then that he began priming his new prime minister, Viktor Yanukovich, erstwhile governor of the Donetsk region, to replace him as president.

Aleksander Lukashenka, the beleaguered president of Belarus is equally unlucky. The Czechs flatly refused him an entry visa due to human rights violations in his country. Minsk threatened to sever its diplomatic relations with Prague. In November 2002, the European Union imposed a travel ban on Lukashenka and 50 members of his administration. The EU has suspended in 1997 most financial aid and bilateral trade programs with Belarus.

In an apparent tit-for-tat Belarus again raised the issue of Chechen refugees on its territory, refused entry by Poland. The Organisation for Security and Cooperation in Europe (OSCE) has been ignoring Belarusian complaints, letting the impoverished country cope with the human flux at its own expense. Lukashenka threatened to open Belarus' anyhow porous borders to unpoliced traffic.

According to Radio Free Europe/Radio Liberty, in a conference in Washington in November 2002, tellingly titled "Axis of Evil: Belarus - The Missing Link" and hosted by the American Enterprise Institute, then US ambassador to Belarus, Michael Kozak, chastised president Lukashenka for having "chosen the wrong side in the war on terrorism" and threatened that he "will soon face the consequences of his illegal arms sales (and military training) to Iraq." The Polish delegate mocked Lukashenka and his "friends in Baghdad". Poland used to rule west Belarus between the world wars and Poles residing there are staunch supporters of the opposition to the wily president.

Belarus implausibly - though vehemently - denies any wrongdoing but Minsk is still the target of delegations from every pariah state - from North Korea to Cuba. Saddam Hussein's Iraqi minister of military industry was a frequent visitor. But Belarus has little choice. Boycotted and castigated by the West and multilateral lending institutions, it has to resort to its Soviet-era export markets for trade and investments.

The October 2004 Belarus Democracy Act, and other proposed bills pending in Congress, grant massive economic assistance to the fledgling opposition and would impose economic sanctions on the much-decried regime. Hitherto supported by an increasingly reluctant Russia, Lukashenka, having expelled the OSCE monitoring and advisory team, remains utterly isolated.

Putin, as opposed to his predecessor, Boris Yeltsin, rejected a union between Russia and Belarus and instead offered to incorporate the 80,000 sq. miles (208,000 square km.), 10 million people, country in the Russian Federation. When Russia effectively joins the WTO, its customs union with Belarus will go. All that's left binding this unlikely couple together are two military bases with questionable relevance.

The friction between the neighboring duo is growing. Belarus owes Russia at least $80 million for subsidized gas supplies since 1999. An angry Gazprom, the partly state-owned Russian energy behemoth, accuses Belarus of pilfering a staggering 15 billion cubic meters of gas from the transit pipeline in the third quarter of 2002 alone.

In a meeting, in November 2002, between Mikhail Kasyanov, prime minister of Russia and Henadz Navitski, his Belarusian counterpart, Russia agreed to cover c. half the outstanding debt and to renew the flow of critical fuel, halved in the previous fortnight.

A possible debt-to-equity takeover of the much-coveted and strategically-located Belarusian pipeline network, Beltranshaz, was also discussed. It is an alluring alternative to the Ukrainian route and the Finnish-Baltic North European Gas Pipeline. The Belarusian potash industry is another likely target once - or if - privatization sinks in.

Should Gazprom cease to sell to Belarus gas at the heavily subsidized Russian prices, the country will grind to a halt. Other suppliers, such as Itera, have already cut their supply by half. Belarus' decrepit industries, still state-owned, centrally planned and managed by old-timers, rely on heavy-handed government subventionary, interventionary and protectionist policies. Heavy machinery, clunky and shoddy consumer goods and petrochemicals constitute the bulk of Belarusian exports.

Strolling the drab, though tidy, streets of soot-suffused Minsk, it is hard to believe that Belarus was once one of the most prosperous parts of the USSR. The average income was 1.2 times the Soviet Union's. GDP per capita was 1.5 times the average. Yet, Belarus has rejected transition. It tolerated only a negligible private sector and mistreated foreign investors.

It is even harder to believe that Lukashenka was once a zealous fighter against corruption in his country. He won the 1994 presidential elections on a "clean hands" ticket, being an obscure state farm director and then a crusading member of parliament. Re-elected in tainted elections in 2001, Lukashenka has imposed a reign of ambient terror on his countrymen. Human rights abuses and mysterious disappearances of dissidents abound.

The president's "market socialism" is replete with five year plans, quotas, and a nomenclature of venal politicians and rent seeking managers. The BBC reports that "farmers are being encouraged to grow bumper harvests for the reward of a free carpet or TV set from the state." In mid-2002 The Economist reported mass arrests of non-supportive company directors.

Some people are afraid to criticize the regime and for good reason. But what the Western media consistently neglect to mention is that many Belarusians are content. As opposed to other countries in transition, until fairly recently, both salaries and pensions - though meager even by east European standards - were paid on time. GDP per capita is a respectable $3000 - three fifths the Czech Republic's and Hungary's.

Official unemployment is 2 percent, though, with underemployment, it is probably closer to 10-15 percent, or half Poland's. According to the Encyclopedia Britannica 2002 Yearbook, Russia spends c. $1 billion annually to subsidize Belarusian energy consumption and to purchase unwanted Belarusian products. But even if true, this amounts to a mere 3 percent of GDP.

The rate of violent crime is low - though electronic crime, the smuggling of drugs and weapons and sex slavery flourish. The streets are clean. Heating is affordable. Food and medicines are subsidized. The ever-receding prospect of union with Russia now attracts the support of the majority of the population. Lukashenka was the only deputy of Belarus' Supreme Soviet to have voted against the dissolution of the USSR. In the current climate, this voting record is a political asset.

The opposition is fractured and cantankerous and has consecutively boycotted the elections. The few influential dissenting voices are from the president's own ranks. The truth is that 51-year old Lukashenka, born in a tiny, backward village, is popular among blue-collar workers and farmers. They call him "father". Granted, judging by his Web site, he is a megalomaniac, but many Belarusians find even this endearing. He is a "strong man" in the age-old tradition of this region.

As far as the West is concerned, Belarus is a dangerous precedent. It proves that there is life after Western sanctions and blatant meddling. Regrettably, the Belarusians have traded their political freedom for bread and order. But, if this sounds familiar, it is because the Russians have done the same. Putin's Russia is a more orderly and lawful place - but political and press freedoms are curtailed, not to mention the massive abuse of human rights in Chechnya.

Yet, no one in the West is contemplating to oust Putin or to boycott Russia. None in Europe or in America is suggesting to apply to the rabid dictators of Central Asia the treatment that the far less virulent Lukashenka is receiving. It is this cynical double standard that gaffe-prone Lukashenka rails against time and again. And justly so.

Biofuels

Technologies that appear at first blush and in the lab to be both benign and efficacious often turn out, upon widespread implementation, to be counter-productive or even detrimental. We have yet to accurately capture and model the complexity of reality. Emergent phenomena, unintended consequences, unexpected and undesirable by-products, ungovernable economic and other processes all conspire to adversely affect the trajectories of even the most thoroughly studied inventions.

Biofuels are the poster children of such good intentions gone terribly awry. Rather than retard global warming, scientists (such as Holly Gibbs, a postdoctoral researcher at Stanford's Woods Institute for the Environment, Matt Struebig from Queen Mary, University of London, and Emily Fitzherbert from the Zoological Society of London and University of East Anglia) are now warning that they may enhance and accelerate it by encouraging deforestation in the tropics. Indeed, the higher the prices fetched by biofuels, the more rainforests are being ferociously decimated in the quest for arable land.

Moreover, biofuels are energy-inefficient: their production consumes more energy than they yield in burning. The disastrous effect they have on food prices is amply documented. Another study demonstrates that their consumption releases more carbon dioxide into the atmosphere than the quantity of fossil fuels that they replace.

This "carbon debt" is especially true if we take into account the gases released by the incineration of trees mowed down to make place for the (often state subsidized) cultivation of biofuels. There is also a "biodiversity debt": up to five-sixths of indigenous species are extinguished once a forest is cleared to make way for oil palm plantations, for instance.

Though much hyped, biofuels should not serve as part and parcel of the energy policy mix. Some wonks suggest that biofuels should be allowed to be grown only on marginal or degraded land. But, this would require enormous investments in fertilizers and other technologies intended to halt soil erosion and nutrient leeching. From the point of view of environmental accounting, such tracts better be re-forested. Forests recycle rainwater, act as carbon skins, prevent floods, and serve as habitats to species, some of them endangered.

Bosnia-Herzegovina, Economy of

Bosnia-Herzegovina (heretofore "Bosnia") is an artificial polity with four, tangentially interacting, economies. Serbs, Croats and their nominal allies, the Bosniaks each maintain their own economy. The bloated, fractured, turf conscious, inefficient, and often corrupt presence of the international community, in the form of the Office of the

High Representative, among others, constitutes the fourth - and most dominant - parallel economy.

The divergence of the economies of these components of Bosnia is so high that the inflation differential between them amounts to 13%. The Bosniak-Croat Federation experienced deflation in 1999 - while the Republika Srpska (RS) was in the throes of 14% inflation. The real effective exchange rate in RS appreciated by 13% and depreciated by 6% in the Federation between 1998-2000. Wages in the Federation are higher by 30% compared to the RS.

The International Crisis Group in its October 8, 2001 report about the Republika Srpska estimated that "the RS economy stands on the verge of collapse. Were it not for a continuing flow of direct international budget supports and soft loans, the RS government would be bankrupt." And the RS actually enjoyed a disproportionate part of the more than $5 billion in aid that flooded Bosnia since 1996. The world Bank has disbursed c. $690 million of the $860 million it committed to Bosnia as a whole - twice its disbursements in Slovenia and Macedonia combined.

These jeremiahs may be overkill. Bosnia, its flourishing informal economy and all-pervasive smuggling notwithstanding, has come a long way since the Dayton accords. It has a functioning central bank with growing foreign exchange reserves and a stable and widely accepted currency-board backed currency, the marka. Its payment and banking systems are surprisingly modern.

Bosnia's anti money laundering and anti corruption legislation is up to scratch and even enforced (especially in the Croat part of the Bosniak-Croat Federation). It is more advanced than all other successor republics to former Yugoslavia in pension, treasury system, and labour market reforms. Its inflation rate is moderate (c. 6% annually) - though reliable consolidated national figures are hard to come by.

Bosnia gained tariff-free access to the EU, enhanced by a Stabilisation and Association Agreement. It also signed a free trade agreement with Croatia which effectively abolished all tariffs by 2004. Similar agreements have either been signed or are being negotiated with Macedonia, Slovenia, and Yugoslavia. WTO accession was slated for 2002. For all these good news, Bosnia has been rewarded with a steady trickle of foreign investors.

Still, Bosnia is quintessentially "Balkan" - stifled by red tape, capricious laws, rampant corruption, venality, nepotism, and cronyism run amok. Its state enterprises are patronage machines and its banks coerced into political and unwise lending, propping up zombie enterprises. Credit to the private sector grows at less than nominal GDP which indicates a failure of financial intermediation by the banking system.

Trade among the ethnically cleansed parts of this country is minimal, privatization non existent, corporate governance a distant dream, as are the rule of law and property rights. Bosnia's impressive average growth figures (5-8% annually since 2000, depending on the source) were skewed by the spurt of reconstruction (especially of the electricity and water supply infrastructure), which followed the devastation of its protracted and savage civil war. This phase over, and the victim of a severe drought, the economy is faltering now, stagnant at less than half the prewar output levels (though more than double the 1995 level, at the end of civil war).

Bosnia faces growing unemployment (officially at close to 40%) and social disintegration provoked by excruciating poverty. Poor tax collection, a minimal tax base, and the transition to a new payment and bank supervision systems - all led to diminishing tax and customs revenues (which created an addiction to the kindness of strangers in donor conferences). Bosnians flee their impromptu country and it suffers a massive brain drain.

Industrial actions are a daily matter - for instance, by disgruntled teachers in in the canton of Central Bosnia in late 2001. The government hasn't paid their salaries since August 2001. Bosnia's trade (and budget) figures are notoriously irrelevant (defense spending is still off budget, for instance) but it trades mainly with Germany, Switzerland, and Croatia. It has gaping fiscal (6% of GDP, including arrears) and current account (22% of GDP excluding transfers!) deficits and heavy external debt (close to 80% of GDP) - though a lot of it is long term and concessionary.

Had it not been for unilateral transfers of aid (c. $1 billion a year), remittances from Bosnians abroad to their families, and the exploding drug trade (Bosnia is an important thoroughfare of illicit goods, including cigarettes and smuggled cars) - Bosnia would have been in dire straits.

It could have been different. Bosnia has rich agricultural endowments: soil and climate. Yet, its myriad tiny, family owned, farms are non-competitive and it is, thus, a net food importer. Its (mostly military, vehicular, heavy, and obsolete) industry is labour-intensive and ridden with obstructive hidden unemployment. It parasitically thrives on services (close to 60% of its economy) - mainly to expatriates and peacekeepers. And wages (especially in the Federation) are set at Hungarian levels, making both the public and private sectors woefully uncompetitive.

Bosnia's economy teaches us two diametrically opposed lessons: that Man can put aside a brutal past and work towards a better future and that such an effort is doomed if it is the result of external pressure to sustain a political fiction.

The internecine war lasted three years, from 1992 to 1995. It displaced more than one quarter of the population. Of 4.4 million people, at least 250,000 are missing and at least 40 percent of these, most of them men, are presumed dead. Education was disrupted, disability benefits soared, destitute, single parent families are the norm.

The damages are unimaginable. The costs of ruined infrastructure, devastated crops, demolished real estate - amount to tens of billions of dollars in a country whose GDP, at $4 billion, or $1000 per capita, is one half of its pre-war level. Industrial production ceased altogether during the years of fighting.

The international community has poured well over $5 billion into Bosnia-Herzegovina since the Dayton Accords were signed on November 21, 1995. The World Bank accounts for one fifth of this inordinate amount. This is more than $1000 per every citizen. What do donors and creditors have to show for it?

Not much. To start with, most of the money went to support the peacekeeping force and UN administration in BiH and to repay its bilateral and multilateral public debt. An international force of 21,000 soldiers - known as SFOR - succeeded a 60,000 strong IFOR in 1996. Additionally, the two mutually-hostile entities which comprise the unprecedented entity that is BiH spend between one quarter and one third of their meager budgets on defense.

It seems that most of the cash flows - domestic and foreign - of this turbulent "republic" go towards keeping its constituents from each other's throats. The rest is brazenly stolen by vast networks of patronage, crime, and money laundering.

In the meantime, the rate of unemployment has leveled off at 40 percent. In the Republika Srpska, a family of four typically consumes one and a half times the average salary. The Sarajevo-based UN Independent Bureau for Human Issues found that 60 percent of BiH's population lives below the poverty line. Imports exceed exports by a margin of 4 to 1. Corruption scandals erupt daily.

But there are signs of renewal. Refugees are returning, albeit hesitatingly. One hundreds thousand of them came back last year, double the number in 2000. Volkswagen decided to reinstate the assembly of its popular "Golf IV" model in Sarajevo - subject to customs privileges and an effective, republic-wide, customs system. Production of the "Beatle" in the much-tortured city was halted during the war.

BiH completed free trade agreements with all the republics of former Yugoslavia. Yet, vast swathes of the economy subsist on international aid and consist of catering to expats and peacekeepers. Like Kosovo, Afghanistan, the Palestinian Authority, and others charmed spots, BiH is addicted to other people's money.

The new International High representative, BiH's procurator, is Paddy Ashdown, a British Liberal-Democrat, an erstwhile commando, a member of the House of Lords. He might need all these trades in his new post.

Quoted by the International War and Peace Report, he says:

"The truth is that Bosnia and Herzegovina spends far too much money on its politicians and far too little on its people. The same is true for defense. Proportionately, Bosnia spends twice as much on defense as the United States and four times more than the European average. Bosnia has twice as many judges per head of population as Germany, yet each German judge deals with four times as many cases per year as his Bosnian counterpart."

The outgoing High Representative, Petritsch, was much less diplomatic in an interview he gave to Associated Press upon his return from Brussels on May 24:

"(Bosnians must) understand that many people in other countries that are financing this have their own problems and they don't want to be bothered with (Bosnia's) problems."

Still, why is Bosnia so economically backward?

The politicians of BiH have perfected their mendicity - as well as their venality - into art forms. A former president, Izetbegovic, and his cronies, were alleged by Western media to have absconded with more than $1 billion in aid money in less than 4 years.

Moreover, Bosnians of all ethnic groups are powered by an overwhelming sense of entitlement. They sincerely feel that the world owes them - either because it stood by as a genocide unfolded (the way the Moslems see it), or because it spitefully deprived them of an imminent victory (as the Serbs perceive it).

Bosnia's beggars are assertive choosers. Beriz Belkic, the Chairman of the make-belief presidency of BiH, had the temerity to say this, in connection with a forthcoming Srebrenica donors conference:

"The programme is planned to last until 2004, and in my opinion it should be a symbolic start of the international community's care for this region against which serious mistakes were committed during the war by the very same international community."

Content to maintain the precarious house of cards that passes for a polity, IFI's have rarely applied pressure to implement in BiH the prescriptions of the "Washington Consensus" over-zealously and indiscriminately applied elsewhere.

When the World Bank submitted recently a report about the privatization of Aluminji Mostar, an aluminum plant in Croat territory, the BiH Federation government thumbed its nose at it and issued this statement:

"(The Federation Government) confirmed its commitment to protecting the state capital in all companies which are strategically vital to the Bosnia-Herzegovina Federation economy."

This timidity of the gatekeepers of the international community was exploited to the hilt by intertwined networks of politicians, bureaucrats, militias, businessmen, managers, and criminals in Bosnia. Economic enterprises were transformed into cash cows and money laundering fronts. The payment system - a relic of socialist times - served as a mammoth "off-shore", Hawala-like, cash conveyance web until it was dismantled.

BiH has no checks and balances. Its institutions are utterly compromised and distrusted. Its police and judiciary are little more than private enforcers at the employ of the criminalized wealthy and mighty. Its Potemkin banks are dysfunctional and arthritic. Its triple and multilayered bureaucracies refuse to collaborate. Red tape suffocates entrepreneurships and barriers to entry often culminate at the point of a gun.

While International Financial Institutions and donors - such as the IMF, the World Bank, the European Development Bank, the EU, and the UNDP - stressed foreign investment, no one paid attention to inward flows.

The EBRD has floated a few sporadic initiatives to encourage small and medium sized enterprises and the World Bank provides microfinance through the Local Initiatives Project (LIP). But the emphasis was overwhelmingly on trying to secure headline-grabbing, big-ticket, FDI.

Yet, foreign investors - deterred by political instability, pernicious graft, crime, and economic stagnation - are unlikely to pitch their tent in Bosnia any time soon - unless they are provided with economically counterproductive tax and customs benefits, passim Volkswagen. Even the resilient and persevering McDonald's failed to penetrate the thicket of Bosnian demands for backhanders coupled with self-serving and contradictory regulations.

BiH had a surprisingly large, entrepreneurial, and cosmopolitan middle-class before the war. Its assets (mainly real estate) and savings (largely foreign exchange deposits) were expropriated and squandered by the warring parties and other, post-war, scoundrels.

The revival of this middle class, the institution of incentives to save and to form capital, the introduction of competing financial intermediaries into the moribund banking system, the encouragement of domestic investment, the enhancement of business-related services, the establishment of new institutions (such as business courts) to circumvent the hopelessly corrupt ones Bosnia sports - should have been the top priorities of the successive High Representatives of this makeshift country.

Yet, they were not. The multilaterals appeared to have been concerned chiefly with tax collection - but not with engendering a taxable economy. Until the latter part of 2000, they did not even bother to significantly reform the intractable, business-repelling, and corruption-inducing tax code. Nor was the legal environment made more business-friendly. Numerous and tedious inspections, regulations, controls, and conflicting permits afflict every shop, plant, and service establishment in the land.

Incredibly, it was as late as last week that the World Bank approved a $44 million "Business Environment Adjustment Credit". At one third the size of the government's annual budget, it is supposed to support these long-overdue reforms:

"Facilitating business entry through the creation of a simplified and transparent countrywide approach to business registration, and licensing and a strengthened legal framework and capacity for attracting foreign investment; Streamlining business operations by reducing administrative and regulatory compliance costs through the rationalization of inspections and regulations; building judicial and extra-judicial capacity to resolve commercial disputes; improving enforcement of secured transactions, and ensuring equal access to public procurement; and, easing business exit through strengthened bankruptcy and liquidation systems."

Yet, this program is bound to fail. IFI's, governments, and development banks - hypnotized by the mantra of "country ownership" - keep pretending that Bosnia meets the definition of a state, with functioning institutions, and patriotic politicians. They keep conveniently ignoring the fact that Bosnia has no banks, no courts, no police and that its customs service is a primitive extortion racket.

The international community should have founded parallel financial, tax, customs, bureaucratic, and judicial systems to cater to the needs of the emerging private sector, now less than 40 percent of Bosnia's moribund economy.

The likes of the EBRD and the World Bank should have sapped the stifling might of the putrid elites of Bosnia by fearlessly providing functional and, where necessary, foreign-managed, alternatives. This is not without precedent. Bosnia's Central Bank is successfully governed by an IMF-appointed New Zealander. The EBRD runs much of business-related regulatory organs.

Instead, the multilaterals keep enriching and empowering the mortal foes of private enterprise: criminalized monopolists, power-inebriated virulent nationalists, corrupt officials, and their penumbral sidekicks, the Bosnian "bankers".

Every soft loan, every grant, every subsidized credit, and every round of "negotiations" with the criminals that pass for politicians and government officials in BiH and its constituents - demonstrates to potential investors - Bosnians and foreigners alike - that the international community is unwilling, or, worse, unable, to take on the entrenched anti-business kleptocracies of BiH.

There is an enormous pent-up demand for small business finance. The World Bank summarizes the astounding success of its - single - microcredit facility in Bosnia thus:

"Five years after the start of the LIP, the overall evaluation of the project is highly satisfactory. As of March 31, 2001, some 80,000 loans have been disbursed to microentrepreneurs throughout the country helping to create or sustain over 100,000 jobs. Monthly disbursements support more than 3,000 new loans. Levels of repayment are very high at 98.5%, with only 1.21% of outstanding repayments (30 days past due).

On the ground, these numbers translate in improved living conditions and a renewed sense of hope and confidence for many of the poor. An independent Client Survey commissioned by the Local Initiative Departments (the monitoring agencies of the project) in 1999 found that 79% of borrowers considered that the loan had significantly improved their economic situation. Furthermore, some microfinance institutions have used microcredit as a tool to bring together people previously divided by the war.

On the operational and financial side, the LIP has been equally successful. Just three years after the project was initiated, seven microfinance institutions became operationally sustainable, meaning that they are able to cover their operating expenses from their operating income. Four of these institutions were financially sustainable, i.e., they can cover all expenses, including the cost of maintaining the value of their capital, as well as adjustments that fully account for subsidies and write-offs for non-recoverable loans. These results make microfinance institutions in Bosnia and Herzegovina high performers among such initiatives worldwide."

This is not counting the prospering informal ("grey") economy - equal in size to the formal bit - and the massive remittances of hundreds of thousands of Bosnians abroad. The drain of brains and entrepreneurship is inexorable. A United Nations survey conducted earlier this year found that 62 percent of the youth dream of leaving BiH, six years into the Dayton peace process.

The World Bank approved a second, $20 million, LIP last July. Yet, it is telling - and outrageous - that credits for SME (small and medium enterprises) and microcredits amount to less than 1 percent of the funds expended in Bosnia hitherto.

Bosnia fosters in IFI's a keen and sudden adherence to their charters and mandates. The IMF, which would have encroached gleefully on the World Bank's turf in almost any other country, confines itself in Bosnia to taxation.

While not averse, in dozens of countries, from Macedonia to Indonesia, to sonorously conditioning its programs upon painful structural reforms and development priorities - in the minefield that is Bosnia, the IMF is content to tiptoe and procrastinate apologetically.

Public posturing - together with the US, EU, the World Bank, and others - over the botched privatization process at the end of 1999 notwithstanding, the IMF's subservience to its American paymasters is nowhere more transparent than in BiH.

Despite having consistently reneged on all its obligations, Bosnia's 1998 standby agreement with the Fund has - most unusually - been extended three times over. A new agreement was finally negotiated late last year.

As global interest wanes, BiH is likely to face a precipitous decline in international aid. This will result in an economic crash akin to the one experienced by Cambodia when the UN withdrew in 1993. A Lebanon-like country, governed by Russian-style oligarchs, with African-level poverty and Serb-reminiscent nationalism - Bosnia's future is unlikely to improve on its sorry past.

Bra

Mary Phelps Jacob - a rich socialite - received the first patent for a bra in 1914. Her corset - replete with whaleback bones was visible under a brand new evening gown she purchased. She used handkerchiefs and ribbon to replace the bones. The bra was born. she sold the patent to Warner Brothers Corset Company in Bridgeport, Connecticut, for $1,500. They made $15 million over the next 30 years. Bras were one size fits all until 1928.

An interesting coincidence: one of the forerunners of the bra was patented by a George Phelps in 1875. Other bra-like devices were patented in 1893 and 1889.

During the first world war, in 1917, the US War Industries Board called on women to stop buying metal-rich corsets. Some 28,000 tons of metals were thus made available to the war effort.

Brain Drain

Human trafficking and people smuggling are multi-billion dollar industries. At least 50% of the 150 million immigrants the world over are illegal aliens. There are 80 million migrant workers found in virtually every country. They flee war, urban terrorism, crippling poverty, corruption, authoritarianism, nepotism, cronyism, and unemployment. Their main destinations are the EU and the USA - but many end up in lesser countries in Asia or Africa.

The International Labour Organization (ILO) published the following figures in 1997:

Africa had 20 Million migrant workers, North America - 17 million, Central and South America - 12 million, Asia - 7 million, the Middle East - 9 million, and Europe - 30 million.

Immigrants make up 15% of staid Switzerland's population, 9% of Germany's and Austria's, 7.5% of France's (though less than 4% of multi-cultural Blairite Britain). There are more than 15 million people born in Latin America living in the States. According to the American Census Bureau, foreign workers comprise 13% of the workforce (up from 9% in 1990). A million have left Russia for Israel. In this past century, the world has experienced its most sweeping wave of both voluntary and forced immigration - and it does not seem to have abated.

According to the United Nations Population Division, the EU would need to import 1.6 million migrant workers annually to maintain its current level of working age population. But it would need almost 9 times as many to preserve a stable workers to pensioners ratio.

The EU may cope with this shortage by simply increasing labour force participation (74% in labour-short Netherlands, for instance). Or it may coerce its unemployed (and women) into low-paid and 3-d (dirty, dangerous, and difficult) jobs. Or it may prolong working life by postponing retirement.

These are not politically palatable decisions. Yet, a wave of xenophobia that hurtled lately across a startled Europe - from Austria to Denmark - won't allow the EU to adopt the only other solution: mass (though controlled and skill-selective) migration.

As a result, Europe has recently tightened its admission (and asylum) policies even more than it has in the 1970's. It bolted and shut its gates to primary (economic) migration. Only family reunifications are permitted. Well over 80% of all immigrants to Britain are women joining their husbands, or children joining their father. Migrant workers are often discriminated against and abused and many are expelled intermittently.

Still, economic migrants - lured by European riches - keep pouring in illegally (about half a million every year -to believe The Centre for Migration Policy Development in Vienna). Europe is the target of twice as many illegal migrants as the USA. Many of them (known as "labour tourists") shuttle across borders seasonally, or commute between home and work - sometimes daily. Hence the EU's apprehension at allowing free movement of labour from the candidate countries and the "transition periods" (really moratoria) it wishes to impose on them following their long postponed accession.

According to the American Census Bureau's March 2002 "Current Population Survey", 20% of all US residents are of "foreign stock" (one quarter of them Mexican). They earn less than native-born Americans and are less likely to have health insurance. They are (on average) less educated (only 67% of immigrants age 25 and older completed high school compared to 87% of native-born Americans). Their median income, at $36,000 is 10% lower and only 49% of them own a home (compared to 67% of households headed by native-born Americans). The averages mask huge disparities between Asians and Hispanics, though. Still, these ostensibly dismal figures constitute a vast improvement over comparable data in the country of origin.

But these are the distant echoes of past patterns of migration. Traditional immigration is becoming gradually less attractive. Immigrants who came to Canada between 1985-1998 earn only 66% of the wages of their predecessors. Labour force participation of immigrants fell to 68% (1996) from 86% (1981).

While most immigrants until the 1980's were poor, uneducated, and unskilled - the current lot is middle-class, reasonably affluent, well educated, and highly skilled. This phenomenon - the exodus of elites from all the developing and less developed countries - is called "brain drain", or "brain hemorrhage" by its detractors (and "brain exchange" or "brain mobility" by its proponents). These metaphors conjure up images of the inevitable outcomes of some mysterious processes, the market's invisible hand plucking the choicest and teleporting them to more abundant grounds.

Yet, this is far from being true. The developed countries, once a source of such emigration themselves (more than 100,000 European scientists left for the USA in the wake of the Second World War) - actively seek to become its destination by selectively attracting only the skilled and educated citizens of developing countries. They offer them higher salaries, a legal status (however contingent), and tempting attendant perks. The countries of origin cannot compete, able to offer only $50 a month salaries, crumbling universities, shortages of books and lab equipment, and an intellectual wasteland.

The European Commission had this to say last month:

"The Commission proposes, therefore, that the Union recognize the realities of the situation of today: that on the one hand migratory pressures will continue and that on the other hand in a context of economic growth and a declining and aging population, Europe needs immigrants. In this context our objective is not the quantitative increase in migratory flows but better management in qualitative terms so as to realize more fully the potential of immigrants' admitted."

And the EU's Social and Employment Commission added, as it forecast a deficit of 1.7 million workers in Information and Communications Technologies throughout the Union:

"A declining EU workforce due to demographic changes suggests that immigration of third country nationals would also help satisfy some of the skill needs [in the EU]. Reforms of tax benefit systems may be necessary to help people make up their minds to move to a location where they can get a job...while ensuring that the social objectives of welfare systems are not undermined."

In Hong Kong, the "Admission of Talents Scheme" (1999) and "The Admission of Mainland Professionals Scheme" (May 2001) allow mainlanders to enter it for 12 month periods, if they:

"Possess outstanding qualifications, expertise or skills which are needed but not readily available in Hong Kong. They must have good academic qualifications, normally a doctorate degree in the relevant field."

According the January 2002 issue of "Migration News", even now, with unemployment running at almost 6%, the US H1-B visa program allows 195,000 foreigners with academic degrees to enter the US for up to 6 years and "upgrade" to immigrant status while in residence. Many H1-B visas were cancelled due to the latest economic slowdown - but the US provides other kinds of visas (E type) to people who invest in its territory by, for instance, opening a consultancy.

The UK has just implemented the Highly Skilled Migrant Programme which allows "highly mobile people with the special talents that are required in a modern economy" to enter the UK for a period of one year (with indefinite renewal). Even xenophobic Japan allowed in 222,000 qualified foreigners last year (double the figure in 1994).

Germany has absorbed 10,000 computer programmers (mainly from India and Eastern Europe) since July 2000. Ireland was planning to import twenty times as many over 7 years - before the dotcoms bombed. According to "The Economist", more than 10,000 teachers have left Ecuador since 1998. More than half of all Ghanaian medical doctors have emigrated (120 in 1998 alone). More than 60% of all Ethiopian students abroad never return. There are 64,000 university educated Nigerians in the USA alone. More than 43% of all Africans living in North America have acquired at least a bachelor's degree.

Barry Chiswick and Timothy Hatton demonstrated ("International Migration and the Integration of Labour Markets", published by the NBER in its "Globalisation in Historical Perspective") that, as the economies of poor countries improve, emigration increases because people become sufficiently wealthy to finance the trip.

Poorer countries invest an average of $50,000 of their painfully scarce resources in every university graduate - only to witness most of them emigrate to richer places.

The haves-not thus end up subsidizing the haves by exporting their human capital, the prospective members of their dwindling elites, and the taxes they would have paid had they stayed put. The formation of a middle class is often irreversibly hindered by an all-pervasive brain drain.

Politicians in some countries decry this trend and deride those emigrating. In a famous interview on state TV, the late prime minister of Israel, Yitzhak Rabin, described them as "a fallout of the jaded". But in many impoverished countries, local kleptocracies welcome the brain drain as it also drains the country of potential political adversaries.

Emigration also tends to decrease competitiveness. It increase salaries at home by reducing supply in the labour market (and reduces salaries at the receiving end, especially for unskilled workers). Illegal migration has an even stronger downward effect on wages in the recipient country - illegal aliens tend to earn less than their legal compatriots. The countries of origin, whose intellectual elites are depleted by the brain drain, are often forced to resort to hiring (expensive) foreigners. African countries spend more than $4 billion annually on foreign experts, managers, scientists, programmers, and teachers.

Still, remittances by immigrants to their relatives back home constitute up to 10% of the GDP of certain countries - and up to 40% of national foreign exchange revenues. The World Bank estimates that Latin American and Caribbean nationals received $15 billion in remittances in 2000 - ten times the 1980 figure. This may well be a gross underestimate. Mexicans alone remitted $6.7 billion in the first 9 months of 2001 (though job losses and reduced hours may have since adversely affected remittances). The IADB thinks that remittances will total $300 billion in the next decade (Latin American immigrants send home c. 15% of their wages).

Official remittances (many go through unmonitored money transfer channels, such as the Asian Hawala network) are larger than all foreign aid combined. "The Economist" calculates that workers' remittances in Latin America and the Caribbean are three times as large as aggregate foreign aid and larger than export proceeds. Yet, this pecuniary flood is mostly used to finance the consumption of basics: staple foods, shelter, maintenance, clothing. It is non-productive capital.

Only a tiny part of the money ends up as investment. Countries - from Mexico to Israel, and from Macedonia to Guatemala - are trying to tap into the considerable wealth of their diasporas by issuing remittance-bonds, by offering tax holidays, one-stop-shop facilities, business incubators, and direct access to decision makers - as well as matching investment funds.

Migrant associations are sprouting all over the Western world, often at the behest of municipal authorities back home. The UNDP, the International Organization of Migration (IOM), as well as many governments (e.g., Israel, China, Venezuela, Uruguay, Ethiopia), encourage expatriates to share their skills with their counterparts in their country of origin. The thriving hi-tech industries in Israel, India, Ireland, Taiwan, and South Korea were founded by returning migrants who brought with them not only capital to invest and contacts - but also entrepreneurial skills and cutting edge technologies.

Thailand established in 1997, within the National Science and Technology Development Agency, a 2.2 billion baht project called "Reverse the Brain Drain". Its aim is to "use the 'brain' and 'connections' of Thai professionals living overseas to help in the Development of Thailand, particularly in science and technology."

The OECD ("International Mobility of the Highly Skilled") believes that:

"More and more highly skilled workers are moving abroad for jobs, encouraging innovation to circulate and helping to boost economic growth around the globe."

But it admits that a "greater co-operation between sending and receiving countries is needed to ensure a fair distribution of benefits".

The OECD noted, in its "Annual Trends in International Migration, 2001" that (to quote its press release):

"Migration involving qualified and highly qualified workers rose sharply between 1999 and 2000, helped by better employment prospects and the easing of entry conditions. Instead of granting initial temporary work permits only for one year, as in the past, some OECD countries, particularly in Europe, have been issuing them for up to five years and generally making them renewable. Countries such as Australia and Canada, where migration policies were mainly aimed at permanent settlers, are also now favoring temporary work permits valid for between three and six years ... In addition to a general increase in economic prosperity, one of the main factors behind the recent increase in worker migration has been the development of information technology, a sector where in

2000 there was a shortage of around 850,000 technicians in the US and nearly 2 million in Europe..."

But the OECD underplays the importance of brain drain:

"Fears of a "brain drain" from developing to technologically advanced countries may be exaggerated, given that many professionals do eventually return to their country of origin. To avoid the loss of highly qualified workers, however, developing countries need to build their own innovation and research facilities ... China, for example, has recently launched a program aimed at developing 100 selected universities into world-class research centers. Another way to ensure return ... could be to encourage students to study abroad while making study grants conditional on the student's return home."

The key to a pacific and prosperous future lies in a multilateral agreement between brain-exporting, brain-importing, and transit countries. Such an agreement should facilitate the sharing of the benefits accruing from migration and "brain exchange" among host countries, countries of origin, and transit countries. In the absence of such a legal instrument, resentment among poorer nations is likely to grow even as the mushrooming needs of richer nations lead them to snatch more and more brains from their already woefully depleted sources.

Meritocracy and Brain Drain

Groucho Marx, the famous Jewish-American comedian, once said:

"I would never want to belong to a club which would accept me as a member."

We are in the wake of the downfall of all the major ideologies of the 20th century - Fascism, Communism, etc. The New Order, heralded by President Bush, emerged as a battle of Open Club versus Closed Club societies, at least from the economic point of view.

All modern states and societies belong to one of these two categories: meritocracy (the rule of merit) or oligarchy (the rule of a minority over the majority). In both cases, the social and economic structures are controlled by elites. In this complex world, the rule of elites is inevitable. The amount of knowledge needed in order to exercise effective government has become so large - that only a select few can attain it. What differentiates meritocracy from oligarchy is not the absolute number of members of a ruling (or of a leading) class - the number is surprisingly small in both systems.

The difference between them lies in the membership criteria and in the way that they are applied.

The meritocratic elite is an open club because it satisfies four conditions:

a. The rules of joining it and the criteria to be satisfied are publicly known.

b. The application and ultimate membership procedures are uniform, equal to all and open to public scrutiny and criticism (transparent).

c. The system alters its membership parameters in direct response to public feedback and to the changing social and economic environment.

d. To belong to a meritocracy one needs to satisfy a series of demands.

Whether he (or she) satisfies them or not - is entirely up to him (her).

In other words, in meritocracy the rules of joining and of membership are cast in iron. The wishes and opinions of those who happen to belong to the club at a given moment are of no importance and of no consequence. In this sense, meritocracy is a "fair play" approach: play by the rules and you have a chance to benefit equal to anyone else's. Meritocracy, in other words, is the rule of law.

To join a meritocratic club, one needs to demonstrate that he is in possession of, or that he has access to, "inherent" parameters: intelligence, a certain level of education, a given amount of contribution to the social structure governed (or led, or controlled) by the meritocratic elite. An inherent parameter is a criterion which is independent of the views and predilections of those who are forced to apply it. All the members of a certain committee can disdain an applicant. All of them might wish not to include the candidate in their ranks. All of them could prefer someone else for the job because they owe this "Someone Else" something, or because they play golf with him. Still, they will be forced to consider the applicant's or the candidate's "inherent" parameters: does he have the necessary tenure, qualifications, education, experience? Does he contribute to his workplace, community, society at large? In other words: is he "worthy"?

Granted: these processes of selection, admission, incorporation and assimilation are administered by mere humans. They are, therefore, subject to human failings. Can qualifications be always judged "objectively, unambiguously, unequivocally"? and what about "the right personality traits" or "the ability to engage in teamwork"? These are vague enough to hide bias and bad will. Still, at least the appearance is kept in most of the cases - and decisions can be challenged in courts.

What characterizes oligarchy is the extensive, relentless and ruthless use of "transcendent" parameters to decide who will belong where, who will get which job and, ultimately, who will enjoy which benefits (instead of the "inherent" ones employed in meritocracy).

A transcendent parameter does not depend on the candidate or the applicant.

It is an accident, an occurrence absolutely beyond the reach of those most affected by it. Race is such a parameter and so are gender, familial affiliation or contacts and influence.

To join a closed, oligarchic club, to get the right job, to enjoy excessive benefits - one must be white (racism), male (sexual discrimination), born to the right family (nepotism), or to have the right political (or other) contacts.

Sometimes, belonging to one such club is the prerequisite for joining another.

In France, for instance, the whole country is politically and economically run by graduates of the Ecole Normale d'Administration (ENA). They are known as the ENArques (=the royal dynasty of ENA graduates).

The drive for privatization of state enterprises in most East and Central European countries provides a glaring example of oligarchic machinations.

In most of these countries (the Czech Republic and Russia are notorious examples) - the companies were sold to political cronies. A unique amalgam of capitalism and oligarchy was thus created: "Crony Capitalism" or Privateering. The national wealth was passed on to the hands of relatively few, well connected, individuals, at a ridiculously low price.

Some criteria are difficult to classify. Does money belong to the first (inherent) or to the second (transcendent) group?

After all, making money indicates some merits, some inherent advantages.

To make money consistently, a person needs to be diligent, hard working, to prevail over hardships, far sighted and a host of other - universally acclaimed - properties. On the other hand, is it fair that someone who made his fortune through corruption, inheritance, or utter luck - be preferred to a poor genius?

That is a contentious issue. In the USA money talks. He who has money is automatically assumed to be virtuous and meritorious. To maintain money inherited is as difficult a task as to make it, the thinking goes.

An oligarchy tends to have long term devastating economic effects.

The reason is that the best and the brightest - when shut out by the members of the ruling elites - emigrate. In a country where one's job is determined by his family connections or by influence peddling - those best fit to do the job are likely to be disappointed, then disgusted and then to leave the place altogether.

This is the phenomenon known as "Brain Drain". It is one of the biggest migratory tidal waves in human history. Capable, well-trained, educated, young people leave their oligarchic, arbitrary, countries and migrate to more predictable meritocracies (mostly to be found in what is collectively termed "The West").

This is colonialism of the worst kind. The mercantilist definition of a colony was: a territory which exports raw materials and imports finished products.

The Brain drain is exactly that: the poorer countries are exporting raw brains and buying back the finished products masterminded by these brains.

Yet, while in classical colonialism, the colony at least received some income for its exports - here the poor country pays to export. The country invests its limited resources in the education and training of these bright young people.

When they depart forever, they take with them this investment - and award it, as a gift, to their new, much richer, host countries.

This is an absurd situation: the poor countries subsidize the rich. Ready made professionals leave the poor countries - embodying an enormous investment in human resources - and land this investment in a rich country. This is also one of the biggest forms of capital flight and capital transfers in history.

Some poor countries understood these basic, unpleasant, facts of life. They imposed an "education fee" on those leaving its border. This fee was supposed to, at least partially, recapture the costs of educating and training those emigrating. Romania and the USSR imposed such levies on Jews emigrating to Israel in the 1970s. Others just raise their hands up in despair and classify the brain drain in the natural cataclysms department.

Very few countries are trying to tackle the fundamental, structural and philosophical flaws of the system, the roots of the disenchantment of those leaving them.

The Brain Drain is so serious that some countries lost up to a third of their total population (Macedonia, some under developed countries in South East Asia and in Africa). Others lost up to one half of their educated workforce (for instance, Israel during the 1980s). this is a dilapidation of the most important resource a nation has: its people. Brains are a natural resource which could easily be mined by society to its penultimate benefit.

Brains are an ideal natural resource: they can be cultivated, directed, controlled, manipulated, regulated. It tends to grow exponentially through interaction and they have an unparalleled economic value added. The profit margin in knowledge and information related industries far exceeds anything exhibited by more traditional, second wave, industries (not to mention first wave agriculture and agribusiness).

What is even more important:

Poor countries are uniquely positioned to take advantage of this third revolution. With cheap, educated workforce - they can monopolize basic data processing and telecommunications functions worldwide. True, this calls for massive initial investments in physical infrastructure. But the important component is here and now: the brains. To constrain them, to disappoint them, to make them run away, to more merit-appreciating places - is to sentence the country to a permanent disadvantage.

Comment on Oligarchy and Meritocracy

Oligarchy and meritocracy are two end-points of a pendulum's trajectory. The transition from oligarchy to meritocracy is natural. No need for politicians to nudge it forward. Meritocracy is a superior survival strategy. Only when states are propped artificially (by foreign aid or soaring oil prices) does meritocracy become irrelevant.

So, why did oligarchs emerge in the transition from communism to capitalism?

Because it was not a transition from communism to capitalism. It wasn't even a transition to proto-capitalism. It was merely a bout of power-sharing: the old oligarchy accepted new members and they re-allocated the wealth of the state among themselves.

Appendix - Why the Beatles Made More Money than Einstein

Why did the Beatles generate more income in one year than Albert Einstein did throughout his long career?

The reflexive answer is:

How many bands like the Beatles were there?

But, on second reflection, how many scientists like Einstein were there?

Rarity or scarcity cannot, therefore, explain the enormous disparity in remuneration.

Then let's try this:

Music and football and films are more accessible to laymen than physics. Very little effort is required in order to master the rules of sports, for instance. Hence the mass appeal of entertainment - and its disproportionate revenues. Mass appeal translates to media exposure and the creation of marketable personal brands (think Beckham, or Tiger Woods).

Yet, surely the Internet is as accessible as baseball. Why did none of the scientists involved in its creation become a multi-billionaire?

Because they are secretly hated by the multitudes.

People resent the elitism and the arcane nature of modern science. This pent-up resentment translates into anti-intellectualism, Luddism, and ostentatious displays of proud ignorance. People prefer the esoteric and pseudo-sciences to the real and daunting thing.

Consumers perceive entertainment and entertainers as "good", "human", "like us". We feel that there is no reason, in principle, why we can't become instant celebrities. Conversely, there are numerous obstacles to becoming an Einstein.

Consequently, science has an austere, distant, inhuman, and relentless image. The uncompromising pursuit of truth provokes paranoia in the uninitiated. Science is invariably presented in pop culture as evil, or, at the very least, dangerous (recall genetically-modified foods, cloning, nuclear weapons, toxic waste, and global warming).

Egghead intellectuals and scientists are treated as aliens. They are not loved - they are feared. Underpaying them is one way of reducing them to size and controlling their potentially pernicious or subversive activities.

The penury of the intellect is guaranteed by the anti-capitalistic ethos of science. Scientific knowledge and discoveries must be instantly and selflessly shared with colleagues and the world at large. The fruits of science belong to the community, not to the scholar who labored to yield them. It is a self-interested corporate sham, of course. Firms and universities own patents and benefit from them financially - but these benefits rarely accrue to individual researchers.

Additionally, modern technology has rendered intellectual property a public good. Books, other texts, and scholarly papers are non-rivalrous (can be consumed numerous time without diminishing or altering) and non-exclusive. The concept of "original" or "one time phenomenon" vanishes with reproducibility. After all, what is the difference between the first copy of a treatise and the millionth one?

Attempts to reverse these developments (for example, by extending copyright laws or litigating against pirates) - usually come to naught. Not only do scientists and intellectuals subsist on low wages - they cannot even augment their income by selling books or other forms of intellectual property.

Thus impoverished and lacking in future prospects, their numbers are in steep decline. We are descending into a dark age of diminishing innovation and pulp "culture". The media's attention is equally divided between sports, politics, music, and films.

One is hard pressed to find even a mention of the sciences, literature, or philosophy anywhere but on dedicated channels and "supplements". Intellectually challenging programming is shunned by both the print and the electronic media as a matter of policy. Literacy has plummeted even in the industrial and rich West.

In the horror movie that our world had become, economic development policy is decided by Bob Geldof, the US Presidency is entrusted to the B-movies actor Ronald Reagan , our reading tastes are dictated by Oprah, and California's future is steered by Arnold Schwarzenegger.

Budget, Balanced

Government budgets represent between 25% and 50% of he Gross Domestic Product (GDP), depending on the country. The members of the European Union (Germany, France) and the Scandinavian countries represent the apex of this encroachment upon the national resources. Other countries (Great Britain, to name one) fare better. But even the more developed countries in South East Asia do not clear the 25% hurdle.

The government budget, therefore, is the single most important economic decision, the most crucial economic event every (fiscal) year.

The government finances its budget mainly by taxing individuals and corporations. Ultimately, households pay the bill. Even corporations are owned by individuals and earn their money by selling products and services to individuals. Higher taxes are likely to be passed on to customers or to employees. There are numerous kinds of taxes, regressive and progressive, direct and indirect, on earnings and on property - but they all serve to finance the budget.

Another method of financing the budget is by borrowing either in the capital markets (by selling bonds as the government of the USA does) - or by "voluntarily" deducting part of the wages (as Israel used to do until a decade ago). Such borrowing has grave repercussions: the national debt grows, debt service (repayments of interest on the debt plus the principal of the debt) consumes more and more of the national resources and the government crowds individuals and - more importantly - businesses out of the credit markets. In other words, the money that is lent to the government is not available to finance consumption, investments and working capital for businesses. The competition on the scarce resource of capital increases its price, interest rates. Government borrowing has disastrous economic consequences in the long term: reduced consumption, heightened interest rates, stagnant investments - all leading to recession and negative or reduced growth rates.

Recognizing these unfortunate results, governments the world over have been converted to the new religion of balanced budgets or, at least, reduced and controlled budget deficits.

The two best known examples are the United States and the European Union.

One of the things which used to distinguish between political camps in the USA - Democrats versus Republicans - was their attitude towards the role of government in the economy. The Democrats believed in an active government, whose role it is to ameliorate the excesses of the markets. This logically led to less hysteria over the size of budget deficits. The Republicans firmly believe in Bad Big Government and in the overriding necessity to constrain it and to abolish as many of its functions as politically and economically feasible. Small Government was a pillar of the treaty with the people which led the Republicans to their landslide Congressional victory in 1994.

It is an absurd that it was a Republican president (Reagan) who was responsible for the biggest increase in the national debt since the USA was established. He reduced the interference of government in economic life mainly by reducing taxes - without the commensurate slimming down of government itself. The result was apocalyptic: enormous twin deficits (budget and trade), a collapse in the exchange rates of the Dollar against all major currencies, recession and the steepest stock market crash in 1987.

Today, the USA owes 5 trillion USD. True, this is only 60% of the GNP - but this time statistics is misleading.

The interest payments on this "benign" level of debt amount to 15% of the budget, or 250,000,000,000 USD per annum. This is more than any other expenditure item in the budget, barring defence. And it is getting worse.

This, however, belongs to the past. Clinton is as much a Republican as any and both parties share the conviction that the budget must be balanced by the beginning of the century. It seems that it is well on its way there. The projections of the objective and reliable Congressional Budget Office (CBO) are positive: the budget will be balance shortly, long before it was projected to do so.

But it was an American, Benjamin Franklin, who once (1789) said: "Only two things are certain in this world - death and taxes". This spectre of a balanced budget already provokes interest group to pressurize the administration to be less tight fisted and possessed more of a social conscience.

Nowhere was the new "less deficits" doctrine more apparent than in the Maastricht Treaty and, especially, in its criteria. The latter determine which of the member countries of the EU will join the Euro single currency zone in the first wave of entrants in 1999. One of the more important criteria is that the deficit in the government's budget will not exceed 3.0% of GDP ("three point zero" - emphasize the Germans who are very worried about the stability of the currency which will replace their treasured DM).

As a result of this rigid criterion, governments have increased taxes (France), imposed one time levies (Italy), engaged in creative accounting (again France with many others) or unsuccessfully tried to do so (the failed attempt to revalue the gold reserves in the coffers of the Bundesbank in Germany). Some were aided by buoyant economies (France), others by favourable public opinion (Italy), yet others by farsightedness (Germany's Kohl). All of them pay a dear economic, political and social price. By restraining the budget deficit, they induce recession or fail to encourage budding economic expansions. Unemployment rates remain stubbornly high, so do interest rates.

This is the price of adhering to an economic fad.

Balanced or low deficits budgets are a good things when the economy is roaring ahead. But there are certain things that only governments can do: defending the country, maintaining law and order, disaster relief, ensuring market competition. One of the more important functions of any administration is to act anti-cyclically, to encourage economic activity in times of recession - and to hold the economic horses when they go wild. A government cannot do this when its hands are tied behind its back by a totally arbitrary limitation: no more than 3% budget deficit (why 3? why not 2.65%?). This Maastricht criterion will prove, in the long run, to be lethal to the very idea of a European Union.

What is a budget?

It is a program. It charts the government's expenditures and allocates its resources for a period of one fiscal year. Some fiscal years start and end in January (Israel), others in October (the USA). But budgets always relate to fiscal years because of their dependence on tax revenues. Modern government budgets make a clear separation between current expenditures and the development elements. These were mixed in the past and this served to cloud issues and to disguise gross misuse of funds.

But this structural separation did not change anything basic. Budgets are statements, mainly of policy. The budget delineates clearly - and if it doesn't do so, it surrenders through careful reading and analysis - the political, economic and social priorities and goals of the government which prepared it. Politicians can talk a lot about the importance of this or that - but it is only when they put (other people's) money where their mouth is that an indisputable priority is established. Money talks (loudly) and the budget proclaims the true face of the government which conceived it.

In this sense, a budget is also a monitoring tool. By comparing financial projections, finances allocated to specific purposes in the budget - to the actual use made of the funds and to the extent that they were expended, it becomes clear whether the government "has kept its word", "changed its mind", or "reneged on its promises". A budget is a promise, it is a contract between the elected government and the nation, it is approved by parliament and has the status of a law. A budget can be altered only through a vote in parliament. It is a document of unparalleled importance, second only to the constitution.

Still, budgets (moreso than constitutions) are like living organisms:

As circumstances change, new priorities and emergencies alter the allocation of resources. The budget is based on economic projections and predictions, not all of them successful and come true.

This is why additional or supplementary budgets are introduced by governments during the fiscal year. These are updated versions of the original budget. They reflect the changed reality better than the outdated original. They help to redefine national priorities, reallocate resources, modify national spending.

These budgets usually include tax increases, new economic or social programs, or additional specific expenditures. In some countries, the legislator must show where will money be found to finance the newfound enthusiasm embedded in the new expenditure items.

Budgets are also influenced by exogenic factors, not controlled by the government. Force Majeure cases, like the floods in the Czech Republic (3 billion USD) and in Poland (2 billion USD). Geopolitical processes like wars and peace agreements in the Middle East (the 1979 peace cost Israel almost 4 billion USD to implement). The onerous, depressingly uniform demands of the IMF from poor countries: austerity, fiscal tightening, a monetary squeeze, privatization, deregulation and so on.

Some countries are voluntarily subject to externalities: the EU countries agreed to amend their budget in order to comply with the Maastricht criteria. The French and German Premiers appointed special committees to review the budget. The reports submitted by these committees forced the governments to cut spending, increase taxes and tighten the fiscal discipline (never mind that the French committee failed to take into account the renaissance of the French economy and greatly exaggerated the projected budget deficit). In all these cases an act of rebalancing the budget is called for.

The USA has a peculiar budgetary procedure. Its Federal budget is made up of 13 separate bills. They are submitted to Congress for approval by the administration. When the President and Congress disagree, some of the bills are not approved and certain government operations are shut down. This happened in the 1996 fiscal year. In fact, the budget for fiscal year 1996 has been approved only after the 1997 budget was.

In the case of such a deadlock, stop gap budgets are passed by Congress to allow the government to continue to function until a final budget is positively voted on.

Budget are acts of humans. They represent hard data implausibly coupled with aspirations, projections, goals and hopes. They are prone to mistakes, greed, cronyism, ulterior motives. The existence of a mechanism to amend budgets is, therefore, of the essence and to be greeted. A budget amendment is often ceased upon by the opposition as proof of the government's fallibility and failure. But in a changing world - they who do not adapt through change are doomed. Governments that amend their budgets midway merely admit that they are made of humans and are doing their nation a service.

Bulgaria, Economy of

Bulgaria is proof that not all currency boards are destined to an Argentine denoument. Having witnessed its GDP plunge by one third between 1989 and 1997, it has risen by 11% in the three years since, driven by net exports and domestic demand, in equal measures. This was achieved as hyperinflation was reduced to an annual rate of 1.7% in

1998. It has since worryingly climed back to 11.4% last year and has come down to only 8% since, due to higher energy prices and a severe draught. Bulgaria also re-paid its sovereign debt so that it now constitutes less than 70% of its GDP. This is often attributed to strict fiscal policies (the budget deficit amounts to c. 1% of official GDP and wage bills in most loss making state enterprises have been frozen) and to a successful implementation of a currency board. The boards is very popular with the Bulgarian: it gave them a stable currency, increased exports, liquified banks and halved interest rates, among other benefits. After years of crony privatizations ("management and employee buyouts") financed by criminal groups and followed by widespread asset stripping and a botched voucher cum investment funds scheme - more than 80% of bank assets and 50% of state enterprises have been genuinely privatized (often through the stock exchange). A series of well publicized and government sponsored raids by police ands tax authorities on the likes of "Multigrup", the penumbral holding company, have gone a long way towards decriminalizing the economy. And corrupt Ministers are being given the boot as a matter of course. The authorities have also been making the right noises regarding health care, pensions and bank supervision. Real investment, depressed wages, and restructuring led to higher productivity and enhanced competitiveness.

All sectors experienced growth. The failed transition from communism to a market economy forced many Bulgarians to go back to agriculture. This process has reversed and re-industrialization commened. Gross fixed investment almost doubled itself to 16% of GDP. Though most foreign direct investment (FDI) comes from poor and non-sophisticated non-EU countries and is plunged into labour-intensive greenfields, FDI (half of it in privatization proceeds) climbed 10-fold to $1 billion. The FDI stock (and with, sorely needed technology, intellectual property, knowledge and management) reached $3 billion at the end of 2000.

Surprisingly, these macro-economic achievements had little effect on the business climate. Bulgarian businessmen have remained largely sceptical of the economic prospects of their country. Enterpreneurship is still obstructed by insufficient infrastructure, inefficient, arbitrage-orientated and lending-averse banks, and over-regulation (e.g., in the energy sector). Venal red tape deters investors. There is no central revenue authority, for instance, and no functioning treasury system. Labour taxes are stratospheric and drive people into the thriving informal economy (estimated to be about one third of the total). And, despite being a trading nation, Bulgarian customs duties and tariffs are both complex and high.

The lot of simple people has not discernibly improved either. Output is 30% below the communist-era peak. Unemployment is high by European standards (between 16 and 18%). The average monthly income in southern Bulgaria (an agricultural and textile area that borders Greece) is still $50 or less, one of the lowest in any economy in transition. Wages are one fourth the EU's. Cheap labour has its advantages, though. It attracts "foreign direct" investment (shoes and textile sweat shops) and generates foreign exchange (seasonal workers).

The pace of structural reform has slowed to a halt in the latter part of 2000. The presentment of important bills (such as the Energy Law) has been postponed. Lucrative but growth retarding monopolies (from tobacco to telecom) have been left untouched, despite a revamped Privatization Law. Should this continue, Bulgaria may find it harder to attract the FDI that, last year, covered its gaping current account deficit (equal to 6% of GDP). Foreign exchange reserves (at $3.6 billion, or almost 6 months of imports) are sufficient to offset a run on the lev - but rising inflation does take its toll on the competitiveness of Bulgarian products. In real terms, the lev has appreciated by 20% since the end of 1996 (1 lev equals 1 DM).

Bulgaria is still too dependent on handouts or multilateral "investments" from the likes of the IMF, the World Bank, and the Stability Pact. It claims to have lost over $6 billion in export proceeds during the Danube-blocking 1999 Kosovo crisis and its aftermath. The war affected rail transport and tourism as well. Bulgaria may be adversely affected by fighting in its tiny neighbour, Macedonia, and in Bosnia. The meltdown of Turkey's economy - one of Bulgaria's important trading partners - and a looming recession in the USA and Japan - may also have an impact. Should inflation or the current account deficit worsen, the government will have to tighten its fiscal stance and, thus, induce a recession. Elections in June may make it difficult to maintain fiscal discipline, though.

Can Bulgaria continue to grow by 5% a year? Not if its investment rate doesn't. It needs to increase by 20%. Human capital needs to be better exploited (unemployment needs to drop). The IMF reckons that "total factor productivity (TFP) growth rates of around 2% p.a. will be required" (IMF Country Report 01/54, p. 6). This cannot be achieved without non-comprmising and socially dislocating structural reform. Bulgaria faces now the tough choices that post-communist countries such Hungary, Poland and Estonia faced years ago.

Bulgaria has only one political voice: the voice of the aspiration to prosperity. The lure of EU membership coupled with the need to comply with IMF and World Bank conditions served to homogenize party platforms across the spectrum. A national consensus regarding free markets, protection of property rights, civil society, EU and NATO membership, institution building, and cautious macroeconomic policy renders the political parties virtually indistinguishable.

Bulgaria experienced one of the most difficult periods of transition among the post-communist countries. Poverty reached a nadir in the years 1993-1998 with food rationing and shortages of basic subsistence goods. The government of the barely reformed Communists ("Bulgarian Socialist Party"), headed by Jan Videnov, wrought total devastation on Bulgaria. Hyperinflation, rising unemployment, a dysfunctional financial sector, cronyism, organized crime, an unrestructured and crumbling industrial sector brought it down in the 1997 elections, won by the UDF (United Democratic Forces) coalition.

The UDF is led by the SDS (Union of Democratic Forces) and incorporates most of the conservative wing of Bulgarian politics: the Democratic Party (DP), a few agrarian splinters and the BSDP (Bulgarian Social Democratic Party). It is led by the energetic Ivan Kostov. His appeal rested with his (relatively) clean record - but mainly with his experience in economic management. Chairman of the Economic Commission and finance minister in two post transition governments, he was perceived to be the right man for the job of reviving Bulgaria's moribund economic fortunes. The UDF espouses a form of free marketry tampered by (rather imperceptible) tinges of "social responsibility". It is ardently pro-EU, pro-privatization and, in short, pro IMF. The introduction of a currency board was a master stroke which served to stabilize the lev and maintain macro-economic and monetary stability. Anti-corruption campaigns enhanced the government's modernizing image. It all had little effect on the quotidian life of the average Bulgarian and disaffection and disillusionment are rampant. But a palpable strengthening of Bulgaria's international posture (visa free travel to the EU, accession talks) ameliorated the national mood of disappointment for a while. Recently, though, a series of corruption and wiretapping scandals and criminal shootouts have tarnished the UDF's image. The war in Macedonia has the potential to scare away foreign investors and embroil Bulgaria in a third Balkan War. Anxiety is high.

On the right, a new and surprising force has emerged.

Simeon Borisov Koburgotski, also known as King Simeon II has lived in exile, in Spain for over 50 years. But in 1996, he visited his homeland. He provoked an hitherto unrequited wave of messianic economic and social expectations. In April 2001, Mr. Koburgotski established the "National Movement". Apart from a few unrealistic ad populist promises, its economic platform is virtually indistinguishable from the UDF's and much vaguer at that:

"...Three essential goals: first, immediate and qualitative change in the standards of living, by turning the economy into a working market economy in accordance with the

European Union criteria for membership, as well as by an increase of the flow of global capital. I am ready to propose a system of economic measures and partnerships which, within 800 days and based on the well known Bulgarian work ethic and entrepreneurial skills, will change your life. Second, by abandoning the political partisanship and unifying the Bulgarian nation along historical ideals and values that have preserved its glory for all its 1300-year history. Third, by introducing new rules and institutions to eliminate corruption, which is the major enemy of Bulgaria, causing poverty and repelling vital foreign investments."

The Bulgarian left provides for a very disheartening political landscape.

The Bulgarian Socialist Party is now the nucleus of an emerging 16-member opposition, the New Left Alliance. The Alliance is made up of parties which support old socialism, labour orientated policies, and the maintenance of a social safety net. This is very akin to other European left and social democratic parties. the parties of the Alliance are intent on merging into a single entity after the elections, though the diversity of the group - nationalists, communists, socialists, agrarians, feminists and Roma - renders this nigh impossible. The Turkish minority is Bulgaria (one tenth of the population) spawned the other opposition grouping, the Movement for Rights and Freedoms and has been excluded from the Alliance. The Alliance's leader, Georgi Parvanov, is making distinctly pro-Western and anti-"archaic Communism" noises. This did not prevent a power sharing pre-election agreement with the unreformed Communist party. Many regard these astonishing twists and turns as sheer opportunism. Other simply ridicule these improbable bedmates. Yet, they may still surprise. They derive hope and courage from the Romanian precedent, where the socialists surged ahead and won the elections. To adopt Romania as a model one truly needs to be desperate, retort many Bulgarians.

Last year (2003), Bulgaria, currently sitting on the Security Council, was one of ten east and southeast European countries - known as the Vilnius Group - to issue a strongly worded statement in support of the United States' attempt to disarm Iraq by military means. This followed a similar, though much milder, earlier statement by eight other European nations, including Hungary, the Czech Republic and Poland, the EU's prospective members in central Europe.

The Vilnius Ten - including Albania, Bulgaria, Croatia, Estonia, Latvia, Lithuania, Macedonia, Romania, Slovakia and Slovenia - called the evidence presented to the Security Council by Colin Powell, the US Secretary of State - "compelling". Iraq posed a "clear and present danger" - they concluded.

Bulgaria and Romania pledged free access to their air spaces and territorial waters. The first US military plane has landed today in the Safarovo airport in the Black Sea city of Burgas in Bulgaria. Other members are poised to provide medical staff, anti-mine units and chemical protection gear.

Such overt obsequiousness did not go unrewarded.

Days after the common statement, the IMF - considered by some to be a long arm of America's foreign policy - clinched a standby arrangement with Macedonia, the first in two turbulent years. On the same day, Bulgaria received glowing - and counterfactual - reviews from yet another IMF mission, clearing the way for the release of a tranche of $36 million out of a loan of $330 million.

Partly in response, six members of parliament from the ruling Simeon II national Movement joined with four independents to form the National Ideal for Unity. According to Novinite.com, a Bulgarian news Web site, they asserted that "the new political morale was seriously harmed" and "accused the government of inefficient economic program of the government that led to the bad economic situation in the country".

Following the joint Vilnius Group declaration, Albania, Croatia, Bulgaria and Macedonia received private and public assurances that their NATO applications now stand a better chance. Bulgaria started the second round of negotiations with the military alliance yesterday and expects to become full member next year. The head of the US Committee on NATO Enlargement Bruce Jackson stated: "I'm sure that Bulgaria has helped itself very much this week."

Yet, the recent rift in NATO (over Turkish use of the Alliance's defense assets) pitted Germany, France and Belgium against the rest of the organization and opposite other EU member states. It casts in doubt the wisdom of the Vilnius Group's American gambit. The countries of central and east Europe may admire the United States and its superpower clout - but, far more vitally, they depend on Europe, economically as well as politically.

Even put together, these polities are barely inconsequential. They are presumptuous to assume the role of intermediaries between a disenchanted Franco-

German Entente Cordiale and a glowering America. Nor can they serve as "US Ambassadors" in the European corridors of power.

The European Union absorbs two thirds of their exports and three quarters of their immigrants. Europe accounts for nine tenths of foreign direct investment in the region and four fifths of aid. For the likes of the Czech Republic and Croatia to support the United states against Germany is nothing short of economic suicide.

Moreover, the United States is a demanding master. It tends to micromanage and meddle in everything, from election outcomes to inter-ethnic relations. James Purdew, America's ambassador to Sofia and a veteran Balkan power broker, spent the last few weeks exerting pressure on the Bulgarian government, in tandem with the aforementioned Bruce Jackson, to oust the country's Prosecutor General and reinstate the (socialist) head of the National Investigation Services.

Bulgaria is already by far the most heavily enmeshed in US military operations in Asia. It served as a launch pad for US planes during the Afghanistan campaign in 2001-2. It stands to be affected directly by the looming war.

Bulgaria is on the route of illicit immigration from Iraq, Palestine and Iran, via Turkey, to Greece and therefrom to the EU. Last Friday alone, it detained 43 Iraqi refugees caught cruising Sofia in two Turkish trucks on the way to the Greek border. The Ministry of Interior admitted that it expects a "massive flow of (crossing) refugees" if an armed conflict were to erupt.

The Minister of Finance, Milen Velchev, intends to present to the Council of Ministers detailed damage scenarios based on a hike in the price of oil to $40 per barrel and a 3-4 months long confrontation. He admitted to the Bulgarian National Radio that inflation is likely to increase by at least 1-1.5 percentage points.

The daily cost of a single 150-member biological and chemical defense unit stationed in the Gulf would amount to $15,000, or c. $500,000 per month, said the Bulgarian news agency, BTA. The Minister of Defense, Nikolai Svinarov, told the Cabinet that he expects "maximum (American) funding and logistical support" for the Bulgarian troops. The United States intends to base c. 400 soldiers-technicians and 18 planes on the country's soil and will pay for making use of the infrastructure, as they have done during operation "Enduring Freedom" (the war in Afghanistan).

Bulgaria stands to benefit in other ways. The country's Deputy Foreign Minister, Lyubomir Ivanov, confirmed in another radio interview that the Americans pledged that Iraqi debts to Bulgaria will be fully paid. This can amount to dozens of millions of US dollars in fresh money.

Is this Bulgaria's price? Unlikely. Bulgaria, like the other countries of the region, regards America as the first among equals in NATO. The EU is perceived in east Europe as a toothless, though rich, club, corrupted by its own economic interests and inexorably driven by its bloated bureaucracy. The EU and its goodwill and stake in the region are taken for granted - while America has to be constantly appeased and mollified.

Still, the members of the Vilnius Groups have misconstrued the signs of the gathering storm: the emerging European rapid deployment force and common foreign policy; the rapprochement between France and Germany at the expense of the pro-American but far less influential Britain, Italy and Spain; the constitutional crisis setting European federalists against traditional nationalists; the growing rupture between "Old Europe" and the American "hyperpower".

The new and aspiring members of NATO and the EU now face a moment of truth and are being forced to reveal their hand. Are they pro-American, or pro-German (read: pro federalist Europe)? Where and with whom do they see a common, prosperous future? What is the extent of their commitment to the European Union, its values and its agenda?

The proclamations of the European eight (including the three central European candidates) and the Vilnius Ten must have greatly disappointed Germany - the unwavering sponsor of EU enlargement. Any further flagrant siding with the United States against the inner core of the EU would merely compound those errors of judgment. The EU can punish the revenant nations of the communist bloc with the same dedication and effectiveness with which it has hitherto rewarded them. Ask Israel, it should know.

There is something worrying about a neophyte politician who promises to improve the living standards of his electorate "in 800 days" - less than 80 days after he returned to his country following an absence of 50 years. There is an eerie similarity between the promises made by the UDF upon its ascendance to power four years ago - and those made by the ex-King's party on the election trail. Ivan Kostov, the former Prime Minister, also came to power surrounded by eager, reform-touting, Western minded, business-orientated young geeks. They were all co-opted by corrupt interests within the year. Kostov lost power because he failed to improve the economic lot of ordinary citizens while displaying a suspicious reluctance to tackle virulent corruption in high places. Curiously, the economic advisor to the President of Bulgaria is the PM's son - Cyril Koburgotsky.

After taking an oath of loyalty in parliament, the new PM attended a special prayer service. Prayers are called for. The Bulgarian economy is sputtering. After a spectacular recovery of 11% between 1998-2000, growth has stalled, unemployment is close to 20%, and inflation shot up to 8%. Half the population is under the official poverty line. A sham privatization of state assets allowed criminal business groups to infiltrate the Bulgarian economy. The private sector is encumbered by venal red tape and inflexible labour laws. These problems are further compounded by the deteriorating economic outlook of Turkey, one of Bulgaria's largest trade partners - and the political strife in Macedonia, its neighbour and vital transport route.

The new Minister of Finance, Milen Velchev, 35, is an expert in the restructuring of sovereign external debt and has worked for Merril Lynch in London. In an interview he granted to "The Economist" (July 21st-27th issue) he had nothing original to say. "Our economic philosophy is much the same as the UDF's". But he did promise to be "more radical" in implementing it. No wonder the UDF pledged it "would co-operate with the new government on issues that would continue the reformist programme of the past four years". Mr. Saxe-Coburg already vowed to preserve the crowning achievement of the previous government, the DM-pegged currency board. To fight corruption, he promised to streamline procedures in investor-friendly "one stop shops".

How is all this related to the rampant poverty of the PM's constituency? It is not. In the heat of the campaign, the Royal did not hesitate to dole out promises of interest-free loans (5000 levs - c. 2200 US dollars - per household), coupled with massive increases in pensions and pay. There is not the slightest chance or intention to keep these profligate undertakings. The new economic ministers are fiscal conservatives, aiming at zero public borrowing. Interest free loans? To small businesses only, mumble the embarrassed former stock broker, Velchev: "Don't expect miracles. We would hope that things start improving by the third year. The king himself talks of 800 days." The PM made clear that "The Bulgarian economy cannot grow without growth of the income of the population", and that he intended to attract back Bulgarian flight capital by revamping the banking system, introducing international accounting standards, and attracting foreign investors to buy shares in Bulgarian firms.

In December 1999, in an interview to the BBC, Velchev said: "In 1999 Bulgaria consolidated the macro-economic stability that it achieved in 1997 and 1998. (It was) a successful step by the Government the fact that the World Bank and the IMF guaranteed the balance of payments and the gradual increase in Bulgaria's foreign exchange reserves. This gave the necessary political courage to carry out the redenomination of the lev... (Yet) no successful deals were completed in 1999... There has been talk of successful deals in the energy sector for quite a long time, but there is still no information that any of them has been finalized. ... Giving grounds for even greater concerns is the small interest in the pearl of the Bulgarian banking system - Bulbank - which means that very few Western banks find business in Bulgaria promising. The key deal which we are all following at the moment is the privatization of the Bulgarian Telecommunications Company, whose completion is still not certain. As a consultant to one of the potential buyers I do not want to comment on why the talks took so long," said Velchev.

Macro-economic stability, privatization of key state assets, and a restructuring of the baking sector are still the main concerns of the new Minister of Finance.

His colleague, US educated Deputy Prime Minister and Minister of the Economy, Nikolai Vassilev, 32, is an emergent market analyst. His economic agenda includes the tired - and hitherto vague - recipes of privatization, fighting corruption, reinforcing capital markets, and tax reform to encourage re-investment by firms. Vassilev and Ljubka Kachakova (a PriceWaterhouseCoopers Brussels employee) authored the inventory of free-market slogans that passes for the economic platform of National Movement for Simeon II. Kostov immediately pointed out the incompatibility of said platform with Bulgaria's current and future obligations to the EU.

"We are going to finish the process... within 2-3 years. Everything that should be privatized will be privatized." - said Vassilev recently, referring mainly to the tobacco monopoly, the telecom, and one or two major banks.

In a debate about the recent issuance of Eurobonds by Bulgaria, Vassilev made these comments:

"Each country has its good and bad moments. If a state like Bulgaria bears problems and then decides to emit for the first time Eurobonds, it is not necessary to sell them. The emission of eurobonds is required because afterwards private companies may enter the international markets ... The budget deficit must be next to 0 per cent and the currency board must remain unconditionally".

He suggested a reduction of profit tax and income tax and predicted that such a cut will prove to be conducive to economic growth.

On another occasion, as a member of the "Bulgarian Easter" initiative of the previous government, he expressed concern regarding the decline in Bulgaria's foreign exchange reserves due to the need to repay 1.3 billion US dollars of foreign debt this year. He warned against a negative tendency in the trade balance of Bulgaria as imports far exceeded exports in the last few years. In the same event, he opinionated that the capital markets should be completely liberalized. He argued for free purchases of land - including agricultural land - by foreigners. He identified these restrictions as the cause of the decline in the value of Bulgarian assets and its divergence from the EU. Bulgarians - he exclaimed - underestimate the potential role and contribution of capital markets. "In the updated 'Program 2001' of the Bulgarian Government, the economic and financial policies of the incumbents are reduced to envisioning support for the commercial banks of the most elementary type" - he accused. Foreigners - he added - "have no confidence" in the Bulgarian capital markets. He succeeded to attract the attention of Kostov himself, who responded to him at length.

But the emerging eclectic political maelstrom that coalesced around the former King does not include only Wall Street whiz kids. Some distinctly unsavoury characters have crept into the lists fielded by the party in Russe and Burgas. Foreigners are worried. Gunter Verheugen, EU commissioner for enlargement remarked, undimplomatically, that there are "reasons to be concerned about some of the promises" made by the campaigning King. Georgy Ganev, a leading Bulgarian liberal economist, summed it up neatly in an interview in the "Financial Times": "Either there will be an economic crisis because the new government will try and meet these expectations. Or there will be a political crisis because it will not." The consolation prize? "The myth of the king will fill a big hole in the lives (of the Bulgarians)." - says Andrey Raichev, Director of Gallup Bulgaria, to the same paper.

Business Plan

There are many types of symbols. Money from investors, banks or financial organisations is one such kind of symbols.

A successful Business Plan (=a successful manipulation of symbols) is one which brings in its wake the receipt of credits (money, another kind of symbol). What are the rules of manipulating symbols? In our example, what are the properties of a successful Business Plan?

(1) That it is closely linked to reality. The symbol system must map out reality in an isomorphic manner. We must be able to identify reality the minute we see the symbols arranged.

If we react to a Business Plan with incredulity ("It is too good to be true" or "some of the assumptions are non realistic") - then this condition is not met and the Business Plan is a failure.

(2) That it rearranges old, familiar data into new, emergent, patterns.

The symbol manipulation must bring to the world some contribution to the sphere of knowledge (very much as a doctoral dissertation should).

When faced with a Business Plan, for instance, we must respond with a modicum of awe and fascination ("That's right! - I never thought of it" or "(arranged) This way it makes sense").

(3) That all the symbols are internally consistent. The demand of external consistency (compatibility with the real world, a realistic representation system) was stipulated above. This is a different one: all symbols must live in peace with one another, the system must be coherent.

In the example of the Business Plan:

Reactions such as: "This assumption / number/ projection defies or contradicts the other" indicate the lack of internal consistency and the certain failure to obtain money (=to manipulate the corresponding symbols).

(4) Another demand is transparency: all the information should be available at any given time. When the symbol system is opaque - when data are missing, or, worse, hidden - the manipulation will fail.

In our example: if the applicant refuses to denude himself, to expose his most intimate parts, his vulnerabilities as well as his strong points - then he is not likely to get financing. The accounting system in Macedonia - albeit gradually revised - is a prime example of concealment in a placewhere exposition should have prevailed.

(5) The fifth requirement is universality. Symbol systems are species of languages. The language should be understood by all - in an unambiguous manner. A common terminology, a dictionary, should be available to both manipulator and manipulated.

Clear signs of the failure of a Business Plan to manipulate would be remarks like: "Why is he using this strange method for calculation?", "Why did he fail to calculate the cost of financing?" and even: "What does this term mean and what does he mean by using it?"

(6) The symbol system must be comprehensive. It cannot exclude certain symbols arbitrarily. It cannot ignore the existence of competing meanings, double entendres, ambiguities. It must engulf all possible interpretations and absolutely ALL the symbols available to the system.

Let us return to the Business Plan:

A Business Plan must incorporate all the data available - and all the known techniques to process them. It can safely establish a hierarchy of priorities and of preferences - but it must present all the possibilities and only then make a selection while giving good reasons for doing so.

(7) The symbol system must have links to other, relevant, symbol systems. These links can be both formal and

informal (implied, by way of mental association, or by way of explicit reference or incorporation).

Coming back to the Business Plan:

There is no point in devising a Business Plan which will ignore geopolitical macro-economic and marketing contexts. Is the region safe for investments?

What are the prevailing laws and regulations in the territory and how likely are they to be changed? What is the competition and how can it be neutralized or co - opted? These are all external variables, external symbol systems. Some of them are closely and formally linked to the business at hand (Laws, customs tariffs, taxes, for instance). Some are informally linked to it: substitute products, emerging technologies, ethical and environmental considerations. The Business Plan is supposed to resonate within the mind of the reader and to elicit the reaction: "How very true!!!"

(8) The symbol system must have a discernible hierarchy. There are - and have been - efforts to invent and to use non-hierarchical symbol systems. They all failed and resulted in the establishment of a formal, or an informal, hierarchy. The professional term is "Utility Functions". This is not a theoretical demand. Utility functions dictate most of the investment decisions in today's complex financial markets.

The author(s) of the Business Plan must clearly state what he wants and what he wants most, what is an absolute sine qua non and what would be nice to have. He must fix and detail his preferences, priorities, needs and requirements. If he were to attach equal weight to all the parts of the

Business Plan, his message will confuse those who are trying to decode it and they will deny his application.

(9) The symbol system must be seen to serve a (useful) purpose and it must demonstrate an effort at being successful. It must, therefore, be direct, understandable, clear and it must contain lists of demands and wishes (all of them prioritized, as we have mentioned).

When a computer faces a few tasks simultaneously - it prioritizes them and allocates its resources in strict compliance with this list of priorities.

A computer is the physical embodiment of a symbol system - and so is a bank doling out credit. The same principles apply to the human organism.

All natural (and most human) systems are goal-oriented.

(10) The last - but by no means the least - requirement is that the symbol system must be interfaced with human beings. There is not much point in a having a computer without a screen, or a bank without clients, or a Business Plan without someone to review it. We must always - when manipulating symbol systems - bear in mind the "end user" and be "user friendly" to him. There is no such thing as a bank, a firm, or even a country. At the end of the line, there are humans, like me and you.

To manipulate them into providing credits, we must motivate them into doing so. We must appeal to their emotions and senses: our symbol system (=presentation, Business Plan) must be aesthetic, powerful, convincing, appealing, resonating, fascinating, interesting. All these are irrational (or, at least, non-cognitive) reactions.

We must appeal to their cognition. Our symbol system must be rational, logical, hierarchical, not far fetched, true, consistent, internally and externally. All this must lead to motor motivation: the hand that signs the check given to us should not shake.

THE PROBLEM, THEREFORE, IS NOT WHERE TO GO, NOT EVEN WHEN TO GO IN ORDER TO OBTAIN CREDITS.

THE ISSUE IS HOW TO COMMUNICATE (=to manipulate symbols) IN ORDER TO MOTIVATE.

Using this theory of the manipulation of symbols we can differentiate three kinds of financing organizations:

(1) Those who deal with non-quantifiable symbols. The World Bank, for one, when it evaluates business propositions, employs criteriawhich cannot be quantified (how does one quantify the contribution to regional stability or the increase in democracy and the improvement in human rights records?).

(2) Those who deal with semi-quantifiable symbols. Organizations such as the IFC or the EBRD employ sound - quantitative - business and financial criteria in their decision making processes. But were they totally business oriented, they would probably not have made many of the investments that they are making and in the geographical parts of the world that they are making them.

(3) And there are those classical financing organizations which deal exclusively with quantifiable, measurable variables. Most of us come across this type of financing institutions: commercial banks, private firms, etc.

Whatever the kind of financial institution, we must never forget:

We are dealing with humans who are influenced mostly by the manipulation of symbol systems. Abiding by the aforementioned rules would guarantee success in obtaining funding. Making the right decision on the national level - would catapult Macedonia into the 21st century without having first to re-visit the twentieth.

C

Capital Flows, Global

The upheavals in the world financial markets during the latter part of the 1990s were quelled by the immediate intervention of both international financial institutions (IFIs) such as the IMF and of domestic ones in the developed countries, such as the Federal Reserve in the USA. The danger seemed to have passed. But, subsequent tremors in South Korea, Brazil and Taiwan and mounting imbalances inside the USA (the "twin deficits") and in the international exchange rates system do not augur well. We may face yet another crisis of the same or a larger magnitude.

What are the lessons that we can derive from the last crisis to avoid the next?

The first lesson, it would seem, is that short term and long term capital flows are two disparate phenomena with not much in common. The former is speculative and technical in nature and has very little to do with fundamental realities. The latter is investment oriented and committed to the increasing of the welfare and wealth of its new domicile.

It is, therefore, wrong to talk about "global capital flows". There are investments (including even long term portfolio investments and venture capital) – and there is speculative, "hot" money. While "hot money" is very useful as a lubricant on the wheels of liquid capital markets in rich countries – it can be destructive in less liquid, immature economies or in economies in transition.

The two phenomena should be accorded a different treatment. While long term capital flows should be completely liberalized, encouraged and welcomed – the short term, "hot money" type should be controlled and even discouraged. The introduction of fiscally-oriented capital controls (as Chile has implemented) is one possibility.

The less attractive Malaysian model springs to mind. It is less attractive because it penalizes both the short term and the long term financial players. But it is clear that an important and integral part of the new International Financial Architecture must be the control of speculative money in pursuit of ever higher yields. There is nothing inherently wrong with high yields – but some capital markets provide yields connected to economic depression and to price collapses through the mechanism of short selling and through the usage of certain derivatives. This aspect of things must be neutered or at least countered.

The second lesson is the important role that central banks and other financial authorities play in the precipitation of financial crises – or in their prolongation. Financial bubbles and asset price inflation are the result of euphoric and irrational exuberance – said the Chairman of the Federal Reserve Bank of the United States, the legendary Mr. Greenspan and who can dispute this?

But the question that had hitherto been delicately side-stepped was: who is responsible for financial bubbles? Expansive monetary policies, well timed signals in the interest rates markets, liquidity injections, currency interventions, international salvage operations – are all coordinated by central banks and by other central or international institutions.

Official inaction is as conducive to the inflation of financial bubbles as is official action. By refusing to restructure the banking system, to regulate and transparently trade derivatives and other complex financial instruments, to introduce appropriate bankruptcy procedures, corporate transparency and good corporate governance, by engaging in protectionism and isolationism, by avoiding the implementation of anti competition legislation – many countries have fostered the vacuum within which financial crises erupt.

The third lesson is that international financial institutions can be of some help – when not driven by political or geopolitical considerations and when not married to a dogma. Unfortunately, these are the rare cases. Most IFIs – notably the IMF and, to a lesser extent, the World Bank – are both politicized and doctrinaire.

It is only lately and following the recent mega-crisis in Asia, that IFIs began to "reinvent" themselves, their doctrines and their recipes. This added conceptual and theoretical flexibility led to improved results. It is always better to tailor a solution to the needs of the client. Perhaps this should be the biggest evolutionary step:

That IFIs will cease to regard the countries and governments within their remit as inefficient and corrupt beggars, in constant need of financial infusions. Rather they should regard these countries as clients, customers in need of service. After all, this, exactly, is the essence of the free market – and it is from IFIs that such countries should learn its ways.

In broad outline, there are two types of emerging solutions. One type is market oriented – and the other, interventionist. The first type calls for free markets, specially designed financial instruments (see the example of the Brady bonds) and a global "laissez faire" environment to solve the issue of financial crises. The second approach regards the free markets as the source of the problem, rather than its solution. It calls for domestic and where necessary international intervention and assistance in resolving financial crises.

Both approaches have their merits and both should be applied in varying combinations on a case by case basis.

Indeed, this is the greatest lesson of all:

There are no magic bullets, perfect solutions, right ways and only recipes. This is a a trial and error process and in war one should not limit one's arsenal. Let us employ all the weapons at our disposal to achieve the best results for everyone involved.

Casino

154,000,000. This is the number of Americans who visited the gambling institutions in the USA in 1995. Another 177,000,000 participated in other forms of gambling: car races, horse races, other sports tournaments. They have spent well over 44 BILLION USD on gambling. On average, they lost 20% of the money that they invested - and this, approximately, is the profit of this industry in the US. The industry's annual growth rate is 11% which is an excellent figure for an industry which commenced its operations in 1940 in a desert in the State of Nevada. Wall Street likes casinos and shares of gambling related companies skyrocketed and yielded much more than the Dow Jones Average Index. Hotels chains - such as Hilton and ITT - are competing fiercely to purchase casinos.

Casinos do not like to call themselves "Gambling Outfits" (which is really what they are). The politically correct name today is: "Gaming and Leisure establishments".

The reason is that gambling has a lot of what we, economists, like to call "negative externalities". Put in less delicate terms: casinos exact a heavy social and economic price from the countries in which they operate.

Lately the Government of Macedonia has decided to liberalize gaming. Anyone with 500,000 DM will be allowed to establish and operate a casino. Certain gambling - hitherto monopolized by the Macedonian Lottery - will be open to other, private operators.

I am not privy to the considerations behind these decisions. Yet, it is a safe bet to assume that the same political and economic motivating force is in operation here as it was in the USA: money. Gambling is considered the easy way out. Gamblers will come from all over, leave their money with the casino and go home. The local and national governments will tax the casinos heavily and a perpetuum mobile will be created, virtually providing money at no cost.

But there is one law in economy which is indisputable and unbreachable: THERE IS NO FREE LUNCH AND THERE IS NO SUCH THING AS MONEY WITHOUT ITS PRICE TO PAY.

In warmly embracing the casino culture, Macedonia maybe committing a grave error.

Let us try and understand why:

(1) To be a success, a casino must be geographically isolated and almost a monopoly. The most successful casinos in human history were established by the American mob (=Mafia) in a desert (in Las Vegas). There were no other casinos available. Gamblers who came all the way to the desert - had to stay a few days. This encouraged the construction of hotels, restaurants and other tourist attractions and diversions. This also increased the revenues of the casinos considerably.

Macedonia is surrounded by neighbours with a rich and well developed casino culture. Greece, Bulgaria and Turkey are casino superpowers. Casinos also exist in Slovenia, Croatia, Hungary and Romania. So, Macedonia will be competing headlong with powerful gambling realities. The situation would have been different if Macedonia were to attract affluent tourism. But tourism in Macedonia has all but collapsed. Its tourist-related infrastructure has dwindled and it cannot support an influx of tourists. In Skopje, the cultural and economic hub of Macedonia, a city of 600,000 inhabitants - there are only two class "A" hotels (which really compare to 4 star hotels in the West). Until such an infrastructure is re-instated and tourist attractions - natural and artificial - are maintained - tourists will not flock into Macedonia.

Thus, a casino in Macedonia will be fed by the gambling of LOCAL CITIZENS and one-day (or one night) tourists. This is the wrong way to operate a casino. A casino cannot look forward to an economically viable future based on these types of clients. Moreover, a casino which will take the local citizens (anyhow scarce) money will wreak havoc on the social fabric of Macedonia. It will not be very different from the impact exerted by the collapse of the various pyramid schemes (in Albania) and Stedilnicas (in Macedonia). Gambling is equivalent to mild drugs: some people get addicted. The social cost is an important factor.

One way to avoid these unfortunate consequences is to prohibit Macedonians from gambling in the casinos in Macedonia. But this will ruin the economic justification for the establishment of such an institutions. Experience gathered in other countries also teaches us that the local citizens will find ways around this prohibition.

(2) Governments think about casinos as a way to create employment and to enlarge the tax base (=to generate additional taxes). These two assumptions are quite dubious, according to recent research.

When a casino is established, its owners and operators usually promise that they will invest money in the locality. They promise to renew decrepit city centres, to repave roads, to invest in infrastructure and to assist the establishment of restaurants and hotels. Some states in the USA have earmarked revenues from gambling to specific purposes. All the income generated by the New York State lottery goes to education and the construction of new schools. In Israel, the money earned by the state monopoly of Gambling is transferred to the Government's annual development budget and is invested in the construction of schools, community centres and clinics.

But even the gambling industry itself admits - in its annual Harra's Survey of the Gaming and Leisure Industries - that the investments in the economy, generated by casinos are far less than even the most modest expectations.

True, in the USA alone, casinos employ 367,000 people - a 24% increase over 1994.

But most of these jobs are menial. These are temporary jobs without job security and without a career plan or future. They are dead end jobs for desperate people.

Casinos also cause jobs to be cancelled. Older firms (old hotels, restaurants, service firms) are closed down and people get fired. The number quoted above also does not take into consideration the natural (not related to gambling) growth in employment in the USA as a whole. Taking all this into account, the claims that casinos create jobs looks more and more dubious. The more casinos established - the less business each of them is able to do. Some of them are making losses and are firing people, exacerbating a bad employment scene.

Casinos did invest in municipal infrastructure. Yet, they preferred decoration to grass roots, ornamental veneer type visible investments - rather than real improvement in things less glorious (such as the sewage system, for example). Cities with casinos enjoyed a brief renaissance which was followed by the collapse and degeneration of the city centre's scape.

(3) Casinos not only generate revenues. They also generate enormous direct (not to mention the indirect) costs. Criminal elements tend to gather around casinos and sometimes try to own them. Gambling addicts commit crimes in a desperate attempt to obtain funds. So, a lot of money has to be expended on an increase in the police

force and on the additional work of other law enforcement agencies. There is also a sizeable increase in the costs of cleaning the street, sanitation and extra social services needed to cope with the break up of families and with gambling addictions.

Taking all this into consideration, it is not at all clear that casinos are a net benefit to the economy and it is almost certain that they are not a net benefactor of society as a whole.

(4) Casinos undoubtedly hurt the local economy when they take money from local citizens. A Macedonian with free income could use it to buy clothes, go to a restaurant or buy a computer. If he spends this money in a casino - other businesses suffer. Their turnover is reduced. They must fire employees. They also pay less taxes - which offsets the taxes that casinos pay. No one has ever calculated which is more: the taxes that casinos pay - or the taxes which businesses stop to pay because of reduced consumption by local citizens who spent all their money in a casino. Sometimes these businesses close down altogether. Anyone who visited Atlantic City or Gary, Indiana can testify to this. Atlantic City is a gambling capital - and, yet, it is was of the most trodden down cities of the USA.

Statistics show that casinos prefer to employ non-local people. They employ foreigners. If this is not possible, they will try to employ people from Bitola in Skopje - and vice versa. This is intended to prevent collusions and conspiracies between the staff and the gamblers. More than 60% of casino employees in the USA do not live in the city in which the casino is located. So, we cannot even say that a casino generates employment for the inhabitants of a city whose infrastructure it uses.

(5) There are some alarming statistics. Nevada has the highest suicide rate in the USA. It also has the highest accident rate (per mile driven). It has amongst the highest rates of crime and school drop out rates. Its economy is totally dependent on gambling. It is like a laboratory in which what happens to a gambling state can be tested and measured - and the results are far from encouraging.

Moreover, 4% of the population are "pathological gamblers". Those who cannot stop and who will stop at nothing - crime included - to get the money that they need in order to gamble. 10% of the gamblers account for 80% of the money wagered in casinos. 40% of white collar crime (especially embezzlement and fraud) is rooted in gambling. Families, immediate social circles and colleagues in the workplace are gravely affected. The direct costs are enormous. One small town in Massachusetts (in the neighbourhood of a casino) had to increase its police budget by $400,000 per year. Think what the costs are for big cities with casinos in them!!!

Small countries are advised to think well before it commits itself to a casino.

Establishing a casino is as much a gamble as playing in one.

Cellular Telephony

The government of Yugoslavia, usually strapped for cash, has agreed to purchase 29 percent of Telekom Srbija, of which it already owns 51 percent. It will pay the seller, Italia International, close to $200 million. The Greek telecom, OTE, owns the rest.

On Friday, the Serb privatization minister, Aleksandar Vlahovic, continued to spar in public with a Milosevic-era oligarch, Blagoljub Karic, over his share of Mobtel, Serbia's largest cellular phone operator. The company, announced the minister, will be privatized by tender and Karic's share will be diluted to 30 percent.

Such clashes signal rich pickings.

The mobile phone market is booming throughout central and eastern Europe. According to Baskerville's Global Mobile industry newsletter, annual subscriber growth in countries as rich as Russia and as impoverished as Albania exceeds 100 percent. Belarus is off the charts with 232 percent. Macedonia (82 percent), Ukraine (79 percent), Moldova (86 percent), Lithuania (84 percent) and Bulgaria (79 percent) are not far behind.

Growth rates are positively correlated with the level of penetration. More than four fifths of Slovenes and Czechs have access to a cellphone. Hence the lackadaisical annual increases of 14 and 37 percent respectively. But even these are impressive numbers by west European standards. Annual subscriber growth there is a meager 7 percent.

Penetration, in turn, is a function of the population's purchasing power and the state of the - often decrepit - fixed phone network. Thus, in Serbia, smarting from a decade of war and destitution, both the penetration and the growth rates are dismal, at c. 20 percent.

Russia alone accounts for one of every five subscribers in the region and one third of the overall market growth. According to the Jason & Partners consultancy, the number of mobile phone subscribers in Russia has more than doubled in 2002 to 17.8 million users. AC&M, another telecommunications consulting outfit, pegs the growth at 117-124 percent.

Mobile TeleSystems (MTS) services one third of all users, Vimpelcom more than one quarter and MegaFon about one sixth. But there is a host of much smaller companies nibbling at their heels. Advanced cellular networks - such as under the 2.5G protocol - are expected to take off.

Usage in Russia is still largely confined to metropolitan areas. While the country-wide penetration is c. 12 percent (more than double the 2001 figure) - Moscow's is an impressive 48 percent. St. Petersburg, Russia's second most important metropolis, is not far behind with 33 percent.

Still, as urban markets mature, the regions and provinces represent untapped opportunities. Vimpelcom, backed by Norway's Telenor, paid last month $26.5 million for Vostok-Zapad Telecom, a company whose sole assets are licenses covering the Urals. This was the operator's third such purchase this year. Earlier, it purchased Extel which covers the Baltic exclave of Kaliningrad and Orensot, another Urals licensee.

Vimpelcom is up against Uralsvyazinform, a Perm-based fixed-line and mobile-phone telecommunications operator in the Urals Federal District. According to Radio Free Europe/Radio Liberty and Prime-TASS, the former has increased its capacity last year by some 265,000 cellular-phone numbers.

But Vimpelcom is undeterred. According to Gazeta.ru, it has announced its expansion to Siberia (Karsnoyarski Krai) to compete head on with two indigenous incumbents, EniseiTelecom and SibChallenge. Vimpelcom's competitors are pursuing a similar strategy: MTS has recently purchased Kuban GSM, the country's fourth largest operator, mainly in its south.

Local initiatives have emerged where cellular phone services failed to transpire. RIA-Novosti recounted how 11 pensioners, the residents of a village in Novgorod Oblast have teamed up to invest in a community mobile phone to be kept by the medic. The fixed line network extended only to the nearest village.

The industry is bound to consolidate as new technologies, developing user expectations and exiting foreign investors - mainly Scandinavian, American and German telecoms - increase the pressure on profit margins. One of the major problems is collecting on consumer credit.

Vedomosti, the Russian business weekly, reported that Vimpelcom was forced to write off $16 million in non-performing credit last year. Close to 2 percent of its clients are more than 60 days in arrears. Vremya Novosti, another Russian paper, puts the accounts receivable at 15 percent of revenues in Vimpelcom, though only 5 percent at MTS.

The cellular phone market throughout central and eastern Europe is at least as exciting as it is in Russia.

As of Jan 1, Romania's fixed line telecommunications system, Romtelecom, majority owned by the Greek OTE, has lost its monopoly status. In the wake of this long awaited liberalization, more than 700 applications for operating licences have been filed with the Romanian authorities, many of them for both fixed and mobile numbers. Fixed line density is so low, mobile penetration, at 20 percent, so dismal, prices so inflated and service so inefficient - that new operators are bound to make a killing on their investment.

Past liberalizations in central European markets - Poland, the Czech Republic and Hungary - have not been auspicious. Prices rose, the erstwhile monopoly largely retained its position and competition remained muted. But Romania is different. Its liberalization is neither partial, nor hesitant. The process is not encumbered by red tape and political obstruction. Even so, mobile phones are likely to be the big winners as the fixed line infrastructure recovers glacially from decades of neglect.

Bulgaria's GSM operator, MobiTel is on the block, though a deal concluded with an Austrian consortium last year fell through. It is considering an initial public offering next year. Another GSM licensee, GloBul, attracted 330,000 subscribers in its first year of operation and covers 65 percent of the population. The country's first cellphone company, Mobikom, intends to branch into GSM and CDMA, following a recent reallocation of national radio frequencies.

Macedonia's second mobile operator, MTS, owned by the Greek OTE, was involved last year in bitter haggling with Mobimak (owned by Makedonski Telekom), the only incumbent, over its inter-connection price. The telecommunications administration threatened to cut off Mobimak but, finding itself on murky legal ground, refrained from doing so.

The British cellular phone company, Vodafone, has expressed interest in the past in Promonte, Montenegro's mobile outfit.

Mobile phone companies are going multinational. Russia's MTS owns a - much disputed - second license in Belarus. It has pledged, last November, to plough $60 million into a brand new network. MTS also acquired a majority stake in Ukrainian Mobile Communications (UMC), the country's second largest operator. The Russian behemoth is eyeing Bulgaria and Moldova as well.

Wireless telephony is a prime example of technological leapfrogging. Faced with crumbling fixed line networks, years on waiting lists, frequent interruptions of service and a venal bureaucracy, subscribers opt to go cellular. Last year, the aggregate duration of mobile phone calls in Croatia leapt by 50 percent. It nudged up by a mere 0.5 percent on wired lines.

New services, such as short messages (SMS) and textual information pages are booming. Romania's operator, Orange, has launched multimedia messaging. Macedonia introduced WAP, a protocol allowing cellphones to receive electronic data including e-mail messages and Web pages. The revenues from such value added offerings will shortly outweigh voice communications in the west. The east is attentive to such lessons.

Central Banks, Role in Crises of

I. The Credit Crunch of 2007-2009

The global credit crunch induced by the subprime mortgage crisis in the United States, in the second half of 2007, engendered a tectonic and paradigmatic shift in the way central banks perceive themselves and their role in the banking and financial systems.

On December 12, 2007, America's Federal Reserve, the Bank of England, the European Central Bank (ECB), the Bank of Canada and the Swiss National Bank, as well as Japan's and Sweden's central banks joined forces in a plan to ease the worldwide liquidity squeeze.

This collusion was a direct reaction to the fact that more conventional instruments have failed. Despite soaring spreads between the federal funds rate and the LIBOR (charged in interbank lending), banks barely touched money provided via the Fed's discount window. Repeated and steep cuts in interest rates and the establishment of reciprocal currency-swap lines fared no better.

The Fed then proceeded to establish a "Term Auction Facility (TAF)", doling out one-month loans to eligible banks. The Bank of England multiplied fivefold its regular term auctions for three months maturities. On December 18, the ECB lent 350 million euros to 390 banks at below market rates.

In March 2008, the Fed lent 29 billion USD to JP Morgan Chase to purchase the ailing broker-dealer Bear Stearns and hundreds of billions of dollars to investment banks through its discount window, hitherto reserved for commercial banks. The Fed agreed to accept as collateral securities tied to "prime" mortgages (by then in as much trouble as their subprime brethren).

The Fed doled the funds out through anonymous auctions, allowing borrowers to avoid the stigma attached to accepting money from a lender of last resort. Interest rates for most lines of credit, though, were set by the markets in (sometimes anonymous) auctions, rather than directly by the central banks, thus removing the central banks' ability to penalize financial institutions whose lax credit policies were, to use a mild understatement, negligent.

Moreover, central banks broadened their range of acceptable collateral to include prime mortgages and commercial paper. This shift completed their transformation from lenders of last resort. Central banks now became the equivalents of financial marketplaces, and akin to many retail banks. Fighting inflation - their erstwhile raison d'etre - has been relegated to the back burner in the face of looming risks of recession and protectionism. In September 2008, the Fed even borrowed money from the Treasury when its own resources were depleted.

As The Economist neatly summed it up (in an article titled "A dirty job, but Someone has to do it", dated December 13, 2007):

"(C)entral banks will now be more intricately involved in the unwinding of the credit mess. Since more banks have access to the liquidity auction, the central banks are implicitly subsidising weaker banks relative to stronger ones. By broadening the range of acceptable collateral, the central banks are taking more risks onto their balance sheets."

Regulatory upheaval is sure to follow. Investment banks are likely to be subjected to the same strictures, reserve requirements, and prohibitions that have applied to commercial banks since 1934. Supervisory agencies and functions will be consolidated and streamlined.

Ultimately, the state is the mother of all insurers, the master policy, the supreme underwriter. When markets fail, insurance firm recoil, and financial instruments disappoint - the government is called in to pick up the pieces, restore trust and order and, hopefully, retreat more gracefully than it was forced to enter.

The state would, therefore, do well to regulate all financial instruments: deposits, derivatives, contracts, loans, mortgages, and all other deeds that are exchanged or traded, whether publicly (in an exchange) or privately. Trading in a new financial instrument should be allowed only after it was submitted for review to the appropriate regulatory authority; a specific risk model was constructed; and reserve requirements were established and applied to all the players in the financial services industry, whether they are banks or other types of intermediaries.

II. Central Banks

Central banks are relatively new inventions. An American President (Andrew Jackson) even dispensed with his country's central bank in the nineteenth century because he did not think that it was very important. But things have changed since. Central banks today are the most important feature of the financial systems of the majority of countries.

Central banks are bizarre hybrids. Some of their functions are identical to those of regular, commercial banks. Other tasks are unique to the central bank. On certain functions it has an absolute legal monopoly.

Central banks take deposits from other banks and, in certain cases, from foreign governments which deposit their foreign exchange and gold reserves for safekeeping (for instance, with the Federal Reserve Bank of the USA).

The Central Bank invests the foreign exchange reserves of its country while trying to maintain an investment portfolio similar to the trade composition of its client: the state.

The Central bank also holds onto the gold reserves of the country. Most central banks have until recently tried to get rid of their gold, due to its ever declining prices. Since the gold is registered in their books in historical values, central banks have shown a handsome profit on this sideline of activity.

Central banks (especially the US Fed) also participate in important, international negotiations. If they do not do so directly, they exert influence behind the scenes. The German Bundesbank virtually dictated Germany's position in the give-and-take leading to the Maastricht treaty. It forced the hands of its co-signatories to agree to strict terms of accession into the euro single currency project. The Bundesbank demanded that a country's economy be totally stable (possessed of low debt ratios and low inflation) before it is accepted into the eurozone. It is an irony of history that Germany itself is no longer eligible under these criteria and would not have been accepted as a member in the very club whose rules it had assisted to formulate.

But all these constitute a secondary and marginal plank of a central banks activities.

The main function of a modern central bank is the monitoring and regulation of interest rates in the economy. The central bank does this by changing the interest rates that it charges on money that it lends to the banking system through its "discount windows".

Interest rates are supposed to influence the level of economic activity in the economy. This purported linkage has not been unequivocally substantiated by economic research. Also, there usually is a delay between the alteration of interest rates and the foreseen impact on the economy as "transmission mechanisms" set into gear.

This makes an assessment of interest rate policies difficult. Still, central banks use interest rates to fine tune the economy. Higher interest rates lead to lower economic activity and lower inflation. The reverse is also supposed to be true. Even shifts of a quarter of a percentage point are sufficient to send stock exchanges tumbling together with bond markets.

In 1994, a long term trend of increase in interest rates commenced in the USA, doubling them from 3 to 6 percent. Investors in the bond markets lost 1 trillion (that's 1000 billion!) US dollars within twelve months. Even today, currency traders all around the world dread the decisions of the Federal Reserve ("Fed") or the European Central Bank (ECB) and sit with their eyes glued to their trading screens on days in which announcements are expected.

Tinkering with interest rates is only the latest in a series of fads of macroeconomic management. Prior to this - and under the influence of the Chicago school of economics - central banks used to monitor and manipulate money supply aggregates. Simply put, they would sell bonds to the public (and, thus absorb liquidity), or buy them from the public (and, thus, inject liquidity). Additionally, they would restrict the amount of printed money and limit the government's ability to borrow.

Prior to the money supply craze, and for decades, there was a widespread belief in the effectiveness of manipulating exchange rates. This was especially true where exchange controls were still being implemented and currencies were not fully convertible. Britain removed its exchange controls only as late as 1979. The US dollar was pegged to a (gold) standard (and, thus not really freely convertible) as well into 1971. Free flows of currencies are a relatively new thing and their long absence reflects this deeply and widely held superstition of central banks.

Nowadays, exchange rates are considered to be a "soft" monetary instrument and are rarely used by central banks. The latter continue, though, to intervene in the trading of currencies in the international and domestic markets usually to no avail and while losing their credibility in the process. Ever since the ignominious failure in implementing the infamous Louver accord in 1985, currency intervention is considered to be a somewhat rusty relic of the old ways of thinking.

Central banks are heavily enmeshed in the very fabric of the commercial banking system. They perform certain indispensable services for the latter. In most countries, interbank payments pass through the central bank or through a clearing organ which is somehow linked or reports to the central bank. All major foreign exchange transactions are funneled through - and, in many countries, still must be approved by - the central bank. Central banks regulate banks, licence their owners, supervise their operations, and keenly monitor their liquidity. The central bank is the lender of last resort in cases of banking insolvency or illiquidity (aka a "run on the banks").

The frequent claims of central banks all over the world that they were surprised by this or that a banking crisis look, therefore, dubious at best. No central bank can say, with a straight face, that it was unaware of early warning flags, or that it possessed no access to all the data. Impending banking crises give out signals long before they erupt. These precursors ought to be detected by a reasonably managed central bank. Only major neglect could explain why a central bank is caught unprepared.

One sure sign is the number of times that a certain bank chooses to borrow from the central bank's discount windows. Another is if it offers interest rates which are way above the rates proffered by other financing institutions. There are many more tocsins and central banks should be adept at reading them.

This heavy involvement of central banks in the banking system is not limited to the collection and analysis of data. A central bank, by the very definition of its functions, sets the tone to all other banks in the economy. By altering its policies (for instance: by changing its reserve requirements), it can push banks into insolvency or create asset bubbles which are bound to burst.

If it were not for the easy and cheap money provided by the Bank of Japan in the eighties, the stock and real estate markets would not have inflated to the extent that they have. Subsequently, it was the same bank (under a different Governor) that tightened the reins of credit and pierced both bubble markets. The same mistake was repeated in 1992-3 in Israel - and with the same consequences. The pattern recurred in the USA with the Fed during the late 1990s and early 2000s.

This precisely is why central banks, in my view, should not supervise the banking system. When asked to supervise the banking system, central banks are really expected to criticize their own past performance, their policies, and their vigilance.

In most countries in the world, bank supervision is a heavy-weight department within the central bank. It samples the balance sheets and practices of banks periodically: it analyses their books thoroughly and imposes rules of conduct and sanctions where necessary.

Yet, the role of central banks in determining the health, behaviour and methods of operation of commercial banks is so paramount that it is highly undesirable for a central bank to supervise them. To reiterate, bank supervision carried out by a central bank means that the central bank has to criticize itself, its own policies and the way that they were enforced as well as objectively review the results of past supervision. Central banks are thus asked to cast themselves in the impossible role of self-sacrificial and impartial saints.

A new trend is to put the supervision of banks under a different "sponsor" and to construct a system of checks and balances, wherein the central bank, its policies and operations are indirectly criticized and reviewed by the supervision of banks. This is the case in Switzerland where the banking system is extremely well regulated and well supervised.

There are two types of central bank: the autonomous and the semi-autonomous.

The autonomous central bank is politically and financially independent. Its Governor is appointed for a period of time which is incommensurate with the terms in office of incumbent elected politicians, so that he is not subject to political pressures. The autonomous central bank's budget is not provided by the legislature or by the executive arm. It is self sustaining: it runs itself as a corporation would. Its profits are used in leaner years in which it loses money.

Prime examples of autonomous central banks are Germany's Bundesbank and the American Federal Reserve Bank.

The second type of central bank is the semi autonomous one. This is a central bank that depends on political parties and, especially, on the Ministry of Finance. Its budget is allocated to it by the Ministry or by the legislature.

The upper echelons of such a bank - the Governor and the Vice Governor - can be impeached by politicians. This is the case with the National (People's) Bank of Macedonia which has to report to Parliament. Such dependent banks fulfill the function of an economic advisor to the government. The Governor of the Bank of England advises the Chancellor of the Exchequer (in their famous weekly meetings, the minutes of which are published) about the desirable level of interest rates. The situation is somewhat better with the Bank of Israel which can play around with interest rates and foreign exchange rates - but is still not entirely freely.

III. The Case of Macedonia 1991-2006

The National Bank of Macedonia (NBM) is highly autonomous under the law regulating its structure and its activities. Its Governor is selected for a period of seven years and can be removed from office only when he is charged with criminal deeds. Still, it is very much subject to political interference. High ranking political figures freely admit to exerting pressures on the central bank (even as they insist that it is completely independent).

In Macedonia, until recently, when a new Law of the Central Bank was enacted, annual surpluses generated by the central bank were transferred to the national budget and could not be utilized by the bank for its own operations or for the staff training and re-skilling.

The NBM is young and most of its staff, though bright, are inexperienced. With the kind of wages that it pays it cannot attract the best available talents. The budgetary surpluses that it generates could have been used for this purpose and to hire world renowned consultants (from Switzerland, for instance) to help the bank overcome the experience gap.

So, in the past the bank had to do with charity received from USAID, the KNOW-HOW FUND and so on. Some of the help thus provided was good and relevant - other advice was, in my view, wrong for the local circumstances. Take bank supervision: it was modeled after the American and British experiences, whose bank supervisors are arguably the worst in the West (if we ignore the Japanese).

The bank also had to cope with extraordinarily difficult circumstances since its very inception. The 1993 banking crisis, the frozen currency accounts, the collapse of the savings houses (culminating in the TAT affair). Older, more experienced central banks would have folded under the pressure. Taking everything under consideration, the NBM has performed remarkably well.

The proof is in the stability of the local currency, the denar. Currency stability is widely thought to be the main function of a central bank. After the TAT affair, there was a moment or two of panic and then the street voted confidence in the management of the central bank, the denar-deutschmark rate reverted to where it was prior to the crisis.

Still, bank supervision needs to be overhauled and lessons need to be learnt. The political independence of the bank needs to be enhanced. The bank must decide what to do with TAT and with the other failing institutions. The issue of who can own banks is high on the agenda with the liquidation of Makedonska Banka, forced on it by the central bank in 2007.

Failing banks can be sold to other banks as portfolios of assets and liabilities. The Bank of England sold Barings Bank in 1995 to the ING Dutch Bank.

The central bank could - and has to - force the owners of failing financial institutions to increase their equity capital (by ploughing in their personal property, where necessary). This was successfully done (again, by the Bank of England) in the 1991 case of the BCCI scandal.

The State of Macedonia could decide to take over the obligations of the failed system and somehow pay back the depositors. Israel (1983), the USA (1985/7) and a dozen other countries have done so recently.

The central bank could increase the reserve requirements and the deposit insurance premiums.

But these are all artificial, ad hoc, solutions. Something more radical needs to be done:

A total restructuring of the banking system. Savings houses have to be abolished. The capital required to open a bank or a branch of a bank has to be lowered (to conform with world standards and with the size of the economy of Macedonia). Banks should be allowed to diversify their activities (as long as they are of a financial nature), to form joint venture with other providers of financial services (such as insurance companies), and to open a thick network of branches.

And bank supervision must be separated from the central bank, so that it could criticize the central bank and its policies, decisions and operations on a regular basis.

There are no reasons why Macedonia should not become a financial centre of the Balkans and there are many reasons why it should. But, ultimately, it all depends on the Macedonians themselves.

Central Europe, Economies of

Invited by a grateful United States, the Czech Republic on Saturday sent a representative to meet with Iraqi opposition in Kurdish north Iraq. The country was one of the eight signatories on a letter, co-signed by Britain, Italy, Spain and the two other European Union central European candidate-members, Poland and Hungary, in support of US policy in the Gulf.

According to The Observer and the New York Times, American troops in Germany - and the billions of dollars in goods and services they consume locally - will be moved further east to the Czech Republic, Poland and the Baltic states. This shift may have come regardless of the German "betrayal". The Pentagon has long been contemplating the futility of stationing tens of thousands of soldiers in the world's most peaceful and pacifistic country.

The letter is a slap in the face of Germany, a member of the "Axis of Peace", together with France and Belgium and the champion of EU enlargement to the east. Its own economic difficulties aside, Germany is the region's largest foreign investor and trading partner. Why the curious rebuff by its ostensible protégés?

The Czech Republic encapsulates many of the economic and political trends in the erstwhile communist swathe of Europe.

The country's economic performance still appears impressive. Figures released yesterday reveal a surge of 6.6 percent in industrial production, to yield an annual increase of 4.8 percent. Retail sales, though way below expectations, were still up 2.7 percent last year. The Czech National Bank (CNB) upgraded its gross domestic product growth forecast on Jan 30 to 2.2-3.5 percent.

But the country is in the throes of a deflationary cycle. The producer price index was down 0.8 percent last year. Year on year, it decreased by 0.4 percent in January. Export prices are down 6.7 percent, though import prices fell by even more thus improving the country's terms of trade.

The Czech koruna is unhealthily overvalued against the euro thus jeopardizing any export-led recovery. The CNB was forced to intervene in the foreign exchange market and buy in excess of 2 billion euros last year - four times the amount it did in 2001. It also cut its interest rates last month to their nadir since independence. This did little to dent the country's burgeoning current account deficit, now at over 5 percent of GDP.

Unemployment in January broke through the psychologically crucial barrier of 10 percent of the workforce. More than 540,000 bread earners (in a country of 10 million inhabitants) are out of a job. In some regions every fifth laborer is laid off. There are more than 13 - and in the worst hit parts, more than 100 - applicants per every position open.

Additionally, the country is bracing itself for another bout of floods, more devastating than last year's and the ones in 1997. Each of the previous inundations caused in excess of $2 billion in damages. The government's budget is already strained to a breaking point with a projected deficit of 6.3 percent this year, stabilizing at between 4 and 6.6 percent in 2006. The situation hasn't been this dire since the toppling of communism in the Velvet Revolution of 1989.

Ironically, these bad tidings are mostly the inevitable outcomes of much delayed reforms, notably privatization. Four fifths of the country's economy is alleged to be in private hands - a rate similar to the free markets of Estonia, Slovakia and Hungary. In reality, though, the state still maintains intrusive involvement in many industrial assets. It is the reluctant unwinding of these holdings that leads to mass layoffs.

Yet, the long term outlook is indisputably bright.

The ministry of finance forecasts a rise in the country's GDP from 59 percent to 70 percent of the European Union's output in 2005 - comparable to Slovenia and far above Poland with a mere 40 percent. The Czech Republic is preparing itself to join the eurozone shortly after it becomes a member of the EU in May 2004.

Foreign investors are gung ho. The country is now the prime investment destination among the countries in transition. In a typical daily occurrence, bucking a global trend, Matsushita intends to expand its television factory in Plzen. Its investment of $8 million will enhance the plant's payroll by one tenth to 1900 workers. Siemens - a German multinational - is ploughing $50 million into its Czech unit. Siemens Elektromotory's 3000 employees export $130 million worth of electrical engines annually.

None of this would have been possible without Germany's vote of confidence and overwhelming economic presence in the Czech Republic. The deteriorating fortunes of the Czech economy are, indeed, intimately linked to the economic stagnation of its northern neighbor, as many an economist bemoan. But this only serves to prove that the former's recovery is dependent on the latter's resurrection.

Either way, to have so overtly and blatantly abandoned Germany in its time of need would surely prove to be a costly miscalculation. The Czechs - like other central and east European countries - mistook a transatlantic tiff for a geopolitical divorce and tried to implausibly capitalize on the yawning rift that opened between the erstwhile allies.

Yet, Germany is one of the largest trading partners of the United States. American firms sell $24 billion worth of goods annually there - compared to $600 million in Poland. Germany's economy is five to six times the aggregated output of the EU's central European new members plus Slovakia.

According to the New York Times, there are 1800 American firms on German soil, with combined sales of $583 billion and a workforce of 800,000 people. Due to its collapsing competitiveness and rigid labor laws, Germany's multinationals relocate many of their operations to central and east Europe, Asia and north and Latin America. Even with its current malaise, Germany invested in 2001 $43 billion abroad and attracted $32 billion in fresh foreign capital.

Indeed, supporting the United States was seen by the smaller countries of the EU as a neat way to counterbalance Germany's worrisome economic might and France's often self-delusional aspirations at helmsmanship. A string of unilateral dictates by the French-German duo to the rest of the EU - regarding farm subsidies and Europe's constitution, for instance - made EU veterans and newcomers alike edgy. Hence the deliberate public snub.

Still, grandstanding apart, the nations of central Europe know how ill-informed are recent claims in various American media that their region is bound to become the new European locomotive in lieu of an aging and self preoccupied Germany. The harsh truth is that there is no central European economy without Germany. And, at this stage, there is no east European economy, period.

Consider central Europe's most advanced post-communist economy.

One third of Hungary's GDP, one half of its industrial production, three quarters of industrial sales and nine tenths of its exports are generated by multinationals. Three quarters of the industrial sector is foreign-owned. One third of all foreign direct investment is German. France is the third largest investor. The situation is not much different in the Czech Republic where the overseas sales of the German-owned Skoda alone account for one tenth the country's exports.

The relationship between Germany and central Europe is mercantilistic. Germany leverages the region's cheap labor and abundant raw materials to manufacture and export its finished products. Central Europe conforms, therefore, to the definition of a colony and an economic hinterland. From a low base, growth there - driven by frenzied consumerism - is bound to outstrip the northern giant's for a long time to come. But Germans stands to benefit from such prosperity no less than the indigenous population.

Aware of this encroaching "economic imperialism", privatization deals with German firms are being voted down throughout the region. In November, the sale of a majority stake in Cesky Telecom to a consortium led by Deutsche Bank collapsed. In Poland, a plan to sell Stoen, Warsaw's power utility, to Germany's RWE was scrapped.

But these are temporary - and often reversible - setbacks. Germany and its colonies share other interests. As The Economist noted correctly recently:

"The Poles may differ with the French over security but they will be with them in the battle to preserve farm subsidies. The Czechs and Hungarians are less wary of military force than the Germans but sympathize with their approach to the EU's constitutional reform. In truth, there are no more fixed and reliable alliances in the EU. Countries will team up with each other, depending on issue and circumstances."

Thus, the partners, Germany and central Europe, scarred and embittered, will survive the one's haughty conduct and the other's backstabbing. That the countries of Europe currently react with accommodation to what, only six decades ago, would have triggered war among them, may be the greatest achievement of the Euro-Atlantic enterprise.

CFO (Chief Finance or Financial Officer)

Sometimes, I harbour a suspicion that Dante was a Financial Director. His famous work, "The Inferno", is an accurate description of the job.

The CFO (Chief Financial Officer) is fervently hated by the workers. He is thoroughly despised by other managers, mostly for scrutinizing their expense accounts. He is dreaded by the owners of the firm because his powers that often outweigh theirs. Shareholders hold him responsible in annual meetings. When the financial results are good – they are attributed to the talented Chief Executive Officer (CEO). When they are bad – the Financial Director gets blamed for not enforcing budgetary discipline. It is a no-win, thankless job. Very few make it to the top. Others retire, eroded and embittered.

The job of the Financial Director is composed of 10 elements. Here is a universal job description which is common throughout the West.

Organizational Affiliation

The Chief Financial Officeris subordinated to the Chief Executive Officer, answers to him and regularly reports to him.

The CFO is in charge of:

1. The Finance Director;
2. The Financing Department;
3. The Accounting Department which answers to him and regularly reports to him.

Despite the above said, the CFO can report directly to the Board of Directors through the person of the Chairman of the Board of Directors or by direct summons from the Board of Directors.

In many developing countries this would be considered treason – but, in the West every function holder in the company can – and regularly is – summoned by the (active) Board. A grilling session then ensues: debriefing the officer and trying to spot contradictions between his testimony and others'. The structure of business firms in the USA reflects its political structure. The Board of Directors resembles Congress, the Management is the Executive (President and Administration), the shareholders are the people. The usual checks and balances are applied: the authorities are supposedly separated and the Board criticizes the Management.

The same procedures are applied: the Board can summon a worker to testify – the same way that the Senate holds hearings and cross-questions workers in the administration. Lately, however, the delineation became fuzzier with managers serving on the Board or, worse, colluding with it. Ironically, Europe, where such incestuous practices were common hitherto – is reforming itself with zeal (especially Britain and Germany).

Developing countries are still after the cosy, outdated European model. Boards of Directors are rubber stamps, devoid of any will to exercise their powers. They are staffed with cronies and friends and family members of the senior management and they do and decide what the General Managers tell them to do and to decide. General Managers – unchecked – get nvolved in colossal blunders (not to mention worse). The concept of corporate governance is alien to most firms in developing countries and companies are regarded by most general managers as milking cows – fast paths to personal enrichment.

Functions of the Chief Financial Officer (CFO):

(1) To regulate, supervise and implement a timely, full and accurate set of accounting books of the firm reflecting all its activities in a manner commensurate with the relevant legislation and regulation in the territories of operation of the firm and subject to internal guidelines set from time to time by the Board of Directors of the firm.

This is somewhat difficult in developing countries. The books do not reflect reality because they are "tax driven" (i.e., intended to cheat the tax authorities out of tax revenues). Two sets of books are maintained: the real one which incorporates all the income – and another one which is presented to the tax authorities. This gives the CFO an inordinate power. He is in a position to blackmail the management and the shareholders of the firm. He becomes the information junction of the firm, the only one who has access to the whole picture. If he is dishonest, he can easily enrich himself. But he cannot be honest: he has to constantly lie and he does so as a life long habit.

He (or she) develops a cognitive dissonance: I am honest with my superiors – I only lie to the state.

(2) To implement continuous financial audit and control systems to monitor the performance of the firm, its flow of funds, the adherence to the budget, the expenditures, the income, the cost of sales and other budgetary items.

In developing countries, this is often confused with central planning. Financial control does not mean the waste of precious management resources on verifying petty expenses. Nor does it mean a budget which goes to such details as how many tea bags will be consumed by whom and where. Managers in developing countries still feel that they are being supervised and followed, that they have quotas to complete, that they have to act as though they are busy (even if they are, in reality, most of the time, idle). So, they engage in the old time central planning and they do it through the budget. This is wrong.

A budget in a firm is no different than the budget of the state. It has exactly the same functions. It is a statement of policy, a beacon showing the way to a more profitable future. It sets the strategic (and not the tactical) goals of the firm: new products to develop, new markets to penetrate, new management techniques to implement, possible collaborations, identification of the competition, of the relative competitive advantages. Above all, a budget must allocate the scarce resources of the firm in order to obtain a maximum impact (=efficiently). All this, unfortunately, is missing from budgets of firms in developing countries.

No less important are the control and audit mechanisms which go with the budget. Audit can be external but must be complemented internally. It is the job of the CFO to provide the management with a real time tool which informs them what is happening in the firm and where are the problematic, potential problem areas of activity and performance.

Additional functions of the CFO include:

(3) To timely, regularly and duly prepare and present to the Board of Directors financial statements and reports as required by all pertinent laws and regulations in the territories of the operations of the firm and as deemed necessary and demanded from time to time by the Board of Directors of the Firm.

The warning signs and barbed wire which separate the various organs of the Western firm (management from Board of Directors and both from the shareholders) – have yet to reach developing countries. As I said: the Board in these countries is full with the cronies of the management. In many companies, the General Manager uses the Board as a way to secure the loyalty of his cronies, friends and family members by paying them hefty fees for their participation (and presumed contribution) in the meetings of the Board. The poor CFO is loyal to the management – not to the firm. The firm is nothing but a vehicle for self enrichment and does not exist in the Western sense, as a separate functional entity which demands the undivided loyalty of its officers. A weak CFO is rendered a pawn in these get-rich-quick schemes – a stronger one becomes a partner. In both cases, he is forced to collaborate, from time to time, with stratagems which conflict with his conscience.

It is important to emphasize that not all the businesses in developing countries are like that. In some places the situation is much better and closer to the West. But geopolitical insecurity (what will be the future of developing countries in general and my country in particular), political insecurity (will my party remain in power), corporate insecurity (will my company continue to exist in this horrible economic situation) and personal insecurity (will I continue to be the General Manager) combine to breed short-sightedness, speculative streaks, a drive to get rich while the going is good (and thus rob the company) – and up to criminal tendencies.

(4) To comply with all reporting, accounting and audit requirements imposed by the capital markets or regulatory bodies of capital markets in which the securities of the firm are traded or are about to be traded or otherwise listed.

The absence of a functioning capital market in many developing countries and the inability of developing countries firms to access foreign capital markets – make the life of the CFO harder and easier at the same time. Harder – because there is nothing like a stock exchange listing to impose discipline, transparency and long-term, management-independent strategic thinking on a firm. Discipline and transparency require an enormous amount of investment by the financial structures of the firm: quarterly reports, audited annual financial statements, disclosure of important business developments, interaction with regulators (a tedious affair) – all fall within the remit of the CFO. Why, therefore, should he welcome it?

Because discipline and transparency make the life of a CFO easier in the long run. Just think how much easier it is to maintain one set of books instead of two or to avoid conflicts with tax authorities on the one hand and your management on the other.

(5) To prepare and present for the approval of the Board of Directors an annual budget, other budgets, financial plans, business plans, feasibility studies, investment memoranda and all other financial and business

documents as may be required from time to time by the Board of Directors of the firm.

The primal sin in developing countries was so called "privatization". The laws were flawed. To mix the functions of management, workers and ownership is detrimental to a firm, yet this is exactly the path that was chosen in numerous developing countries. Management takeovers and employee takeovers forced the new, impoverished, owners to rob the firm in order to pay for their shares. Thus, they were unable to infuse the firm with new capital, new expertise, or new management. Privatized companies are dying slowly.

One of the problems thus wrought was the total confusion regarding the organic structure of the firm. Boards were composed of friends and cronies of the management because the managers also owned the firm – but they could be easily fired by their own workers, who were also owners and so on. These incestuous relationships introduced an incredible amount of insecurity into management ranks (see previous point).

(6) To alert the Board of Directors and to warn it regarding any irregularity, lack of compliance, lack of adherence, lacunas and problems whether actual or potential concerning the financial systems, the financial operations, the financing plans, the accounting, the audits, the budgets and any other matter of a financial nature or which could or does have a financial implication.

The CFO is absolutely aligned and identified with the management. The Board is meaningless. The concept of ownership is meaningless because everyone owns everything and there are no identifiable owners (except in a few companies). Absurdly, Communism (the common ownership of means of production) has returned in full vengeance, though in disguise, precisely because of the ostensibly most capitalist act of all, privatization.

(7) To collaborate and coordinate the activities of outside suppliers of financial services hired or contracted by the firm, including accountants, auditors, financial consultants, underwriters and brokers, the banking system and other financial venues.

Many firms in developing countries (again, not all) are interested in collusion – not in consultancy. Having hired a consultant or the accountant – they believe that they own him. They are bitterly disappointed and enraged when they discover that an accountant has to comply with the rules of his trade or that a financial consultant protects his reputation by refusing to collaborate with shenanigans of the management.

(8) To maintain a working relationship and to develop additional relationships with banks, financial institutions and capital markets with the aim of securing the funds necessary for the operations of the firm, the attainment of its development plans and its investments.

One of the main functions of the CFO is to establish a personal relationship with the firm's bankers. The financial institutions which pass for banks in developing countries lend money on the basis of personal acquaintance more than on the basis of analysis or rational decision making. This "old boy network" substitutes for the orderly collection of data and credit rating of borrowers. This also allows for favouritism and corruption in the banking sector. A CFO who is unable to participate in these games is deemed by the management to be "weak", "ineffective" or "no-good". The lack of non-bank financing options and the general squeeze on liquidity make matters even worse for the finance manager. He must collaborate with the skewed practices and decision making processes of the banks – or perish.

(9) To fully computerize all the above activities in a combined hardware-software and communications system which integrates with the systems of other members of the group of companies.

(10) Otherwise, to initiate and engage in all manner of activities, whether financial or other, conducive to the financial health, the growth prospects and the fulfillment of investment plans of the firm to the best of his ability and with the appropriate dedication of the time and efforts required.

It is this, point 10, that occupies the working time of Western CFOs. it is their brain that is valued – not their connections or cunning.

Chechnya, Cost of War in

One hundred and eighteen hostages and 50 of their captors died in the heavy handed storming of the theatre occupied by Chechen terrorists in 2002. Then, two years later, hundreds of children and teachers were massacred together with their captors in a school in Beslan. This has been only the latest in a series of escalating costs in a war officially terminated in 1997. On August 22, 2002 alone a helicopter carrying 115 Russian servicemen and unauthorized civilians went down in flames.

The Russian military is stretched to its limits. Munitions and spare parts are in short supply. The defense industry shrunk violently following the implosion of the USSR. Restarting production of small-ticket items is prohibitively expensive. Even bigger weapon systems are antiquated. A committee appointed by the Duma, Russia's lower house of parliament, found that the average age of the army's helicopters is 20. Russia lost dozens of them hitherto and does not have the wherewithal to replace them.

The Russian command acknowledges 3000 fatalities and 8000 wounded but the numbers are probably way higher. The Committee of Soldiers' Mothers pegs the number of casualties at 12-13,000. Unpaid, disgruntled, and under-supplied troops exert pressure on their headquarters to air-strafe Chechnya, to withdraw, or to multiply the money budgeted to support the ill-fated operation.

Russia maintains c. 100,000 troops in Chechnya, including 40,000 active soldiers and 60,000 support and logistics personnel. The price tag is sizable though not unsustainable. As early as October 1999, the IMF told Radio Free Europe/Radio Liberty: "Yes, we're concerned that it could undermine the progress in improving (Russia's) public finances."

As they did in the first Chechen conflict in 1994-6, both the IMF and the World Bank reluctantly kept lending billions to Russia throughout the current round of devastation. A $4.5 billion arrangement was signed with Russia in July 1999. Though earmarked, funds are fungible. The IMF has been accused by senior economists, such as Jeffrey Sachs and Marshall Goldman, of financing the Russian war effort against the tiny republic and its 1.5 million destitute or internally displaced citizens. Even the staid Jane's World Armies concurred.

No one knows how much the war has cost Russia hitherto. It is mostly financed from off-budget clandestine bank accounts owned and managed by the Kremlin, the military, and the security services. Miriam Lanskoy, Program Manager at the Institute for the Study of Conflict, Ideology and Policy at Boston University, estimated for "NIS Observed" and "The Analyst" that Russia has spent, by November 2001, c. $8 billion on the war, money sorely needed to modernize its army and maintain its presence overseas.

Russia was forced to close, post haste, bases in Vietnam and Cuba, two erstwhile pillars of its geopolitical and geostrategic presence. It was too feeble to capitalize on its massive, multi-annual assistance to the Afghan Northern Alliance in both arms and manpower. The USA effortlessly reaped the fruits of this continuous Russian support and established a presence in central Asia which Russia will find impossible to dislodge.

The Christian Science Monitor has pegged the cost of each month in the first three months of offensive against the separatists at $500 million. This guesstimate is supported by the Russians but not by Digby Waller, an economist at the International Institute for Strategic Studies (IISS), a London-based military think tank. He put the real, out-of-pocket expense at $110 million a month. Other experts offer comparable figures - $100-150 a month.

Similarly, Jane's Defense Weekly put the outlay at $40-50 million a day - but most of it in cost-free munitions produced during Soviet times. A leading Soviet military analyst, Pavel Felgengauer, itemized the expenditures. The largest articles are transport, fuel, reconstruction of areas shattered by warfare, and active duty bonuses to soldiers.

The expense of this brawl exceed the previous scuffle's. The first Chechen war is estimated to have cost at most $5.5 billion and probably between $1.3 and $2.6 billion. Russia allocated c. $1 billion to the war in its 2000 budget. Another $263 million were funded partly by Russia's behemoth electricity utility, UES. Still, these figures are misleading underestimates. According too the Rosbalt News Agency, last year, for instance, Russia was slated to spend c. $516 million on rebuilding Chechnya - but only $158 million of these resources made it to the budget.

Russia has been lucky to enjoy a serendipitous confluence of an export-enhancing and import-depressing depreciated currency, tax-augmenting inflation, soaring oil prices, and Western largesse. It is also a major producer and exporter of weapons. Chechnya serves as testing grounds where proud designers and trigger-craving generals can demonstrate the advantages and capabilities of their latest materiel.

Some - like the Institute of Global Issues - say that the war in Chechnya has fully self-financed by reviving the military-industrial complex and adding billions to Russia's exports of armaments. This surely is a wild hyperbole. Chechnya - a potentially oil-rich territory - is razed to dust.

Russia is ensnared in an ever-escalating cycle of violence and futile retaliation. Its society is gradually militarized and desensitized to human rights abuses. Corruption is rampant. Russia's Accounting Board disclosed that a whopping 12 percent of the money earmarked to fight the war five years ago has vanished without a trace.

About $45 million dollars in salaries never reached their intended recipients - the soldiers in the field. Top brass set up oil drilling operations in the ravaged territory. They are said by Rosbalt and "The Economist" to be extracting up to 2000 tons daily - double the amount the state hauls.

Another 7000 tons go up in smoke due to incompetence and faulty equipment. There are 60 oil wells in Grozny alone. Hence the predilection to pursue the war as leisurely - and profitably - as possible. Often in cahoots with their ostensible oppressors, dispossessed and dislocated Chechens export crime and mayhem to Russia's main cities.

The war is a colossal misallocation of scarce economic resources and an opportunity squandered. Russia should have used the windfall to reinvent itself - revamp its dilapidated infrastructure and modernize its institutions. Oil prices are bound to come down one day and when they do Russia will discover the true and most malign cost of war - the opportunity cost.

Child Labor

From the comfort of their plush offices and five to six figure salaries, self-appointed NGO's often denounce child labor as their employees rush from one five star hotel to another, $3000 subnotebooks and PDA's in hand. The hairsplitting distinction made by the ILO between "child work" and "child labor" conveniently targets impoverished countries while letting its budget contributors - the developed ones - off-the-hook.

Reports regarding child labor surface periodically. Children crawling in mines, faces ashen, body deformed. The agile fingers of famished infants weaving soccer balls for their more privileged counterparts in the USA. Tiny figures huddled in sweatshops, toiling in unspeakable conditions. It is all heart-rending and it gave rise to a veritable not-so-cottage industry of activists, commentators, legal eagles, scholars, and opportunistically sympathetic politicians.

Ask the denizens of Thailand, sub-Saharan Africa, Brazil, or Morocco and they will tell you how they regard this altruistic hyperactivity - with suspicion and resentment. Underneath the compelling arguments lurks an agenda of trade protectionism, they wholeheartedly believe. Stringent - and expensive - labor and environmental provisions in international treaties may well be a ploy to fend off imports based on cheap labor and the competition they wreak on well-ensconced domestic industries and their political stooges.

This is especially galling since the sanctimonious West has amassed its wealth on the broken backs of slaves and kids. The 1900 census in the USA found that 18 percent of all children - almost two million in all - were gainfully employed. The Supreme Court ruled unconstitutional laws banning child labor as late as 1916. This decision was overturned only in 1941.

The GAO published a report last week in which it criticized the Labor Department for paying insufficient attention to working conditions in manufacturing and mining in the USA, where many children are still employed. The Bureau of Labor Statistics pegs the number of working children between the ages of 15-17 in the USA at 3.7 million. One in 16 of these worked in factories and construction. More than 600 teens died of work-related accidents in the last ten years.

Child labor - let alone child prostitution, child soldiers, and child slavery - are phenomena best avoided. But they cannot and should not be tackled in isolation. Nor should underage labor be subjected to blanket castigation. Working in the gold mines or fisheries of the Philippines is hardly comparable to waiting on tables in a Nigerian or, for that matter, American restaurant.

There are gradations and hues of child labor. That children should not be exposed to hazardous conditions, long working hours, used as means of payment, physically punished, or serve as sex slaves is commonly agreed. That they should not help their parents plant and harvest may be more debatable.

As Miriam Wasserman observes in "Eliminating Child Labor", published in the Federal Bank of Boston's "Regional Review", second quarter of 2000, it depends on "family income, education policy, production technologies, and cultural norms." About a quarter of children under-14 throughout the world are regular workers. This statistic masks vast disparities between regions like Africa (42 percent) and Latin America (17 percent).

In many impoverished locales, child labor is all that stands between the family unit and all-pervasive, life threatening, destitution. Child labor declines markedly as income per capita grows. To deprive these bread-earners of the opportunity to lift themselves and their families incrementally above malnutrition, disease, and famine - is an apex of immoral hypocrisy.

Quoted by "The Economist", a representative of the much decried Ecuador Banana Growers Association and Ecuador's Labor Minister, summed up the dilemma neatly: "Just because they are under age doesn't mean we should reject them, they have a right to survive. You can't just say they can't work, you have to provide alternatives."

Regrettably, the debate is so laden with emotions and self-serving arguments that the facts are often overlooked.

The outcry against soccer balls stitched by children in Pakistan led to the relocation of workshops ran by Nike and Reebok. Thousands lost their jobs, including countless women and 7000 of their progeny. The average family income - anyhow meager - fell by 20 percent. Economists Drusilla Brown, Alan Deardorif, and Robert Stern observe wryly:

"While Baden Sports can quite credibly claim that their soccer balls are not sewn by children, the relocation of their production facility undoubtedly did nothing for their former child workers and their families."

Such examples abound. Manufacturers - fearing legal reprisals and "reputation risks" (naming-and-shaming by overzealous NGO's) - engage in preemptive sacking. German garment workshops fired 50,000 children in

Bangladesh in 1993 in anticipation of the American never-legislated Child Labor Deterrence Act.

Quoted by Wasserstein, former Secretary of Labor, Robert Reich, notes:

"Stopping child labor without doing anything else could leave children worse off. If they are working out of necessity, as most are, stopping them could force them into prostitution or other employment with greater personal dangers. The most important thing is that they be in school and receive the education to help them leave poverty."

Contrary to hype, three quarters of all children work in agriculture and with their families. Less than 1 percent work in mining and another 2 percent in construction. Most of the rest work in retail outlets and services, including "personal services" - a euphemism for prostitution. UNICEF and the ILO are in the throes of establishing school networks for child laborers and providing their parents with alternative employment.

But this is a drop in the sea of neglect. Poor countries rarely proffer education on a regular basis to more than two thirds of their eligible school-age children. This is especially true in rural areas where child labor is a widespread blight. Education - especially for women - is considered an unaffordable luxury by many hard-pressed parents. In many cultures, work is still considered to be indispensable in shaping the child's morality and strength of character and in teaching him or her a trade.

"The Economist" elaborates:

"In Africa children are generally treated as mini-adults; from an early age every child will have tasks to perform in the home, such as sweeping or fetching water. It is also common to see children working in shops or on the streets. Poor families will often send a child to a richer relation as a housemaid or houseboy, in the hope that he will get an education."

A solution recently gaining steam is to provide families in poor countries with access to loans secured by the future earnings of their educated offspring. The idea - first proposed by Jean-Marie Baland of the University of Namur and James A. Robinson of the University of California at Berkeley - has now permeated the mainstream.

Even the World Bank has contributed a few studies, notably, in June, "Child Labor: The Role of Income Variability and Access to Credit Across Countries" authored by Rajeev Dehejia of the NBER and Roberta Gatti of the Bank's Development Research Group.

Abusive child labor is abhorrent and should be banned and eradicated. All other forms should be phased out gradually. Developing countries already produce millions of unemployable graduates a year - 100,000 in Morocco alone. Unemployment is rife and reaches, in certain countries - such as Macedonia - more than one third of the workforce. Children at work may be harshly treated by their supervisors but at least they are kept off the far more menacing streets. Some kids even end up with a skill and are rendered employable.

Common Agricultural Policy (CAP)

The June 2005 budget summit in Brussels foundered on the issue of farm support and subsidies which now consume directly 46.2% of the European Union's (EU) funds. Tony Blair refused to let go of Britain's infamous rebate (amounting to two thirds of its net contributions to the community's coffers) unless and until these handouts (which Britain's dilapidated agriculture does not enjoy) are slashed. This followed close on the hills of the rejection of the proposed EU constitution in French and the Dutch referenda in May-June 2005.

One of the undeniable benefits of the enlargement of the European Union (EU) accrues to its veteran members rather than to the acceding countries. The EU is forced to revamp its costly agricultural policies and attendant bloated bureaucracy. This, undoubtedly, will lead, albeit glacially, to the demise of Europe's farming sector as we know it.

Contrary to public misperceptions, Europe is far more open to trade than the United States. According to the United Nations (UN), the International Monetary Fund (IMF) and the Organization of Economic Cooperation and Development (OECD), its exports amount to 14 percent of gross domestic product (GDP) compared to America's 11.5 percent. It is also the world's second largest importer. In constant dollar terms, it is the world's largest trader.

A Trade Policy Review released in 2002 by the World Trade Organization (WTO) mentions two notable exceptions: farm products and textiles. Europe's average tariff on agricultural produce is four times those levied on non-agricultural goods. Yet, a number of trends conspire to break the eerie stranglehold of 3-4 percent of Europe's population - its farmers - on its budget and political process.

The introduction of the euro rendered prices transparent across borders and revealed to the European consumer how expensive his food is. Scares like the mishandled mad cow disease dented consumer confidence in both politicians and bureaucrats. But, most crucially, the integration of the countries of east and central Europe with their massive agricultural sectors makes the EU's Common Agricultural Policy (CAP) untenable.

The CAP guzzles close to half of the EU's $98 billion budget. Recent, controversial reforms, introduced by the European Commission, call for a gradual reduction and diversion of CAP outlays from directly subsidizing production to WTO-compatible investments in agricultural employment, regional development, environment and training and research. Unnoticed, support to farmers by both the EU and member governments has already declined from $120 billion in 1999 to $110 billion in 2000. This decrease has since continued unabated.

Still, the EU is unable to provide the new members with the same level of farm subsidies it doles out to the current 15 members. Close to one quarter of Poland's population is directly or indirectly involved in agriculture - ten times the European average. The agreement struck between Germany and France in September 2002 and adopted in a summit Brussels in October freezes CAP spending in its 2006 level until 2013.

This may further postpone the identical treatment much coveted by the applicants. Theoretically, subsidies for the farm sectors of the new members will increase and subsidies flowing to veteran members will decrease until they are equalized at around 80 percent of present levels throughout the EU by the end of the next budget period in 2013.

But, in reality, the entire CAP stands to be renegotiated in 2005-6. No one can guarantee the outcome of this process, especially when coupled with the Doha round of trade liberalization. The offers made now to the candidate countries are not only mean but also meaningless.

A tweak by Denmark, the president of the EU in the second half of 2002, to peg support for farmers in the new members at two fifths the going rate, won a cautious welcome by the then candidate countries. Some of this novel subventionary largesse will be deducted from a fund for rural development in the new members. Additionally, national governments will be allowed to top up inadequate EU dollops with governmental budget funds.

Even this parsimonious offer - still disputed by the majority of contemporary EU members - will cost the Union an extra $500 million a year. It also fails to tackle equally weighty wrangles about production quotas, EU protectionist "safeguard" measures, import tariffs imposed by the new members against heavily subsidized European farm products, reduced value added taxes on agricultural produce and referential periods and yields - the bases for calculating EU transfers.

It also ignores the distinct - and thorny - possibility that the new members will end up as net contributors to the budget.

Quoted by Radio Free Europe/Radio Liberty, Sandor Richter, a senior researcher with the Vienna Institute for International Economic Studies, concluded that the first intake of ten new members, concluded in May 2004, will end up underwriting at least $410 million of the EU's budget in the first year of membership alone. With the GDP per capita of most candidates at one fifth the EU's, this would be a perverse, socially unsettling and politically explosive outcome.

Aware of this, the European Commission denies any intention to actually accept cash from the New Europe. Their net contributions would remain theoretical, it pledges implausibly. Yet, as long as a country such as Poland is incapable of absorbing - disseminating and utilizing - more than 28 percent of the aid it is currently entitled to - veteran EU members rightly question its administrative ability to tackle much larger provisions - c. $20 billion in the first three years after accession.

The prolonged and irascible debate has taken its toll. In some new member countries, pro-EU sentiment is on the wane. Leszek Miller, then Poland's prime minister, told the PAP news agency in late 2002 that Poland should contribute to the EU less than it receives in agricultural subsidies. And what if not? "Nobody would be overly concerned if Poland did not enter the EU together with the first group of new members."

Hungary echoes this argument. Almost two thirds of respondents in surveys conducted by the EU in Estonia, Latvia, Slovenia and Lithuania are undecided about EU membership or opposed to it altogether. The situation in the Czech Republic is not much improved. Only Hungary stalwartly supports the EU's eastern tilt.

Opinion polls periodically conducted by GfK Hungaria, a market research group owned by GfK Germany, paint a more mixed picture. On the one hand, even in countries with a devout following of EU accession, such as Romania, support for integration has declined this year. Support in Hungary and Poland, on the other hand, picked up.

Yet, the EU can't seem to get its act together. According to the Danish paper, Berlingske Tidende, Danish prime minister in 2002, Anders Fogh Rasmussen, ruled out a "take it or leave it" ultimatum to the new members. There will be "real negotiations", he insisted. Not so, says Anders Fogh Rasmussen, the Danish president of the EU until Dec 31, 2002: "The room for maneuver in negotiations will be very limited ... We have a certain framework, and we stick to it."

Yet, disenchantment should not be exaggerated. Naturally, flood-affected farmers throughout the region - from the Czech Republic to Poland - are vigorously protesting their unequal treatment and the compromises their governments were arm-twisted into making. Still, according to a survey released in December 2001 by the European Commission, 60 percent of the denizens of the accession countries supported it.

As the endgame nears, the parties to the negotiations are posturing, though. EU enlargement commissioner, Gunter Verheugen, argued in November 2002 against equalizing support for Poland's 6 million farmers with the subsidies given to the EU's 8 million smallholders. In a typical feat of incongruity he said it will prevent them from modernizing and alienate other professions.

Franz Fischler, the Austrian EU's agriculture commissioner, hinted that miserly production quotas for cereals, meat and dairy products, offered by the EU to the new members, can be augmented. The EU presently provides the new members with funding, within the Special Accession Programme for Agriculture and Rural Development (SAPARD) to support farm investments, to boost processing and marketing of farm and fishery products and to bankroll infrastructure improvements. Hungarian farmers, for instance, are entitled to up to $38 million of SAPARD money annually.

In a thinly veiled threat, Fischler included this in a speech he made in an official visit to Estonia in late 2002:

"The EU enlargement countries should be pleased with the 25 per cent agriculture subsidies, as the member states have not agreed even on that yet, therefore this should be the first goal and only after that can further subsidies be discussed ... It would not be very wise to tell the EU member states that accession countries are not pleased, that would not be positive for the whole process."

Small wonder he was whistled down by irate Polish parliamentarians in an address to a joint session of the parliamentary committees for agriculture and European integration in the Sejm. Poland's fractured farm sector is notoriously inefficient. With one quarter of the labor force it produces less than 4 percent of GDP. But the peasants are well represented in the legislature and soaring unemployment - almost one fifth of all adults - makes every workplace count.

In the meantime, the ten new members of the EU have teamed up to present their case in Brussels. Their ministers of finance, foreign affairs and of agriculture, parliamentary deputies in their finance and farm committees - all issued and issue common statements, position papers, briefings and memoranda of understanding. But no one is inclined to take such ad-hoc alliances among the candidate countries seriously. The disparity between their farm sectors is such that it rules out a single voice.

Moreover, the EU is strained to the limit of its habitual consensus-driven decision making. The breakdown of the European mechanism of deliberation was brought into sharp relief by the way in which the future of the CAP was decided in a series of chats between the leaders of France and Germany in a hotel in Brussels in 2002 . Their deal was later rubber stamped, unaltered, in a summit of all EU members in October 2002.

The Union is in constitutional and institutional flux. Small and even medium sized members - such as the United Kingdom - are marginalized. As the EU bloated to 25 countries, a core of leadership failed to emerge. Germany, France, the UK, and Italy - the industrial locomotives of Europe - are at odds and (with the exception of the UK) sputtering.

Decision-making has been reduced to the Council of Ministers handing down blueprints to be fleshed out by the less significant states and by an increasingly sidelined

European Commission and a make-believe European Parliament. The constitution which was supposed to restore central authority and participatory democracy is dead in the water.

The countries of central and eastern Europe are and will, for a long time, be second class citizens, tolerated merely because they provide cheap, youthful, labor, raw materials and close-by markets for finished goods. The new members are strategically located between the old continent and booming Asia.

EU enlargement is a thinly disguised exercise in mercantilism tinged with the maudlin ideology of embracing revenant brothers long lost to communism. But beneath the veneer of civility and kultur lurk the cold calculations of realpolitik. The New Europe - the EU's hinterland - would do well to remember this.

According to a June 2005 OECD report, and contrary to popular, media-fostered impressions, farm subsidies are being phased out almost everywhere. Turkey is an exception. It spent in 2002-4 (wasted, more like it) more than 4% of its Gross Domestic Product (GDP) on aiding and abetting its inefficient agricultural sector (compared to 4.3% in 1986-8).

Other figures: Switzerland almost 2% (4%), Japan - 1.5% (2.2%), European Union - 1.2% (2.8%), Mexico - 1.2% (3%), USA - 0.9% (1.3%), Canada - 0.8% (1.8%), Australia - 0.3% (0.8%), Poland - 1.2% in 2001-3 (2.2% in 1991-3). On average, farm subsidies declined from 2.3% of GDP in 1986-8 to less than 1.2% of GDP in 2002-4.

Farm protection in OECD countries fell from 37% of farm receipts (1986-8) to 30% (2002-4) - still around $279 billion. This statistic masks yawning disparities between countries. In New Zealand and Australia, producer support amounts to less than 5% of farm receipts. It stands at 20% in North America and climbs to 34% in the EU and 60% in Japan.

Virtually all subsidies linked to production levels are being phased out everywhere, albeit glacially. Their distorting and pernicious effects on the allocation of scarce economic resources in the farm sector is widely recognized. They now comprise less than 75% of all compensation in the EU (compared to 90% in 1986-8) and 90% in Japan and Korea (compared to 100%). Compensation is now more commonly linked to acreage, number of cattle heads, and average historical prices.

Still, the farm lobby in rich countries is formidable. In the USA, for instance, Bill Clinton's 1996 farm bill which meant to gradually eliminate farm protections was all but reversed by George Bush's 2002 package of laws that nearly doubled agricultural subsidies.

The WTO has recently taken a more active role in fighting discriminatory practices. Brazil won cases against American cotton subventions and EU sugar protections. The EU reacted by announcing a cut of 39% in its average sugar subsidy.

Yet, nothing much has changed in the last three years (2002-5). It is instructive to study a speech given in January 2003 by Herve Gaymard, then French Minister for Agriculture, Food, Fisheries and Rural Affairs to the misnamed "Real Solutions for the Future" Oxford

Farming Conference. Gaymard drew the battle lines and made clear that the French resistance is alive and kicking - at least with regards to the European Commission's proposed reforms of the European Union's Common Agricultural Policy (CAP).

France - and six other EU countries - intend to stick religiously to a deal struck, tête-à-tête, between the French president and the German chancellor in 2002. The CAP - which now consumes close to half of the EU's budget - will not be revamped until 2013 at the earliest, though outlays will be frozen in real terms and, starting in 2006, gradually diverted from subsidizing production to environmental and other good causes ("decoupling" and "modulation" in EU jargon).

This upset the EU's ten new members, which joined it in May 2004. With spending capped, they are unlikely to enjoy the same pecuniary support bestowed on the veterans, even after 2013. As it is, their agricultural benefits are phased over ten years and face an uncertain future when the CAP is, inevitably and finally, scrapped.

Moreover, France's recalcitrance imperils the crucial Doha round of trade talks. Both the EU and the USA revealed their hands by March 2003. The USA called for a total elimination of all manner of farm subsidies. The EU fudged. The developing countries are already up in arms over promises made by the richer polities in the protracted Uruguay round and then promptly ignored by them.

Agriculture is arguably the poorer members' highest priority. They demand the opening of the rich world's markets, whittling down export and production subsidies and the abrogation of non-tariff trade barriers and practices, such as the profuse application of anti-dumping quotas and duties.

Gaymard proffered the usual woolly mantras of "farm products are more than marketable goods", "France, and Europe in general, need security of food supply", "food cannot be left to the mercy of market forces". Farmers, unlike industrialists - insisted the Minister counterfactually - cannot simply relocate and agrarian pursuits are a pillar of the nation's culture and its attachment to the land.

Yet, it cannot be denied that Gaymard advanced in his speech a few thought-provoking and oft-overlooked points.

He convincingly argued that farm products covered by EU subsidies are rarely in direct competition with the crops of the poor in Africa and Asia. The cotton, rice and groundnut oil subventions generously doled out to growers in the United States - the EU's most vocal critic - harm the third world smallholders and sharecroppers it purports to defend. The IMF - perceived in Europe as the long and heartless arm of the Americans - has dismantled the coffee regime and marketing structures causing irreparable damage to its indigent growers, Gaymard said.

The CAP, insists Gaymard, does not encourage environmental ills. The policy does not subsidize the husbandry of disease-prone poultry and pigs, nor does it support genetically modified crops. The CAP is also way cheaper than portrayed by its detractors. Food constitutes only 16 percent of the family budget - one third of its share when the CAP was instituted, four decades ago. The CAP amounts to a mere 1 percent of the combined public spending of all EU members. The comparable figure in America is 1.5 percent.

This last argument is, of course, spurious. It ignores the distorting effects of the CAP: exorbitant food prices in the EU, double payments by EU denizens, once as taxpayers and then as consumers, mountains of butter and rivers of milk produced solely for the sake of finagling subsidies out of an inert and bloated bureaucracy and deteriorating relationships with irate trade partners.

Gaymard is no less parsimonious with the full truth elsewhere in his counterattack.

He claims that the EU provides tariff-free and quota-free access to farm products from the world's 49 Highly Indebted Poor Countries (HIPCs). This is partly untrue and partly misleading. Important commodities - such as sugar, rice and bananas - are virtually excluded by long phase-in periods. Non-tariff and non-quota barriers abound. Macedonian lamb is regularly barred on sanitary grounds, for instance. Health, sanitary, standards-related and quality regulations render a lot of the supposed access theoretical.

Still, it is true that the EU's larger economies are more open to international trade than the United States. Gaymard flaunted a telling statistic: the EU absorbs well over two fifths of Brazil's farm exports. The USA - in geographical proximity to Brazil and a self-described ardent champion of free trade - takes in less than 15 percent.

The problem with farming in the developing world is its concentration on cash crops, whose prices are volatile.

This subverts traditional agriculture. Gaymard implied that the destitute would do well to introduce a CAP all their own and thus underwrite a thriving indigenous sector for internal consumption and more stable export revenues.

They can expect no help from the industrialized nations, he made crystal clear:

"(The rich countries) are not ready to eliminate their support for agriculture. They have not committed themselves to doing so in international forums and do not believe that, as far as they Are concerned, it would be to the developing countries' advantage. Therefore," - he concluded soberly - "let us stop dreaming." This was received with a standing ovation of the 500 conference delegates.

The conspiracy minded stipulate that France was actually merely seeking to strengthen its bargaining chips. Finally, they go, it will accept decoupling and modulation. But recent policy initiatives do not point this way. France all but renationalized its beef markets, proposed to continue dairy quotas till 2013, sought to index milk prices and defended the much-reviled current sugar regime.

These are bad news, indeed. Agriculture is a thorny issue within the EU no less than outside it. A recessionary Germany (and a more dynamic UK) have been bankrolling sated and affluent French and Spanish farmers for decades now. This has got to stop and will - whether amicably, or acrimoniously.

The new members - most of them from heavily agrarian central and east Europe - will demand equality sooner, or later. Poor nations will give up on the entire trade architecture so laboriously erected in the last 20 years - if they become convinced, as they should, that it is all prestidigitation and a rich boys' club. It is a precipice and France has just taken us all one step forward.

Common Investment Schemes

The credit and banking crisis of 2007-9 has cast in doubt the three pillars of modern common investment schemes. Mutual funds (known in the UK as "unit trusts"), hedge funds, and closed-end funds all rely on three assumptions:

Assumption number one

That risk inherent in assets such as stocks can be "diversified away". If one divides one's capital and invests it in a variety of financial instruments, sectors, and markets, the overall risk of one's portfolio of investments is lower than the risk of any single asset in said portfolio.

Yet, in the last decade, markets all over the world have moved in tandem. These highly-correlated ups and downs gave the lie to the belief that they were in the process of "decoupling" and could, therefore, be expected to fluctuate independently of each other. What the crisis has revealed is that contagion transmission vectors and mechanisms have actually become more potent as barriers to flows of money and information have been lowered.

Assumption number two

That investment "experts" can and do have an advantage in picking "winner" stocks over laymen, let alone over random choices. Market timing coupled with access to information and analysis were supposed to guarantee the superior performance of professionals. Yet, they didn't.

Few investment funds beat the relevant stock indices on a regular, consistent basis. The yields on "random walk" and stochastic (random) investment portfolios often surpass managed funds. Index or tracking funds (funds who automatically invest in the stocks that compose a stock market index) are at the top of the table, leaving "stars", "seers", "sages", and "gurus" in the dust.

This manifest market efficiency is often attributed to the ubiquity of capital pricing models. But, the fact that everybody uses the same software does not necessarily mean that everyone would make the same stock picks. Moreover, the CAPM and similar models are now being challenged by the discovery and incorporation of information asymmetries into the math. Nowadays, not all fund managers are using the same mathematical models.

A better explanation for the inability of investment experts to beat the overall performance of the market would perhaps be information overload. Recent studies have shown that performance tends to deteriorate in the presence of too much information.

Additionally, the failure of gatekeepers - from rating agencies to regulators - to force firms to provide reliable data on their activities and assets led to the ascendance of insider information as the only credible substitute. But, insider or privileged information proved to be as misleading as publicly disclosed data. Finally, the market acted more on noise than on signal. As we all know, noise it perfectly randomized. Expertise and professionalism mean nothing in a totally random market.

Assumption number three

That risk can be either diversified away or parceled out and sold. This proved to be untenable, mainly because the very nature of risk is still ill-understood: the samples used in various mathematical models were biased as they relied on data pertaining only to the recent bull market, the longest in history.

Thus, in the process of securitization, "risk" was dissected, bundled and sold to third parties who were equally at a loss as to how best to evaluate it. Bewildered, participants and markets lost their much-vaunted ability to "discover" the correct prices of assets. Investors and banks got spooked by this apparent and unprecedented failure and stopped investing and lending. Illiquidity and panic ensued.

If investment funds cannot beat the market and cannot effectively get rid of portfolio risk, what do we need them for?

The short answer is: because it is far more convenient to get involved in the market through a fund than directly. Another reason: index and tracking funds are excellent ways to invest in a bull market.

Commonwealth of Independent States, Economies of

The Lucerne Conference on the then 9 months old CIS-7 Initiative ended two years ago with yet another misguided call upon charity-weary donors to grant the poorest seven countries (Armenia, Azerbaijan, Georgia, Kyrgyz

Republic, Moldova, Tajikistan, and Uzbekistan) of the Commonwealth of Independent States financial assistance in the form of grants rather than credits.

The World Bank's Managing Director, Shengman Zhang, concluded with the deliriously incoherent statement that "donor assistance in the form of highly concessional finance and debt relief will only succeed if linked to effective reform". None of the other five co-sponsors - the IMF, the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB) and the indefatigable Dutch and Swiss governments - questioned this non sequitur.

Since independence a decade ago - aided and abetted by the same founts of Washington wisdom - the seven unfortunates have regressed to a malignant combination of unbridled autocracy and perpetual illiquidity. Poverty soared to African proportions, the region's economies shriveled and public and external debts mounted dizzyingly.

Ever the autistic solipsists, the IMF and World Bank maintained in a press release that the talk shop "broadened and deepened the debate to include a range of economic, institutional and social issues that must be tackled if the seven countries are to achieve the targets of the Millennium Development Goals".

The release is strewn with typical IMF-newspeak.

The destitute, oppressed and diseased people of the region should achieve "ownership of the reform agenda" in accordance with "clear national priorities". Worry not, reassures the anonymous hack: the World Bank has embarked on Poverty Reduction Strategy processes in all seven fiefs.

The cynical cover-up of the west's abysmal failure in the region comes replete with unflinchingly triumphant balderdash: the policies of the Bretton-Woods institutions are "putting the countries themselves in the driver's seat of reforms". According to Mr. Zhang, corruption in the CIS-7 is "moderating" and the investment climate is "beginning to improve".

The solution? "More regional integration" - in other words, more trading among the indigent and the demonetized. This and better access to markets in "the rest of the world" will assure "recovery and future prosperity".

Mr. Zhang conveniently neglected to mention the Stalinesque rulers of most of the CIS-7, the political repression, the personality cults, the blatant looting of the state by pernicious networks of cronies, the rampant nepotism, the elimination of the free media and the proliferation of every conceivable abuse of human and civil rights, up to - and including - the assassination of opponents and dissidents. To raise these delicate issues would have been impolitic when the IMF's largest shareholder - the United States - has embraced these despots as newfound allies.

And from fantasyland to harsh reality:

According to the World Bank's own numbers, with the exception of Uzbekistan, the current gross domestic product of the reluctant members of the CIS-7 is between 29 percent (Georgia) and 80 percent (Armenia) of its level ten years ago.

Armenia's annual GDP per capita is a miserly $670. More than half the population is below the poverty line. These dismal results are despite seven years of strong growth pegged at 6 percent annually and remittances from abroad which equal a staggering one eighth of GDP. Armenia is the second most prosperous of the lot. Its inflation is down to two digits. Its currency is stable. Its trade is completely liberalized (a-propos Zhang's nostrums).

Azerbaijan, its foe and neighbor, should be so lucky. Close to nine tenth of its population live as paupers. This despite a tripling of oil prices, its mainstay commodity. The World Bank notes wistfully that its agriculture is picking up. Its oil fund, insist the sponsoring institutions, incredibly, is "governed by transparent and prudent management rules".

Georgia flies in the face of the Washington Consensus. Petrified by a meltdown of its economy in the early 1990s, a surging inflation and $1 billion in external debt - it adhered religiously to the IMF's prescriptions and proscriptions. To no avail. Annual GDP growth collapsed from 10 percent in 1996-7 to less than 3 percent thereafter.

The Kyrgyz Republic is a special case even by the dismal standards of the region. Again, nine tenths of its population live on less than $130 (one half on less than $70) monthly. Poverty actually increased in the last few years when economic growth picked up. At $310, the country's GDP per capita is sub-Saharan. Is this appalling performance the outcome of brazen disregard for the IMF's sagacious counsel?

Not so. according to the CIS-7 Web site "the Kyrgyz Republic is currently the most reformed country of the Central Asia and sustains a very liberal economic regime." The Kyrgyz predicament defies years of robust growth, single digit inflation, a surplus in the trade balance and other oft-rehashed IMF benchmarks. That the patient is as sick as ever casts in doubt the doctors' competence.

Moldova - with $420 in GDP per capita and 85 percent of the population under the line of poverty - is only in marginally better shape, mainly due to the swift recovery of its principal export market, Russia.

The best economic performance of the lot was Uzbekistan's. It is often wheeled out as a success story and used as a fig leaf. Uzbekistan's GDP is, indeed, unchanged compared to 1989. GDP per capita is $450 - but only one third of the population are under - the famine-level - national poverty line.

But a closer scrutiny reveals the - customary - prestidigitation by the proponents of the Washington orthodoxy.

With the exception of Belarus, another relative economic success story, Uzbekistan resisted the IMF's bitter medicine longer than any other country in transition. Its accomplishments cannot be attributed by any mental gymnastics to anything the west has done, or said. The CIS-7 Web site describes this contrarian polity thus:

"Today significant distortions in foreign exchange allocation remain, reflected in a large difference between the official and curb market exchange rates (about 60% in mid-2002). The current economic system retains the key features of soviet economy, with the state owning and exercising quite active control over the production and distribution decisions of a significant number of Uzbek enterprises."

There lurks an important lesson.

Central Europe - with its industrial and liberal-democratic past should not be lumped together with east Europe. The moral seems to be that transition in the former Soviet Union, in the east and in the Balkans was a foolhardy and ill-informed exercise, administered by haughty and inexperienced bureaucrats and avaricious advisors.

The countries who resisted western pressures and chose to preserve Soviet era institutions even as they gradually liberalized prices and unleashed market forces - seem to have fared far better than the more obsequious lot. This is the Chinese model - as opposed to the "shock therapy" prescribed by western armchair "experts". Tajikistan - with $170 GDP per capita and an unearthly 96 percent of its denizens under the poverty line - may be regretting not having heeded this lesson earlier.

Communism

The core countries of Central Europe (the Czech Republic, Hungary and, to a lesser extent, Poland) experienced industrial capitalism in the inter-war period. But the countries comprising the vast expanses of the New Independent States, Russia and the Balkan had no real acquaintance with it. To them its zealous introduction is nothing but another ideological experiment and not a very rewarding one at that.

It is often said that there is no precedent to the extant fortean transition from totalitarian communism to liberal capitalism. This might well be true. Yet, nascent capitalism is not without historical example. The study of the birth of capitalism in feudal Europe may yet lead to some surprising and potentially useful insights.

The Barbarian conquest of the teetering Roman Empire (410-476 AD) heralded five centuries of existential insecurity and mayhem. Feudalism was the countryside's reaction to this damnation. It was a Hobson's choice and an explicit trade-off. Local lords defended their vassals against nomad intrusions in return for perpetual service bordering on slavery. A small percentage of the population lived on trade behind the massive walls of Medieval cities.

In most parts of central, eastern and southeastern Europe, feudalism endured well into the twentieth century. It was entrenched in the legal systems of the Ottoman Empire and of Czarist Russia. Elements of feudalism survived in the mellifluous and prolix prose of the Habsburg codices and patents. Most of the denizens of these moribund swathes of Europe were farmers - only the profligate and parasitic members of a distinct minority inhabited the cities. The present brobdignagian agricultural sectors in countries as diverse as Poland and Macedonia attest to this continuity of feudal practices.

Both manual labour and trade were derided in the Ancient World. This derision was partially eroded during the Dark Ages. It survived only in relation to trade and other "non-productive" financial activities and even that not past the thirteenth century. Max Weber, in his opus, "The City" (New York, MacMillan, 1958) described this mental shift of paradigm thus: "The medieval citizen was on the way towards becoming an economic man ... the ancient citizen was a political man."

What communism did to the lands it permeated was to freeze this early feudal frame of mind of disdain towards "non-productive", "city-based" vocations. Agricultural and industrial occupations were romantically extolled. The cities were berated as hubs of moral turpitude, decadence and greed. Political awareness was made a precondition for personal survival and advancement. The clock was turned back. Weber's "Homo Economicus" yielded to communism's supercilious version of the ancient Greeks' "Zoon Politikon". John of Salisbury might as well have been writing for a communist agitprop department when he penned this in "Policraticus" (1159 AD): "...if (rich people, people with private property) have been stuffed through excessive greed and if they hold in their contents too obstinately, (they) give rise to countless and incurable illnesses and, through their vices, can bring about the ruin of the body as a whole". The body in the text being the body politic.

This inimical attitude should have come as no surprise to students of either urban realities or of communism, their parricidal off-spring. The city liberated its citizens from the bondage of the feudal labour contract. And it acted as the supreme guarantor of the rights of private property. It relied on its trading and economic prowess to obtain and secure political autonomy. John of Paris, arguably one of the first capitalist cities (at least according to Braudel), wrote: "(The individual) had a right to property which was not with impunity to be interfered with by superior authority - because it was acquired by (his) own efforts" (in Georges Duby, "The age of the Cathedrals: Art and

Society, 980-1420, Chicago, Chicago University Press, 1981). Despite the fact that communism was an urban phenomenon (albeit with rustic roots) - it abnegated these "bourgeoisie" values. Communal ownership replaced individual property and servitude to the state replaced individualism. In communism, feudalism was restored. Even geographical mobility was severely curtailed, as was the case in feudalism. The doctrine of the Communist party monopolized all modes of thought and perception - very much as the church-condoned religious strain did 700 years before. Communism was characterized by tensions between party, state and the economy - exactly as the medieval polity was plagued by conflicts between church, king and merchants-bankers. Paradoxically, communism was a faithful re-enactment of pre-capitalist history.

Communism should be well distinguished from Marxism. Still, it is ironic that even Marx's "scientific materialism" has an equivalent in the twilight times of feudalism. The eleventh and twelfth centuries witnessed a concerted effort by medieval scholars to apply "scientific" principles and human knowledge to the solution of social problems. The historian R. W. Southern called this period "scientific humanism" (in "Flesh and Stone" by Richard Sennett, London, Faber and Faber, 1994). We mentioned John of Salisbury's "Policraticus". It was an effort to map political functions and interactions into their human physiological equivalents. The king, for instance, was the brain of the body politic. Merchants and bankers were the insatiable stomach. But this apparently simplistic analogy masked a schismatic debate. Should a person's position in life be determined by his political affiliation and "natural" place in the order of things - or should it be the result of his capacities and their exercise (merit)? Do the ever changing contents of the economic "stomach", its kaleidoscopic innovativeness, its "permanent revolution" and its propensity to assume "irrational" risks - adversely affect this natural order which, after all, is based on tradition and routine? In short: is there an inherent incompatibility between the order of the world (read: the church doctrine) and meritocratic (democratic) capitalism? Could Thomas Aquinas' "Summa Theologica" (the world as the body of Christ) be reconciled with "Stadt Luft Macht Frei" ("city air liberates" - the sign above the gates of the cities of the Hanseatic League)?

This is the eternal tension between the individual and the group. Individualism and communism are not new to history and they have always been in conflict. To compare the communist party to the church is a well-worn cliché. Both religions - the secular and the divine - were threatened by the spirit of freedom and initiative embodied in urban culture, commerce and finance. The order they sought to establish, propagate and perpetuate conflicted with basic human drives and desires. Communism was a throwback to the days before the ascent of the urbane, capitalistic, sophisticated, incredulous, individualistic and risqué West. it sought to substitute one kind of "scientific" determinism (the body politic of Christ) by another (the body politic of "the Proletariat"). It failed and when it unravelled, it revealed a landscape of toxic devastation, frozen in time, an ossified natural order bereft of content and adherents. The post-communist countries have to pick up where it left them, centuries ago. It is not so much a problem of lacking infrastructure as it is an issue of pathologized minds, not so much a matter of the body as a dysfunction of the psyche.

The historian Walter Ullman says that John of Salisbury thought (850 years ago) that "the individual's standing within society... (should be) based upon his office or his official function ... (the greater this function was) the more scope it had, the weightier it was, the more rights the individual had." (Walter Ullman, "The Individual and Society in the Middle Ages", Baltimore, Johns Hopkins University Press, 1966). I cannot conceive of a member of the communist nomenklatura who would not have adopted this formula wholeheartedly. If modern capitalism can be described as "back to the future", communism was surely "forward to the past".

Competition Laws

*A. **THE PHILOSOPHY OF COMPETITION***

The aims of competition (anti-trust) laws are to ensure that consumers pay the lowest possible price (=the most efficient price) coupled with the highest quality of the goods and services which they consume. This, according to current economic theories, can be achieved only through effective competition. Competition not only reduces particular prices of specific goods and services - it also tends to have a deflationary effect by reducing the general price level. It pits consumers against producers, producers against other producers (in the battle to win the heart of consumers) and even consumers against consumers (for example in the healthcare sector in the USA). This everlasting conflict does the miracle of increasing quality with lower prices. Think about the vast improvement on both scores in electrical appliances. The VCR and PC of yesteryear cost thrice as much and provided one third the functions at one tenth the speed.

Competition has innumerable advantages:

a. It encourages manufacturers and service providers to be more efficient, to better respond to the needs of their customers, to innovate, to initiate, to venture. In professional words: it optimizes the allocation of resources at the firm level and, as a result, throughout the national economy.
More simply: producers do not waste resources (capital), consumers and businesses pay less for the same goods and services and, as a result, consumption grows to the benefit of all involved.

b. The other beneficial effect seems, at first sight, to be an adverse one: competition weeds out the failures, the incompetents, the inefficient, the fat and slow to respond. Competitors pressure one another to be more efficient, leaner and meaner. This is the very essence of capitalism. It is wrong to say that only the consumer benefits. If a firm improves itself, re-engineers its production processes, introduces new management techniques, modernizes - in order to fight the competition, it stands to reason that it will reap the rewards. Competition benefits the economy, as a whole, the consumers and other producers by a process of natural economic selection where only the fittest survive. Those who are not fit to survive die out and cease to waste the rare resources of humanity.

Thus, paradoxically, the poorer the country, the less resources it has - the more it is in need of competition. Only competition can secure the proper and most efficient use of its scarce resources, a maximization of its output and the maximal welfare of its citizens (consumers). Moreover, we tend to forget that the biggest consumers are businesses (firms). If the local phone company is inefficient (because no one competes with it, being a monopoly) - firms will suffer the most: higher charges, bad connections, lost time, effort, money and business. If the banks are dysfunctional (because there is no foreign competition), they will not properly service their clients and firms will collapse because of lack of liquidity. It is the business sector in poor countries which should head the crusade to open the country to competition.

Unfortunately, the first discernible results of the introduction of free marketry are unemployment and business closures. People and firms lack the vision, the knowledge and the wherewithal needed to support competition. They fiercely oppose it and governments throughout the world bow to protectionist measures. To no avail. Closing a country to competition will only exacerbate the very conditions which necessitate its opening up. At the end of such a wrong path awaits economic disaster and the forced entry of competitors. A country which closes itself to the world - will be forced to sell itself cheaply as its economy will become more and more inefficient, less and less non-competitive.

The Competition Laws aim to establish fairness of commercial conduct among entrepreneurs and competitors which are the sources of said competition and innovation.

Experience - later buttressed by research - helped to establish the following four principles:

1. There should be no barriers to the entry of new market players (barring criminal and moral

barriers to certain types of activities and to certain goods and services offered).

2. A larger scale of operation does introduce economies of scale (and thus lowers prices). This, however, is not infinitely true. There is a Minimum Efficient Scale - MES - beyond which prices will begin to rise due to monopolization of the markets. This MES was empirically fixed at 10% of the market in any one good or service. In other words: companies should be encouraged to capture up to 10% of their market (=to lower prices) and discouraged to cross this barrier, lest prices tend to rise again.

3. Efficient competition does not exist when a market is controlled by less than 10 firms with big size differences. An oligopoly should be declared whenever 4 firms control more than 40% of the market and the biggest of them controls more than 12% of it.

4. A competitive price will be comprised of a minimal cost plus an equilibrium profit which does not encourage either an exit of firms (because it is too low), nor their entry (because it is too high).

Left to their own devices, firms tend to liquidate competitors (predation), buy them out or collude with them to raise prices. The 1890 Sherman Antitrust Act in the USA forbade the latter (section 1) and prohibited monopolization or dumping as a method to eliminate competitors. Later acts (Clayton, 1914 and the Federal Trade Commission Act of the same year) added forbidden activities: tying arrangements, boycotts, territorial divisions, non-competitive mergers, price discrimination, exclusive dealing, unfair acts, practices and methods. Both consumers and producers who felt offended were given access to the Justice Department and to the FTC or the right to sue in a federal court and be eligible to receive treble damages.

It is only fair to mention the "intellectual competition", which opposes the above premises. Many important economists thought (and still do) that competition laws represent an unwarranted and harmful intervention of the State in the markets. Some believed that the State should own important industries (J.K. Galbraith), others - that industries should be encouraged to grow because only size guarantees survival, lower prices and innovation (Ellis Hawley). Yet others supported the cause of laissez faire (Marc Eisner).

These three antithetical approaches are, by no means, new. One led to socialism and communism, the other to corporatism and monopolies and the third to jungle-ization of the market (what the Europeans derisively call: the Anglo-Saxon model).

B. ***HISTORICAL AND LEGAL CONSIDERATIONS***

Why does the State involve itself in the machinations of the free market? Because often markets fail or are unable or unwilling to provide goods, services, or competition. The purpose of competition laws is to secure a competitive marketplace and thus protect the consumer from unfair, anti-competitive practices. The latter tend to increase prices and reduce the availability and quality of goods and services offered to the consumer.

Such state intervention is usually done by establishing a governmental Authority with full powers to regulate the markets and ensure their fairness and accessibility to new entrants. Lately, international collaboration between such authorities yielded a measure of harmonization and coordinated action (especially in cases of trusts which are the results of mergers and acquisitions).

Yet, competition law embodies an inherent conflict: while protecting local consumers from monopolies, cartels and oligopolies - it ignores the very same practices when directed at foreign consumers. Cartels related to the country's foreign trade are allowed even under GATT/WTO rules (in cases of dumping or excessive export subsidies). Put simply: governments regard acts which are criminal as legal if they are directed at foreign consumers or are part of the process of foreign trade.

A country such as Macedonia - poor and in need of establishing its export sector - should include in its competition law at least two protective measures against these discriminatory practices:

1. ***Blocking Statutes*** - which prohibit its legal entities from collaborating with legal procedures in other countries to the extent that this collaboration adversely affects the local export industry.

2. ***Clawback Provisions*** - which will enable the local courts to order the refund of any penalty payment decreed or imposed by a foreign court on a local legal entity and which exceeds actual damage inflicted by unfair trade practices of said local legal entity. US courts, for instance, are allowed to impose treble damages on infringing foreign

entities. The clawback provisions are used to battle this judicial aggression.

Competition policy is the antithesis of industrial policy. The former wishes to ensure the conditions and the rules of the game - the latter to recruit the players, train them and win the game. The origin of the former is in the 19th century USA and from there it spread to (really was imposed on) Germany and Japan, the defeated countries in the 2nd World War. The European Community (EC) incorporated a competition policy in articles 85 and 86 of the Rome Convention and in Regulation 17 of the Council of Ministers, 1962.

Still, the two most important economic blocks of our time have different goals in mind when implementing competition policies. The USA is more interested in economic (and econometric) results while the EU emphasizes social, regional development and political consequences. The EU also protects the rights of small businesses more vigorously and, to some extent, sacrifices intellectual property rights on the altar of fairness and the free movement of goods and services.

Put differently: the USA protects the producers and the EU shields the consumer. The USA is interested in the maximization of output at whatever social cost - the EU is interested in the creation of a just society, a liveable community, even if the economic results will be less than optimal.

There is little doubt that Macedonia should follow the EU example. Geographically, it is a part of Europe and, one day, will be integrated in the EU. It is socially sensitive, export oriented, its economy is negligible and its consumers are poor, it is besieged by monopolies and oligopolies.

In my view, its competition laws should already incorporate the important elements of the EU (Community) legislation and even explicitly state so in the preamble to the law. Other, mightier, countries have done so. Italy, for instance, modelled its Law number 287 dated 10/10/90 "Competition and Fair Trading Act" after the EC legislation. The law explicitly says so.

The first serious attempt at international harmonization of national antitrust laws was the Havana Charter of 1947. It called for the creation of an umbrella operating organization (the International Trade Organization or "ITO") and incorporated an extensive body of universal antitrust rules in nine of its articles. Members were required to "prevent business practices affecting international trade which restrained competition, limited access to markets, or fostered monopolistic control whenever such practices had harmful effects on the expansion of production or trade". the latter included:

a. Fixing prices, terms, or conditions to be observed in dealing with others in the purchase, sale, or lease of any product;

b. Excluding enterprises from, or allocating or dividing, any territorial market or field of business activity, or allocating customers, or fixing sales quotas or purchase quotas;

c. Discriminating against particular enterprises;

d. Limiting production or fixing production quotas;

e. Preventing by agreement the development or application of technology or invention, whether patented or non-patented; and

f. Extending the use of rights under intellectual property protections to matters which, according to a member's laws and regulations, are not within the scope of such grants, or to products or conditions of production, use, or sale which are not likewise the subject of such grants.

GATT 1947 was a mere bridging agreement but the Havana Charter languished and died due to the objections of a protectionist US Senate.

There are no antitrust/competition rules either in GATT 1947 or in GATT/WTO 1994, but their provisions on antidumping and countervailing duty actions and government subsidies constitute some elements of a more general antitrust/competition law.

GATT, though, has an International Antitrust Code Writing Group which produced a "Draft International Antitrust Code" (10/7/93). It is reprinted in §II, 64 Antitrust & Trade Regulation Reporter (BNA), Special Supplement at S-3 (19/8/93).

Four principles guided the (mostly German) authors:

1. National laws should be applied to solve international competition problems;

2. Parties, regardless of origin, should be treated as locals;

3. A minimum standard for national antitrust rules should be set (stricter measures would be welcome); and

4. The establishment of an international authority to settle disputes between parties over antitrust issues.

The 29 (well-off) members of the Organization for Economic Cooperation and Development (OECD) formed rules governing the harmonization and coordination of international antitrust/competition regulation among its member nations ("The Revised Recommendation of the OECD Council Concerning Cooperation between Member Countries on Restrictive Business Practices Affecting International Trade," OECD Doc. No. C(86)44 (Final) (June 5, 1986), also in 25 International Legal Materials 1629 (1986). A revised version was reissued. According to it, " …Enterprises should refrain from abuses of a dominant market position; permit purchasers, distributors, and suppliers to freely conduct their businesses; refrain from cartels or restrictive agreements; and consult and cooperate with competent authorities of interested countries".

An agency in one of the member countries tackling an antitrust case, usually notifies another member country whenever an antitrust enforcement action may affect important interests of that country or its nationals (see: OECD Recommendations on Predatory Pricing, 1989).

The United States has bilateral antitrust agreements with Australia, Canada, and Germany, which was followed by a bilateral agreement with the EU in 1991. These provide for coordinated antitrust investigations and prosecutions.

The United States thus reduced the legal and political obstacles which faced its extraterritorial prosecutions and enforcement. The agreements require one party to notify the other of imminent antitrust actions, to share relevant information, and to consult on potential policy changes. The EU-U.S. Agreement contains a "comity" principle under which each side promises to take into consideration the other's interests when considering antitrust prosecutions. A similar principle is at the basis of Chapter 15 of the North American Free Trade Agreement (NAFTA) - cooperation on antitrust matters.

The United Nations Conference on Restrictive Business Practices adopted a code of conduct in 1979/1980 that was later integrated as a U.N. General Assembly Resolution [U.N. Doc. TD/RBP/10 (1980)]: "The Set of Multilaterally Agreed Equitable Principles and Rules".

According to its provisions, "independent enterprises should refrain from certain practices when they would limit access to markets or otherwise unduly restrain competition".

The following business practices are prohibited:

1. Agreements to fix prices (including export and import prices);

2. Collusive tendering;

3. Market or customer allocation (division) arrangements;

4. Allocation of sales or production by quota;

5. Collective action to enforce arrangements, e.g., by concerted refusals to deal;

6. Concerted refusal to sell to potential importers; and

7. Collective denial of access to an arrangement, or association, where such access is crucial to competition and such denial might hamper it. In addition, businesses are forbidden to engage in the abuse of a dominant position in the market by limiting access to it or by otherwise restraining competition by:

   a. Predatory behaviour towards competitors;
   b. Discriminatory pricing or terms or conditions in the supply or purchase of goods or services;
   c. Mergers, takeovers, joint ventures, or other acquisitions of control;
   d. Fixing prices for exported goods or resold imported goods;
   e. Import restrictions on legitimately-marked trademarked goods;
   f. Unjustifiably - whether partially or completely - refusing to deal on an enterprise's customary commercial terms, making the supply of goods or services dependent on restrictions on the distribution or manufacturer of other goods, imposing restrictions on the resale or exportation of the same or other goods, and purchase "tie-ins".

C. ANTI - COMPETITIVE STRATEGIES

Any Competition Law in Macedonia should, in my view, excplicitly include strict prohibitions of the following practices (further details can be found in Porter's book - "Competitive Strategy").

These practices characterize the Macedonian market. They influence the Macedonian economy by discouraging foreign investors, encouraging inefficiencies and mismanagement, sustaining artificially high prices, misallocating very scarce resources, increasing unemployment, fostering corrupt and criminal practices and, in general, preventing the growth that Macedonia could have attained.

Strategies' for Monopolization

Exclude competitors from distribution channels. - This is common practice in many countries. Open threats are made by the manufacturers of popular products: "If you distribute my competitor's products - you cannot distribute mine. So, choose." Naturally, retail outlets, dealers and distributors will always prefer the popular product to the new. This practice not only blocks competition - but also innovation, trade and choice or variety.

Buy up competitors and potential competitors. - There is nothing wrong with that. Under certain circumstances, this is even desirable. Think about the Banking System: it is always better to have fewer banks with bigger capital than many small banks with capital inadequacy (remember the TAT affair). So, consolidation is sometimes welcome, especially where scale represents viability and a higher degree of consumer protection. The line is thin and is composed of both quantitative and qualitative criteria. One way to measure the desirability of such mergers and acquisitions (M&A) is the level of market concentration following the M&A. Is a new monopoly created? Will the new entity be able to set prices unperturbed? stamp out its other competitors? If so, it is not desirable and should be prevented.

Every merger in the USA must be approved by the antitrust authorities. When multinationals merge, they must get the approval of all the competition authorities in all the territories in which they operate. The purchase of "Intuit" by "Microsoft" was prevented by the antitrust department (the "Trust-busters"). A host of airlines was conducting a drawn out battle with competition authorities in the EU, UK and the USA lately.

Use predatory [below-cost] pricing (also known as dumping) to eliminate competitors. - This tactic is mostly used by manufacturers in developing or emerging economies and in Japan. It consists of "pricing the competition out of the markets". The predator sells his products at a price which is lower even than the costs of production. The result is that he swamps the market, driving out all other competitors. Once he is left alone - he raises his prices back to normal and, often, above normal. The dumper loses money in the dumping operation and compensates for these losses by charging inflated prices after having the competition eliminated.

Raise scale-economy barriers. - Take unfair advantage of size and the resulting scale economies to force conditions upon the competition or upon the distribution channels. In many countries Big Industry lobbies for a legislation which will fit its purposes and exclude its (smaller) competitors.

Increase "market power (share) and hence profit potential".

Study the industry's "potential" structure and ways it can be made less competitive. - Even thinking about sin or planning it should be prohibited. Many industries have "think tanks" and experts whose sole function is to show the firm the way to minimize competition and to increase its market shares. Admittedly, the line is very thin: when does a Marketing Plan become criminal?

Arrange for a "rise in entry barriers to block later entrants" and "inflict losses on the entrant". - This could be done by imposing bureaucratic obstacles (of licencing, permits and taxation), scale hindrances (no possibility to distribute small quantities), "old boy networks" which share political clout and research and development, using intellectual property right to block new entrants and other methods too numerous to recount. An effective law should block any action which prevents new entry to a market.

Buy up firms in other industries "as a base from which to change industry structures" there. - This is a way of securing exclusive sources of supply of raw materials, services and complementing products. If a company owns its suppliers and they are single or almost single sources of supply - in effect it has monopolized the market. If a software company owns another software company with a product which can be incorporated in its own products - and the two have substantial market shares in their markets - then their dominant positions will reinforce each other's.

"Find ways to encourage particular competitors out of the industry". - If you can't intimidate your competitors you might wish to "make them an offer that they cannot refuse". One way is to buy them, to bribe out the key personnel, to offer tempting opportunities in other markets, to swap markets (I will give my market share in a market which I do not really care about and you will give me your market share in a market in which we are competitors). Other ways are to give the competitors assets, distribution channels and so on providing that they collude in a cartel.

"Send signals to encourage competition to exit" the industry. - Such signals could be threats, promises, policy measures, attacks on the integrity and quality of the competitor, announcement that the company has set a certain market share as its goal (and will, therefore, not tolerate anyone trying to prevent it from attaining this market share) and any action which directly or indirectly intimidates or convinces competitors to leave the industry. Such an action need not be positive - it can be negative, need not be done by the company - can be done by its political proxies, need not be planned - could be accidental. The results are what matters.

Macedonia's Competition Law should outlaw the following, as well:

'Intimidate' Competitors

Raise "mobility" barriers to keep competitors in the least-profitable segments of the industry. - This is a tactic which preserves the appearance of competition while subverting it. Certain, usually less profitable or too small to be of interest, or with dim growth prospects, or which are likely to be opened to fierce domestic and foreign competition are left to the competition. The more lucrative parts of the markets are zealously guarded by the company. Through legislation, policy measures, withholding of technology and know-how - the firm prevents its competitors from crossing the river into its protected turf.

Let little firms "develop" an industry and then come in and take it over. - This is precisely what Netscape is saying that Microsoft is doing to it. Netscape developed the now lucrative Browser Application market. Microsoft was wrong in discarding the Internet as a fad. When it was found to be wrong - Microsoft reversed its position and came up with its own (then, technologically inferior) browser (the Internet Explorer). It offered it free (sound suspiciously like dumping) to buyers of its operating system, "Windows". Inevitably it captured more than 30% of the market, crowding out Netscape. It is the view of the antitrust authorities in the USA that Microsoft utilized its dominant position in one market (that of the Operating Systems) to annihilate a competitor in another (that of the browsers).

Engage in "promotional warfare" by "attacking shares of others". - This is when the gist of a marketing or advertising campaign is to capture the market share of the competition. Direct attack is then made on the competition just in order to abolish it. To sell more in order to maximize profits, is allowed and meritorious - to sell more in order to eliminate the competition is wrong and should be disallowed.

Use price retaliation to "discipline" competitors. - Through dumping or even unreasonable and excessive discounting. This could be achieved not only through the price itself. An exceedingly long credit term offered to a distributor or to a buyer is a way of reducing the price. The same applies to sales, promotions, vouchers, gifts. They are all ways to reduce the effective price. The customer calculates the money value of these benefits and deducts them from the price.

Establish a "pattern" of severe retaliation against challengers to "communicate commitment" to resist efforts to win market share. - Again, this retaliation can take a myriad of forms: malicious advertising, a media campaign, adverse legislation, blocking distribution channels, staging a hostile bid in the stock exchange just in order to disrupt the proper and orderly management of the competitor. Anything which derails the competitor whenever he makes a headway, gains a larger market share, launches a new product - can be construed as a "pattern of retaliation".

Maintain excess capacity to be used for "fighting" purposes to discipline ambitious rivals. - Such excess capacity could belong to the offending firm or - through cartel or other arrangements - to a group of offending firms.

Publicize one's "commitment to resist entry" into the market.

Publicize the fact that one has a "monitoring system" to detect any aggressive acts of competitors.

Announce in advance "market share targets" to intimidate competitors into yielding share their market share.

Proliferate Brand Names

Contract with customers to "meet or match all price cuts (offered by the competition)" thus denying rivals any hope of growth through price competition.

Get a big enough market share to "corner" the "learning curve," thus denying rivals an opportunity to become efficient. - Efficiency is gained by an increase in market share. Such an increase leads to new demands imposed by the market, to modernization, innovation, the introduction of new management techniques (example: Just In Time inventory management), joint ventures, training of personnel, technology transfers, development of proprietary intellectual property and so on. Deprived of a growing market share - the competitor will not feel pressurized to learn and to better itself. In due time, it will dwindle and die.

Acquire a wall of "defensive" patents to deny competitors access to the latest technology.

"Harvest" market position in a no-growth industry by raising prices, lowering quality, and stopping all investment and advertising in it.

Create or encourage capital scarcity. - By colluding with sources of financing (e.g., regional, national, or investment banks), by absorbing any capital offered by the State, by the capital markets, through the banks, by spreading malicious news which serve to lower the creditworthiness of the competition, by legislating special tax and financing loopholes and so on.

Introduce high advertising-intensity. - This is very difficult to measure. There could be no objective criteria which will not go against the grain of the fundamental right to freedom of expression. However, truth in advertising should be strictly imposed. Practices such as dragging a competitor through the mud or derogatorily referring to its products or services in advertising campaigns should be banned and the ban should be enforced.

Proliferate "brand names" to make it too expensive for small firms to grow. - By creating and maintaining a host of absolutely unnecessary brandnames, the competition's brandnames are crowded out. Again, this cannot be legislated against. A firm has the right to create and maintain as many brandnames as it wishes. The market will exact a price and thus punish such a company because, ultimately, its own brandname will suffer from the proliferation.

Get a "corner" (control, manipulate and regulate) on raw materials, government licenses, subsidies, and patents (and, of course, prevent the competition from having access to them).

Build up "political capital" with government bodies; overseas, get "protection" from "the host government".

'Vertical' Barriers

Practice a "preemptive strategy" by capturing all capacity expansion in the industry (simply buying it,

leasing it or taking over the companies that own or develop it).

This serves to "deny competitors enough residual demand". Residual demand, as we previously explained, causes firms to be efficient. Once efficient, develop enough power to "credibly retaliate" and thereby "enforce an orderly expansion process" to prevent overcapacity

Create "switching" costs. - Through legislation, bureaucracy, control of the media, cornering advertising space in the media, controlling infrastructure, owning intellectual property, owning, controlling or intimidating distribution channels and suppliers and so on.

Impose vertical "price squeezes". - By owning, controlling, colluding with, or intimidating suppliers and distributors, marketing channels and wholesale and retail outlets into not collaborating with the competition.

Practice vertical integration (buying suppliers and distributionb and marketing channels).

This has the following effects:

The firm gains a "tap (access) into technology" and marketing information in an adjacent industry. It defends itself against a supplier's too-high or even realistic prices.

It defends itself against foreclosure, bankruptcy and restructuring or reorganization. Owning suppliers means that the supplies do not cease even when payment is not affected, for instance.

It "protects proprietary information from suppliers" - otherwise the firm might have to give outsiders access to its technology, processes, formulas and other intellectual property.

It raises entry and mobility barriers against competitors. This is why the State should legislate and act against any purchase, or other types of control of suppliers and marketing channels which service competitors and thus enhance competition.

It serves to "prove that a threat of full integration is credible" and thus intimidate competitors.

Finally, it gets "detailed cost information" in an adjacent industry (but doesn't integrate it into a "highly competitive industry").

"Capture distribution outlets" by vertical integration to "increase barriers".

'Consolidate' the Industry

Send "signals" to threaten, bluff, preempt, or collude with competitors.

Use a "fighting brand" (a low-price brand used only for price-cutting).

Use "cross parry" (retaliate in another part of a competitor's market).

Harass competitors with antitrust suits and other litigious techniques.

Use "brute force" ("massed resources" applied "with finesse") to attack competitors or use "focal points" of pressure to collude with competitors on price.

"Load up customers" at cut-rate prices to "deny new entrants a base" and force them to "withdraw" from market.

Practice "buyer selection," focusing on those that are the most "vulnerable" (easiest to overcharge) and discriminating against and for certain types of consumers.

"Consolidate" the industry so as to "overcome industry fragmentation".

This arguments is highly successful with US federal courts in the last decade. There is an intuitive feeling that few is better and that a consolidated industry is bound to be more efficient, better able to compete and to survive and, ultimately, better positioned to lower prices, to conduct costly research and development and to increase quality. In the words of Porter: "(The) pay-off to consolidating a fragmented industry can be high because... small and weak competitors offer little threat of retaliation."

Time one's own capacity additions; never sell old capacity "to anyone who will use it in the same industry" and buy out "and retire competitors' capacity".

Conspiracy Theories

Barry Chamish is convinced that Shimon Peres, Israel's wily old statesman, ordered the assassination of Yitzhak Rabin, back in 1995, in collaboration with the French. He points to apparent tampering with evidence. The blood-stained song sheet in Mr. Rabin's pocket lost its bullet hole between the night of the murder and the present.

The murderer, Yigal Amir, should have been immediately recognized by Rabin's bodyguards. He has publicly attacked his query before. Israel's fierce and fearsome internal security service, the Shabak, had moles and agents provocateurs among the plotters. Chamish published a book about the affair. He travels and lectures widely, presumably for a fee.

Chamish's paranoia-larded prose is not unique. The transcripts of Senator Joseph McCarthy's inquisitions are no less outlandish. But it was the murder of John F. Kennedy, America's youthful president, that ushered in a golden age of conspiracy theories.

The distrust of appearances and official versions was further enhanced by the Watergate scandal in 1973-4. Conspiracies and urban legends offer meaning and purposefulness in a capricious, kaleidoscopic, maddeningly ambiguous, and cruel world. They empower their otherwise helpless and terrified believers.

New Order one world government, Zionist and Jewish cabals, Catholic, black, yellow, or red subversion, the machinations attributed to the freemasons and the illuminati - all flourished yet again from the 1970's onwards. Paranoid speculations reached frenzied nadirs following the deaths of celebrities, such as "Princess Di".

Tony Blair, Britain's ever righteous prime minister denounced the "Diana Death Industry". He was referring to the books and films which exploited the wild rumors surrounding the fatal car crash in Paris in 1997. The Princess, her boyfriend Dodi al-Fayed, heir to a fortune, as well as their allegedly inebriated driver were killed in the accident.

Among the exploiters were "The Times" of London which promptly published a serialized book by Time magazine reports. Britain's TV networks, led by Live TV, capitalized on comments made by al-Fayed's father to the "Mirror" alleging foul play.

But there is more to conspiracy theories than mass psychology. It is also big business. Voluntary associations such as the Ku Klux Klan and the John Birch Society are past their heyday. But they still gross many millions of dollars a year.

The monthly "Fortean Times" is the leading brand in "strange phenomena and experiences, curiosities, prodigies and portents". It is widely available on both sides of the Atlantic. In its 29 years of existence it has covered the bizarre, the macabre, and the ominous with panache and open-mindedness.

It is named after Charles Fort who compiled unexplained mysteries from the scientific literature of his age (he died in 1932). He published four bestsellers in his lifetime and lived to see "Fortean societies" established in many countries.

A 12 months subscription to "Fortean Times" costs c. $45. With a circulation of 60,000, the magazine was able to spin off "Fortean Television" - a TV show on Britain's Channel Four. Its reputation was further enhanced when it was credited with inspiring the TV hit series X-Files and The Sixth Sense.

"Lobster Magazine" - a bi-annual publication - is more modest at $15 a year. It is far more "academic" looking and it sells CD ROM compilations of its articles at between $80 (for individuals) and $160 (for institutions and organizations) a piece. It also makes back copies of its issues available.

Its editor, Robin Ramsay, said in a lecture delivered to the "Unconvention 96", organized by the "Fortean Times":

"Conspiracy theories certainly are sexy at the moment ... I've been contacted by five or six TV companies in the past six months - two last week - all interested in making programmes about conspiracy theories. I even got a call from the Big Breakfast Show, from a researcher who had no idea who I was, asking me if I'd like to appear on it ... These days we've got conspiracy theories everywhere; and about almost everything."

But these two publications are the tip of a gigantic and ever-growing iceberg. "Fortean Times" reviews, month in and month out, books, PC games, movies, and software concerned with its subject matter. There is an average of 8 items per issue with a median price of $20 per item.

There are more than 86,600 Web sites dedicated to conspiracy theories in Google's database of 1.6 billion pages. The "conspiracy theories" category in the Open

Directory Project, a Web directory edited by volunteers, contains hundreds of entries.

There are 1077 titles about conspiracies listed in Amazon and another 12078 in its individually-operated ZShops. A new (1996) edition of the century-old anti-Semitic propaganda pamphlet faked by the Czarist secret service, "Protocols of the Learned Elders of Zion", is available through Amazon. Its sales rank is a respectable 64,000 - out of more than 2 million titles stocked by the online bookseller.

In a disclaimer, Amazon states:

"The Protocols of the Learned Elders of Zion is classified under "controversial knowledge" in our store, along with books about UFOs, demonic possession, and all manner of conspiracy theories."

Yet, cinema and TV did more to propagate modern nightmares than all the books combined. The Internet is starting to have a similar impact compounded by its networking capabilities and by its environment of simulated reality - "cyberspace". In his tome, "Enemies Within: The Culture of Conspiracy in Modern America", Robert Alan Goldberg comes close to regarding the paranoid mode of thinking as a manifestation of mainstream American culture.

According to the Internet Movie Database, the first 50 all time hits include at least one "straight" conspiracy theory movie (in the 13th place) - "Men in Black" with $587 million in box office receipts. JFK (in the 193rd place) grossed another $205 million. At least ten other films among the first 50 revolve around a conspiracy theory disguised as science fiction or fantasy. "The Matrix" - in the 28th place - took in $456 million. "The Fugitive" closes the list with $357 million. This is not counting "serial" movies such as James Bond, the reification of paranoia shaken and stirred.

X-files is to television what "Men in Black" is to cinema. According to "Advertising Age", at its peak, in 1998, a 30 seconds spot on the show cost $330,000 and each chapter raked in $5 million in ad revenues. Ad prices declined to $225,000 per spot two years later, according to CMR Business to Business.

Still, in its January 1998 issue, "Fortune" claimed that "X-Files" (by then a five year old phenomenon) garnered Fox TV well over half a billion dollars in revenues. This was before the eponymous feature film was released. Even at the end of 2000, the show was regularly being watched by 12.4 million households - compared to 22.7 million viewers in 1998. But X-files was only the latest, and the most successful, of a line of similar TV shows, notably "The Prisoner" in the 1960's.

It is impossible to tell how many people feed off the paranoid frenzy of the lunatic fringe. I found more than 3000 lecturers on these subjects listed by the Google search engine alone. Even assuming a conservative schedule of one lecture a month with a modest fee of $250 per appearance - we are talking about an industry of c. $10 million.

Collective paranoia has been boosted by the Internet. Consider the computer game "Majestic" by Electronic Arts. It is an interactive and immersive game, suffused with the penumbral and the surreal. It is a Web reincarnation of the borderlands and the twilight zone - centered around a nefarious and lethal government conspiracy. It invades the players' reality - the game leaves them mysterious messages and "tips" by phone, fax, instant messaging, and e-mail. A typical round lasts 6 months and costs $10 a month.

Neil Young, the game's 31-years old, British-born, producer told Salon.com recently:

"... The concept of blurring the lines between fact and fiction, specifically around conspiracies. I found myself on a Web site for the conspiracy theory radio show by Art Bell ... the Internet is such a fabulous medium to blur those lines between fact and fiction and conspiracy, because you begin to make connections between things. It's a natural human reaction - we connect these dots around our fears. Especially on the Internet, which is so conspiracy-friendly. That was what was so interesting about the game; you couldn't tell whether the sites you were visiting were Majestic-created or normal Web sites..."

Majestic creates almost 30 primary Web sites per episode. It has dozens of "bio" sites and hundreds of Web sites created by fans and linked to the main conspiracy threads. The imaginary gaming firm at the core of its plots, "Amin-X", has often been confused with the real thing. It even won the E3 Critics Award for best original product...

Conspiracy theories have pervaded every facet of our modern life. A.H. Barbee describes in "Making Money the Telefunding Way" (published on the Web site of the Institute for First Amendment Studies) how conspiracy theorists make use of non-profit "para-churches".

They deploy television, radio, and direct mail to raise billions of dollars from their followers through "telefunding". Under section 170 of the IRS code, they are tax-exempt and not obliged even to report their income. The Federal Trade commission estimates that 10% of the $143 billion donated to charity each year may be solicited fraudulently.

Lawyers represent victims of the Gulf Syndrome for hefty sums. Agencies in the USA debug bodies - they "remove" brain "implants" clandestinely placed by the CIA during the Cold War. They charge thousands of dollars a pop. Cranks and whackos - many of them religious fundamentalists - use inexpensive desktop publishing technology to issue scaremongering newsletters (remember Mel Gibson in the movie "Conspiracy Theory"?).

Tabloids and talk shows - the only source of information for nine tenths of the American population - propagate these "news". Museums - the UFO museum in New Mexico or the Kennedy Assassination museum in Dallas, for instance - immortalize them. Memorabilia are sold through auction sites and auction houses for thousands of dollars an item.

Numerous products were adversely affected by conspiratorial smear campaigns. In his book "How the Paranoid Style Flourishes and Where it Comes From", Daniel Pipes describes how the sales of Tropical Fantasy plummeted by 70% following widely circulated rumors about the sterilizing substances it allegedly contained - put there by the KKK. Other brands suffered a similar fate: Kool and Uptown cigarettes, Troop Sport clothing, Church's Fried Chicken, and Snapple soft drinks.

It all looks like one giant conspiracy to me. Now, here's one theory worth pondering...

Contracts (in Countries in Transition)

The Kazakh minister of foreign affairs denied vehemently that Kazakhstan would revise contracts it has signed with foreign investors in the heady days of the early 1990's. It was in a meeting on March 26, 2002 with a delegation of nervous businessmen from the USA and it was expected and prudent - if not entirely truthful - of him to say so. He was merely echoing his autocratic president, Nazarbaev, who made the same promises to visiting and anxious State Department officials earlier that month.

Yet, the revision of dubious privatization contracts is now in vogue from Nigeria to the Czech Republic. It is even encouraged - though stealthily - by the new crusaders against corruption, the recently converted IMF and World Bank. This is surprising because these two also champion the protection of property rights and investments. An often politically-motivated revision of past deals is hardly the way to inspire confidence in jumpy foreign investors. The Kazakh minister summed it up neatly: "It (revision) would ruin the investment climate."

The Macedonians are less squeamish. The Macedonian Agency of Privatization has officially announced three years ago the review of 90 privatization deals concluded in more penumbral days. Of the first 9 firms reviewed, concluded the agency grimly, four were heavily tinted with irregularities. These consisted of partial disclosure of assets, leveraging of state-owned property, and reneging on obligations undertaken by the new owners to invest in the privatized firms.

In the wake of the heavily politicized campaign against the now-dismantled oil giant, Yukos, President Vladimir Putin of Russia changed the period for revision of venal privatizations from ten to three years. Still, hundreds of suspect deals under review with the aim of curbing the waning influence of the once almighty oligarchs.

There is no doubt that cronies, family relatives, strongmen, and members of the communist nomenklatura benefited mightily from the injudicious rash of ill-thought privatizations that swept through eastern and central Europe in the wake of the implosion of communism.

Mark Palmer, who served as US ambassador to Hungary in the 1980's, had this to say to RFE/RL:

"When communism was ousted in the late [19]80s, I do not think you had a total change. And these countries have all had to build more or less from scratch a culture of respect for the law, judges that are politically independent, lawyers that are knowledgeable, businessmen who recognize the importance of contracts. All of this has had to be developed, and it's not surprising that it's taking quite a while."

Yet, many question the wisdom of re-opening this particular can of worms. Most of the privatized firms changed owners, or were floated in stock exchanges, merged, or completely transformed themselves. Raising ownership issues in this belated manner may adversely affect significant segments of the tottering economies of the post-communist countries in transition.

The distrust between citizen and state in these countries - already all-pervasive - will only grow if the latter took to arbitrarily and retroactively abrogating contracts they have signed. Few would believe that such "reviews" are not politically motivated. Most would surmise that it is the current regime's way of getting back at its predecessors and re-distributing stolen wealth.

But perhaps a more imminent and long-term danger is the further undermining of the concept of "commercial contract" - a novelty in these nether regions.

In the early period of transition, contracting was debased by the absence of functioning and impartial judicial and law enforcement institutions. Private enforcement of oft-informal contractual obligations by organized crime or corrupt officials was a growth industry - and not only in derelicts like Russia, Ukraine, Belarus, Moldova, Albania, Bulgaria, or Serbia-Montenegro. It was rife even in paragons of EU rectitude such as Hungary, or in the less exalted Czech Republic.

The situation was so bad that Russian managers collaborated only with commercial partners they knew from the days of central planning (Kathryn Hendley and others, 1997, "Observations on the Use of Law by Russian Enterprises," published in Post-Soviet Affairs, Vol. 13).

This made it impossible for newcomers and foreign competitors to break into the market. Long-terms investment and research and development were stymied - as were transfers of technology and know-how. Transaction costs soared.

The emergence of an entrepreneurial middle class changed all that. Contract law is now enforced in courts rather than without. In October 1999, in a position paper prepared for the "Partners in Transition, Lessons for the Next Decade" conference in Warsaw, the IRIS Centre in the University of Maryland felt comfortable to state:

"Significant progress towards an effective rule of law has been made since that period in many of the transition countries. For example, a recent survey of firms in Russia found that both the law and courts were important elements in resolving disputes between firms and promoting the enforcement of contracts."

The evidence is far from decisive though.

Numerous studies (by Hendrix and Pei, by Hendley, Murrell, and Ryterman in their 1998 survey of Russian managers, by Berkowitz, and others) demonstrated that Russian courts were capable of handling contract dispute resolution reasonably adequately. Efforts invested by firms in constructing contracts and in obtaining legal knowledge - pays handsomely even in Russia.

Other scholars (Rose, 1999 and Kaariainen and Furman, 2000, to mention recent ones) report that foreign businessmen complain about a low respect of the law, contradictory legal rulings, and frequent breaches of contract (reported in "Russian Enterprises and Company Law in Transition" by S. Nysten-Haarala and published by the International Institute for Applied Systems Analysis in Austria).

IRIS has identified five key elements critical to the proper functioning of contract law in the transition countries:

1. The law must be a neutral, principled, and unbiased arbiter of disputes;

2. The role of the omnipotent procurator (state prosecutor) must be re-defined;
3. New civil legislation must be consistent, efficiently communicated to the public, and backed by credible policies;
4. Assuring the effectiveness of the enforcement of judgments is critical;
5. Increasing respect for the rule of law by hiring professional, honest, impartial, and capable judges and law enforcers - or by training and educating them to be so.

But how important are enforceable contracts and property rights to start with?

IRIS succinctly concludes:

"Institutions that define and enforce contracts, make possible the use of collateral in borrowing, provide a legal basis for complex long-term transactions, define and ensure property rights, and above all, prescribe and enforce social order, have been shown in a number of IRIS studies to be closely correlated with economic growth."

Cheryl Gray from the World Bank wrote in "Reforming Legal Systems in Developing and Transition Countries":

"If a dense and efficient network of commercial relationships is to flourish in an economy, it needs a credible and low-cost formal legal process to which aggrieved parties can turn when all else fails."

In their article "Contract-Intensive Money: Contract Enforcement, Property Rights, and Economic

Performance", published in Journal of Economic Growth, 1999 - the late Mancur Olson, together with other luminaries (Christopher Clague, Phillip Keefer, Steve Knack), developed the CIM (Contract Intensive Money) index. It is the part of M2 which is not comprised of currency outside banks.

They demonstrated that even "self-enforcing" trades are sensitive to government policies, especially to contract enforceability and property rights. Thus, CIM is high (i.e., people hold cash) where third-party legal enforcement of contracts is unreliable. This is the case in all countries in transition.

In another seminal paper ("Property and Contract Rights in Autocracies and Democracies" in American Journal of Political Science, 1997), the same authors correlated the age of democratic systems with the extent of property rights and dependence on contracts. The younger the democracy, the less these are entrenched. This is because young democracies - such as the countries in transition - have shorter planning horizons. Their interest in future tax collection and national income is limited.

Keefer and Knack proved convincingly (in "Institutions and Economic Performance", Economics and Politics, 1995) that good governance and property rights (or the lack thereof) significantly affect economic growth - and, by implication, poverty reduction. A 1999 study (by Sala-i-Martin) ran 4 million regressions to incontrovertibly confirm the robustness of the indices used by Keefer and Knack.

Blanchard and Kremer ("Disorganization" in Quarterly Journal of Economics Vol. 112, November 1997) went as far as claiming that the absence of contract enforcement mechanisms is sufficient to explain the disastrous contraction in the output of the post-communist countries.

But this may be going way too far.

Johnson, McMillan, and Woodruff studied five transition economies ("Contract Enforcement in Transition" CEPR Discussion Paper 2081, 1999). They discovered that most firms engaged in "relational contracting" and relied on this informal network of relationships - rather than on the courts - to efficiently and expediently resolve commercial disputes.

Hendley, Murrell, and Ryterman ("Law, Relationships, and Private Enforcement", 1999) describe seven strategies used by Russian enterprises in pursuing efficiency and predictability in business relationships, among them self-enforcement, administrative levers of law, and shadows of law (raising the specter of a lawsuit).

Moreover, it would be wrong to lump all the countries in transition together.

Huge disparities among these countries are evident in a series of annual surveys carried out between 1995-8 by the Central European Economic Review, the EBRD, and BEEPS (World Business Environment and Enterprise Performance Survey). "Rule of Law" ratings ranged from 8.7 (Poland) to 2.7 (Albania and Uzbekistan). "Legal Effectiveness" ratings (from 1 to 4) stretched from 1 (Bosnia) to 4 (Czech Republic, Estonia, Macedonia). And "Enforcement" straddled the divide between 0.26 (Ukraine and Moldova) and 0.77 (Estonia).

Corruption (and Transparency)

I. **The Facts**

Just days before a much-awaited donor conference, the influential International Crisis Group (ICG) recommended to place all funds pledged to Macedonia under the oversight of a "corruption advisor" appointed by the European Commission. The donors ignored this and other recommendations. To appease the critics, the affable Attorney General of Macedonia charged a former Minister of Defense with abuse of duty for allegedly having channeled millions of DM to his relatives during the recent civil war. Macedonia has belatedly passed an anti-money laundering law recently - but failed, yet again, to adopt strict anti-corruption legislation.

In Albania, the Chairman of the Albanian Socialist Party, Fatos Nano, was accused by Albanian media of laundering $1 billion through the Albanian government. Pavel Borodin, the former chief of Kremlin Property, decided not appeal his money laundering conviction in a Swiss court. The Slovak daily "Sme" described in scathing detail the newly acquired wealth and lavish lifestyles of formerly impoverished HZDS politicians. Some of them now reside in refurbished castles. Others have swimming pools replete with wine bars.

Pavlo Lazarenko, a former Ukrainian prime minister, is detained in San Francisco on money laundering charges. His defense team accuses the US authorities of "selective prosecution".

They are quoted by Radio Free Europe as saying:

"The impetus for this prosecution comes from allegations made by the Kuchma regime, which itself is corrupt and dedicated to using undemocratic and repressive methods to stifle political opposition ... (other Ukrainian officials) including Kuchma himself and his closest associates, have committed conduct similar to that with which Lazarenko is charged but have not been prosecuted by the U.S. government".

The UNDP estimated, in 1997, that, even in rich, industrialized, countries, 15% of all firms had to pay bribes. The figure rises to 40% in Asia and 60% in Russia.

Corruption is rife and all pervasive, though many allegations are nothing but political mud-slinging. Luckily, in countries like Macedonia, it is confined to its rapacious elites: its politicians, managers, university professors, medical doctors, judges, journalists, and top bureaucrats. The police and customs are hopelessly compromised. Yet, one rarely comes across graft and venality in daily life. There are no false detentions (as in Russia), spurious traffic tickets (as in Latin America), or widespread stealthy payments for public goods and services (as in Africa).

It is widely accepted that corruption retards growth by deterring foreign investment and encouraging brain drain. It leads to the misallocation of economic resources and distorts competition. It depletes the affected country's endowments - both natural and acquired. It demolishes the tenuous trust between citizen and state. It casts civil and government institutions in doubt, tarnishes the entire political class, and, thus, endangers the democratic system and the rule of law, property rights included.

This is why both governments and business show a growing commitment to tackling it. According to Transparency International's "Global Corruption Report 2001", corruption has been successfully contained in private banking and the diamond trade, for instance.

Hence also the involvement of the World Bank and the IMF in fighting corruption. Both institutions are increasingly concerned with poverty reduction through economic growth and development. The World Bank estimates that corruption reduces the growth rate of an affected country by 0.5 to 1 percent annually. Graft amounts to an increase in the marginal tax rate and has pernicious effects on inward investment as well.

The World Bank has appointed last year a Director of Institutional Integrity - a new department that combines the Anti-Corruption and Fraud Investigations Unit and the Office of Business Ethics and Integrity. The Bank helps countries to fight corruption by providing them with technical assistance, educational programs, and lending.

Anti-corruption projects are an integral part of every Country Assistance Strategy (CAS). The Bank also supports international efforts to reduce corruption by sponsoring conferences and the exchange of information. It collaborates closely with Transparency International, for instance.

At the request of member-governments (such as Bosnia-Herzegovina and Romania) it has prepared detailed country corruption surveys covering both the public and the private sectors. Together with the EBRD, it publishes a corruption survey of 3000 firms in 22 transition countries (BEEPS - Business Environment and Enterprise

Performance Survey). It has even set up a multilingual hotline for whistleblowers.

The IMF made corruption an integral part of its country evaluation process. It suspended arrangements with endemically corrupt recipients of IMF financing. Since 1997, it has introduced policies regarding misreporting, abuse of IMF funds, monitoring the use of debt relief for poverty reduction, data dissemination, legal and judicial reform, fiscal and monetary transparency, and even internal governance (e.g., financial disclosure by staff members).

Yet, no one seems to agree on a universal definition of corruption. What amounts to venality in one culture (Sweden) is considered no more than hospitality, or an expression of gratitude, in another (France, or Italy). Corruption is discussed freely and forgivingly in one place - but concealed shamefully in another. Corruption, like other crimes, is probably seriously under-reported and under-penalized.

Moreover, bribing officials is often the unstated policy of multinationals, foreign investors, and expatriates. Many of them believe that it is inevitable if one is to expedite matters or secure a beneficial outcome. Rich world governments turn a blind eye, even where laws against such practices are extant and strict.

In his address to the Inter-American Development Bank on March 14, President Bush promised to "reward nations that root out corruption" within the framework of the Millennium Challenge Account initiative. The USA has pioneered global anti-corruption campaigns and is a signatory to the 1996 IAS Inter-American Convention against Corruption, the Council of Europe's Criminal Law Convention on Corruption, and the OECD's 1997 anti-bribery convention. The USA has had a comprehensive "Foreign Corrupt Practices Act" since 1977.

The Act applies to all American firms, to all firms - including foreign ones - traded in an American stock exchange, and to bribery on American territory by foreign and American firms alike. It outlaws the payment of bribes to foreign officials, political parties, party officials, and political candidates in foreign countries. A similar law has now been adopted by Britain.

Yet, "The Economist" reports that the American SEC has brought only three cases against listed companies until 1997. The US Department of Justice brought another 30 cases. Britain has persecuted successfully only one of its officials for overseas bribery since 1889. In the Netherlands bribery is tax deductible. Transparency International now publishes a name and shame Bribery Payers Index to complement its 91-country strong Corruption Perceptions Index.

Many rich world corporations and wealthy individuals make use of off-shore havens or "special purpose entities" to launder money, make illicit payments, avoid or evade taxes, and conceal assets or liabilities. According to Swiss authorities, more than $40 billion are held by Russians in its banking system alone. The figure may be 5 to 10 times higher in the tax havens of the United Kingdom.

In a survey it conducted last month of 82 companies in which it invests, "Friends, Ivory, and Sime" found that only a quarter had clear anti-corruption management and accountability systems in place.

Tellingly only 35 countries signed the 1997 OECD "Convention on Combating Bribery of Foreign Public Officials in International Business Transactions" - including four non-OECD members: Chile, Argentina, Bulgaria, and Brazil. The convention has been in force since February 1999 and is only one of many OECD anti-corruption drives, among which are SIGMA (Support for Improvement in Governance and Management in Central and Eastern European countries), ACN (Anti-Corruption Network for Transition Economies in Europe), and FATF (the Financial Action Task Force on Money Laundering).

Moreover, The moral authority of those who preach against corruption in poor countries - the officials of the IMF, the World Bank, the EU, the OECD - is strained by their ostentatious lifestyle, conspicuous consumption, and "pragmatic" morality.

II. **What to Do? What is Being Done?**

Two years ago, I proposed a taxonomy of corruption, venality, and graft. I suggested this cumulative definition:

a. The withholding of a service, information, or goods that, by law, and by right, should have been provided or divulged.

b. The provision of a service, information, or goods that, by law, and by right, should not have been provided or divulged.

c. That the withholding or the provision of said service, information, or goods are in the power of the withholder or the provider to withhold or to provide AND That the withholding or the provision of said service, information, or goods constitute an integral and substantial part of the authority or the function of the withholder or the provider.

d. That the service, information, or goods that are provided or divulged are provided or divulged against a benefit or the promise of a benefit from the recipient and as a result of the receipt of this specific benefit or the promise to receive such benefit.

e. That the service, information, or goods that are withheld are withheld because no benefit was provided or promised by the recipient.

There is also what the World Bank calls "State Capture" defined thus:

"The actions of individuals, groups, or firms, both in the public and private sectors, to influence the formation of laws, regulations, decrees, and other government policies to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials."

We can classify corrupt and venal behaviors according to their outcomes:

a. **Income Supplement** - Corrupt actions whose sole outcome is the supplementing of the income of the provider without affecting the "real world" in any manner.

b. **Acceleration or Facilitation Fees** - Corrupt practices whose sole outcome is to accelerate or facilitate decision making, the provision of goods and services or the divulging of information.

c. **Decision Altering (State Capture) Fees** - Bribes and promises of bribes which alter decisions or affect them, or which affect the formation of policies, laws, regulations, or decrees beneficial to the bribing entity or person.

d. **Information Altering Fees** - Backhanders and bribes that subvert the flow of true and complete information within a society or an economic unit (for instance, by selling professional diplomas, certificates, or permits).

e. **Reallocation Fees** - Benefits paid (mainly to politicians and political decision makers) in order to affect the allocation of economic resources and material wealth or the rights thereto. Concessions, licenses, permits, assets privatized, tenders awarded are all subject to reallocation fees.

To eradicate corruption, one must tackle both giver and taker.

History shows that all effective programs shared these common elements:

a. The persecution of corrupt, high-profile, public figures, multinationals, and institutions (domestic and foreign). This demonstrates that no one is above the law and that crime does not pay.

b. The conditioning of international aid, credits, and investments on a monitored reduction in corruption levels. The structural roots of corruption should be tackled rather than merely its symptoms.

c. The institution of incentives to avoid corruption, such as a higher pay, the fostering of civic pride, "good behavior" bonuses, alternative income and pension plans, and so on.

d. In many new countries (in Asia, Africa, and Eastern Europe) the very concepts of "private" versus "public" property are fuzzy and impermissible behaviors are not clearly demarcated. Massive investments in education of the public and of state officials are required.

e. Liberalization and deregulation of the economy. Abolition of red tape, licensing, protectionism, capital controls, monopolies, discretionary, non-public, procurement. Greater access to information and a public debate intended to foster a "stakeholder society".

f. Strengthening of institutions: the police, the customs, the courts, the government, its agencies, the tax authorities - under time limited foreign management and supervision.

Awareness to corruption and graft is growing - though it mostly results in lip service. The Global Coalition for Africa adopted anti-corruption guidelines in 1999. The otherwise opaque Asia Pacific Economic Cooperation (APEC) forum is now championing transparency and good governance. The UN is promoting its pet convention against corruption.

The G-8 asked its Lyon Group of senior experts on transnational crime to recommend ways to fight corruption related to large money flows and money laundering. The USA and the Netherlands hosted global forums on corruption - as will South Korea next year. The OSCE is rumored to respond with its own initiative, in collaboration with the US Congressional Helsinki Commission.

The south-eastern Europe Stability Pact sports its own Stability Pact Anti-corruption Initiative (SPAI). It held its first conference in September 2001 in Croatia. More than 1200 delegates participated in the 10th International Anti-Corruption Conference in Prague last year. The conference was attended by the Czech prime minister, the Mexican president, and the head of the Interpol.

The most potent remedy against corruption is sunshine - free, accessible, and available information disseminated and probed by an active opposition, uncompromised press, and assertive civic organizations and NGO's. In the absence of these, the fight against official avarice and criminality is doomed to failure. With them, it stands a chance.

Corruption can never be entirely eliminated - but it can be restrained and its effects confined. The cooperation of good people with trustworthy institutions is indispensable. Corruption can be defeated only from the inside, though with plenty of outside help. It is a process of self-redemption and self-transformation. It is the real transition.

Note - The Psychology of Corruption

Most politicians bend the laws of the land and steal money or solicit bribes because they need the funds to support networks of patronage. Others do it in order to reward their nearest and dearest or to maintain a lavish lifestyle when their political lives are over.

But these mundane reasons fail to explain why some officeholders go on a rampage and binge on endless quantities of lucre. All rationales crumble in the face of a Mobutu Sese Seko or a Saddam Hussein or a Ferdinand Marcos who absconded with billions of US dollars from the coffers of Zaire, Iraq, and the Philippines, respectively.

These inconceivable dollops of hard cash and valuables often remain stashed and untouched, moldering in bank accounts and safes in Western banks. They serve no purpose, either political or economic. But they do fulfill a psychological need. These hoards are not the megalomaniacal equivalents of savings accounts. Rather they are of the nature of compulsive collections.

Erstwhile president of Sierra Leone, Momoh, amassed hundreds of video players and other consumer goods in vast rooms in his mansion. As electricity supply was intermittent at best, his was a curious choice. He used to sit among these relics of his cupidity, fondling and counting them insatiably.

While Momoh relished things with shiny buttons, people like Sese Seko, Hussein, and Marcos drooled over money. The ever-heightening mountains of greenbacks in their vaults soothed them, filled them with confidence, regulated their sense of self-worth, and served as a love substitute. The balances in their bulging bank accounts were of no practical import or intent. They merely catered to their psychopathology.

These politicos were not only crooks but also kleptomaniacs. They could no more stop thieving than Hitler could stop murdering. Venality was an integral part of their psychological makeup.

Kleptomania is about acting out. It is a compensatory act. Politics is a drab, uninspiring, unintelligent, and, often humiliating business. It is also risky and rather arbitrary. It involves enormous stress and unceasing conflict. Politicians with mental health disorders (for instance, narcissists or psychopaths) react by decompensation. They rob the state and coerce businessmen to grease their palms because it makes them feel better, it helps them to repress their mounting fears and frustrations, and to restore their psychodynamic equilibrium. These politicians and bureaucrats "let off steam" by looting.

Kleptomaniacs fail to resist or control the impulse to steal, even if they have no use for the booty. According to the Diagnostic and Statistical Manual IV-TR (2000), the bible of psychiatry, kleptomaniacs feel "pleasure, gratification, or relief when committing the theft." The good book proceeds to say that " ... (T)he individual may hoard the stolen objects ...".

As most kleptomaniac politicians are also psychopaths, they rarely feel remorse or fear the consequences of their misdeeds. But this only makes them more culpable and dangerous.

Case Study - Yugoslavia

Milosevic and his cronies stand accused of plundering Serbia's wealth - both pecuniary and natural. Yet, the media tends to confuse three modes of action with two diametrically opposed goals. There was state sanctioned capital flight. Gold and foreign exchange were smuggled out of Yugoslavia and deposited in other countries. This was meant to provide a cushion against embargo and sanctions imposed on Yugoslavia by the West.

The scale of these operations has been wildly over-estimated at 4 billion US dollars. A figure half as big is more reasonable. Most of the money was used legitimately, to finance the purchase of food, medicines, and energy products. Yugoslavia would have frozen to death had its leaders not have the foresight to act as they did.

This had nothing to do with party officials, cronies, and their family members enriching themselves by "diverting" export proceeds and commodities into private accounts in foreign lands. The culprits often disguised these acts of plunder as sanctions-busting operations. Hence the confusion.

Thirdly, members of the establishment and their relatives were allowed to run lucrative smuggling and black market operations fuelled by cheap credits coerced out of the dilapidated and politicised "banking" system.

As early as 1987, a network of off-shore bank accounts and holding companies was established by Serbia's Communist party and, later, by Yugoslavia. This frantic groping for alternatives reached a peak during 1989 and

1991 and after 1992 when accounts were opened in Cyprus, Israel, Greece, and Switzerland and virtually all major Yugoslav firms opened Cypriot subsidiaries or holding structures. Starting in 1991, the Central Bank's gold (and a small part of the foreign exchange reserves) were deposited in Switzerland (mainly in Zurich). A company by the name of "Metalurski Kombinat Smederevo - MKS" (renamed "Sartid" after its bogus privatisation) was instrumental in this through its MKS Zurich subsidiary. MKS was a giant complex of metal processing factories, headed by a former Minister of Industry and a Milosevic loyalist, Dusko Matkovic. The latter also served as deputy chairman of Milosevic's party. The lines between party, state and personal fortunes blurred fast. Small banking institutions were established everywhere, even in London (the AY Bank) and conducted operations throughout the world. They were owned by bogus shareholders, out of the reach of the international sanctions regime.

When UN sanctions were imposed in stages (1992-5), the state made sure its export proceeds were out of harm's way and never in sanctions-bound UK and USA banks. The main financial agent was "Beogradska Banka" and its branch in Novi Sad. In a series of complex transactions involving foreign exchange trades, smuggled privatisation proceeds, and inflated import invoices, it was able to stash away hundreds of millions of dollars. This money was used to finance imports and defray the exorbitant commissions, fees, and costs charged by numerous intermediaries. Yugoslavia (and the regime) had no choice - it was either that or starvation, freezing and explosive social discontent.

Concurrently, a massive and deeply criminalized web of smuggling, illegal (customs-exempt) imports, bribe and corruption has stifled all legal manufacturing and commerce activities. Cigarettes through Montenegro, alcohol and oil through Romania, petrol, other goods (finished and semi-finished) and raw materials from Greece through the Vardar river (Macedonia), absolutely everything through Croatia, drugs from Turkey (and Afghanistan). UN personnel happily colluded and collaborated - for a fee, of course. The export of commodities - such as grain or precious metals (gold, even Uranium) - was granted in monopoly to Milosevic stalwarts. These were vast fiefdoms controlled by a few prominent "families" and Milosevic favourites. It was also immensely lucrative. Even minor figures were able to deposit millions of US dollars in their Russian, Cypriot, Lebanese, Greek, Austrian, Swiss, and South African accounts. The regime leaned heavily on Yugoslav banks to finance these new rich with cheap, soft, and often non-returnable, credits. These were often used to speculate in the frenetic informal foreign exchange markets for immediate windfalls.

The new Yugoslav authorities are likely to be deeply frustrated and disappointed. Most of the money was expended on essentials for the population. The personal fortunes made are tiny by comparison and well-shielded in off-shore banking havens. Milosevic himself has almost nothing to his name. His son and daughter may constitute richer pickings but not by much. The hunt for the Milosevic treasure is bound to be an expensive, futile undertaking.

Corruption in Central and Eastern Europe

The three policemen barked "straf", "straf" in unison. It was a Russianized version of the German word for "fine" and a euphemism for bribe. I and my fiancée were stranded in an empty ally at the heart of Moscow, physically encircled by these young bullies, an ominous propinquity. They held my passport ransom and began to drag me to a police station nearby. We paid.

To do the fashionable thing and to hold the moral high ground is rare. Yet, denouncing corruption and fighting it satisfies both conditions. Such hectoring is usually the preserve of well-heeled bureaucrats, driving utility vehicles and banging away at wireless laptops. The General Manager of the IMF makes 400,000 US dollars a year, tax-free, and perks. This is the equivalent of 2,300 (!) monthly salaries of a civil servant in Macedonia - or 7,000 monthly salaries of a teacher or a doctor in Yugoslavia, Moldova, Belarus, or Albania. He flies only first class and each one of his air tickets is worth the bi-annual income of a Macedonian factory worker. His shareholders - among them poor and developing countries - are forced to cough up these exorbitant fees and to finance the luxurious lifestyle of the likes of Kohler and Wolfensohn. And then they are made to listen to the IMF lecture them on belt tightening and how uncompetitive their economies are due to their expensive labour force. To me, such a double standard is the epitome of corruption. Organizations such as the IMF and World Bank will never be possessed of a shred of moral authority in these parts of the world unless and until they forgo their conspicuous consumption.

Yet, corruption is not a monolithic practice. Nor are its outcomes universally deplorable or damaging. One would do best to adopt a utilitarian and discerning approach to it. The advent of moral relativism has taught us that "right" and "wrong" are flexible, context dependent and culture-sensitive yardsticks.

What amounts to venality in one culture (Slovenia) is considered no more than gregariousness or hospitality in another (Macedonia).

Moreover, corruption is often "imported" by multinationals, foreign investors, and expats. It is introduced by them to all levels of governments, often in order to expedite matters or secure a beneficial outcome. To eradicate corruption, one must tackle both giver and taker.

Thus, we are better off asking "cui bono" than "is it the right thing to do". Phenomenologically, "corruption" is a common - and misleading - label for a group of behaviours. One of the following criteria must apply:

(a) The withholding of a service, information, or goods that, by law, and by right, should have been provided or divulged.

To have a phone installed in Russia one must openly bribe the installer (according to a rather rigid tariff). In many of the former republics of Yugoslavia, it is impossible to obtain statistics or other data (the salaries of senior public officeholders, for instance) without resorting to kickbacks.

(b) The provision of a service, information, or goods that, by law, and by right, should not have been provided or divulged.

Tenders in the Czech Republic are often won through bribery. The botched privatizations all over the former Eastern Bloc constitute a massive transfer of wealth to select members of a nomenklatura. Licences and concessions are often granted in Bulgaria and the rest of the Balkan as means of securing political allegiance or paying off old political "debts".

(c) That the withholding or the provision of said service, information, or goods are in the power of the withholder or the provider to withhold or to provide AND That the withholding or the provision of said service, information, or goods constitute an integral and substantial part of the authority or the function of the withholder or the provider.

The post-communist countries in transition are a dichotomous lot. On the one hand, they are intensely and stiflingly bureaucratic. On the other hand, none of the institutions functions properly or lawfully. While these countries are LEGALISTIC - they are never LAWFUL. This fuzziness allows officials in all ranks to usurp authority, to trade favours, to forge illegal consensus and to dodge criticism and accountability. There is a direct line between lack of transparency and venality. Eran Fraenkel of Search for Common Ground in Macedonia has coined the phrase "ambient corruption" to capture this complex of features.

(d) That the service, information, or goods that are provided or divulged are provided or divulged against a benefit or the promise of a benefit from the recipient and as a result of the receipt of this specific benefit or the promise to receive such benefit.

It is wrong to assume that corruption is necessarily, or even mostly, monetary or pecuniary. Corruption is built on mutual expectations. The reasonable expectation of a future benefit is, in itself, a benefit. Access, influence peddling, property rights, exclusivity, licences, permits, a job, a recommendation - all constitute benefits.

(e) That the service, information, or goods that are withheld are withheld because no benefit was provided or promised by the recipient.

Even then, in CEE, we can distinguish between a few types of corrupt and venal behaviours in accordance with their OUTCOMES (utilities):

(1) Income Supplement

Corrupt actions whose sole outcome is the supplementing of the income of the provider without affecting the "real world" in any manner.

Though the perception of corruption itself is a negative outcome - it is so only when corruption does not constitute an acceptable and normative part of the playing field. When corruption becomes institutionalised - it also becomes predictable and is easily and seamlessly incorporated into decision making processes of all economic players and moral agents. They develop "by-passes" and "techniques" which allow them to restore an efficient market equilibrium. In a way, all-pervasive corruption is transparent and, thus, a form of taxation.

This is the most common form of corruption exercised by low and mid-ranking civil servants, party hacks and municipal politicians throughout the CEE.

More than avarice, the motivating force here is sheer survival. The acts of corruption are repetitive, structured and in strict accordance with an un-written tariff and code of conduct.

(2) Acceleration Fees

Corrupt practices whose sole outcome is to ACCELERATE decision making, the provision of goods and services or the divulging of information. None of the outcomes or the utility functions are altered. Only the speed of the economic dynamics is altered. This kind of corruption is actually economically BENEFICIAL. It is a limited transfer of wealth (or tax) which increases efficiency. This is not to say that bureaucracies and venal officialdoms, over-regulation and intrusive political involvement in the workings of the marketplace are good (efficient) things. They are not. But if the choice is between a slow, obstructive and passive-aggressive civil service and a more forthcoming and accommodating one (the result of bribery) - the latter is preferable.

Acceleration fees are collected mostly by mid-ranking bureaucrats and middle rung decision makers in both the political echelons and the civil service.

(3) Decision Altering Fees

This is where the line is crossed from the point of view of aggregate utility. When bribes and promises of bribes actually alter outcomes in the real world - a less than optimal allocation of resources and distribution of means of production is obtained. The result is a fall in the general level of production. The many is hurt by the few. The economy is skewed and economic outcomes are distorted. This kind of corruption should be uprooted on utilitarian grounds as well as on moral ones.

(4) Subversive Outcomes

Some corrupt collusions lead to the subversion of the flow of information within a society or an economic unit. Wrong information often leads to disastrous outcomes. Consider a medical doctor or an civil engineer who bribed their way into obtaining a professional diploma.

Human lives are at stake. The wrong information, in this case is the professional validity of the diplomas granted and the scholarship (knowledge) that such certificates stand for. But the outcomes are lost lives. This kind of corruption, of course, is by far the most damaging.

Unfortunately, it is widespread in CEE. It is proof of the collapse of the social treaty, of social solidarity and of the fraying of the social fabric.

No Western country accepts CEE diplomas without further accreditation, studies and examinations. Many "medical doctors" and "engineers" who emigrated to Israel from Russia and the former republics of the USSR - were suspiciously deficient professionally. Israel was forced to re-educate them prior to granting them a licence to practice locally.

(5) Reallocation Fees

Benefits paid (mainly to politicians and political decision makers) in order to affect the allocation of economic resources and material wealth or the rights thereto. Concessions, licences, permits, assets privatised, tenders awarded are all subject to reallocation fees. Here the damage is materially enormous (and visible) but, because it is widespread, it is "diluted" in individual terms. Still, it is often irreversible (like when a sold asset is purposefully under-valued) and pernicious. a factory sold to avaricious and criminally minded managers is likely to collapse and leave its workers unemployed.

Corruption pervades daily life even in the prim and often hectoring countries of the West. It is a win-win game (as far as Game Theory goes) - hence its attraction. We are all corrupt to varying degrees. But it is wrong and wasteful - really, counterproductive - to fight corruption in CEE in a wide front and indiscriminately. It is the kind of corruption whose evil outcomes outweigh its benefits that should be fought. This fine (and blurred) distinction is too often lost on decision makers and law enforcement agencies in both East and West.

ERADICATING CORRUPTION

An effective program to eradicate corruption must include the following elements:

1. Egregiously corrupt, high-profile, public figures, multinationals, and institutions (domestic and foreign) must be singled out for harsh (legal) treatment and thus demonstrate that no one is above the law and that crime does not pay.

2. All international aid, credits, and investments must be conditioned upon a clear, performance-based, plan to reduce corruption levels and intensity. Such a plan should be monitored and revised as needed. Corruption retards development and produces instability by undermining the credentials of democracy, state institutions, and the political class. Reduced corruption is, therefore, a major target of economic and institutional developmental.

3. Corruption cannot be reduced only by punitive measures. A system of incentives to avoid corruption must be established. Such incentives should include a higher pay, the fostering of civic pride, educational campaigns, "good behaviour" bonuses, alternative income and pension plans, and so on.

4. Opportunities to be corrupt should be minimized by liberalizing and deregulating the economy. Red tape should be minimized, licensing abolished, international trade freed, capital controls eliminated, competition introduced, monopolies broken, transparent public tendering be made mandatory, freedom of information enshrined, the media should be directly supported by the international community, and so on. Deregulation should be a developmental target integral to every program of international aid, investment, or credit provision.

5. Corruption is a symptom of systemic institutional failure. Corruption guarantees efficiency and favourable outcomes. The strengthening of

institutions is of critical importance. The police, the customs, the courts, the government, its agencies, the tax authorities, the state owned media - all must be subjected to a massive overhaul. Such a process may require foreign management and supervision for a limited period of time. It most probably would entail the replacement of most of the current - irredeemably corrupt - personnel. It would need to be open to public scrutiny.

6. Corruption is a symptom of an all-pervasive sense of helplessness. The citizen (or investor, or firm) feels dwarfed by the overwhelming and capricious powers of the state. It is through corruption and venality that the balance is restored. To minimize this imbalance, potential participants in corrupt dealings must be made to feel that they are real and effective stakeholders in their societies. A process of public debate coupled with transparency and the establishment of just distributive mechanisms will go a long way towards rendering corruption obsolete.

Recently, the most unusual event has gone unnoticed in the international press. A former minister of finance has accused the more prominent members of the diplomatic corps in his country of corruption. He insisted that these paragons of indignant righteousness and hectoring morality have tried to blackmail him into paying them hefty commissions from money allotted to exigent humanitarian aid. This was immediately and from afar - and, therefore, without proper investigation - denied by their superiors in no uncertain terms.

The facts are these: most (though by no means all) Western diplomats in the nightmarish wasteland that is East Europe and the Balkan, the unctuously fulsome and the frowzily wizened alike, are ageing and sybaritic basket cases. They have often failed miserably in their bootless previous posts - or have insufficiently submerged in the Byzantine culture of their employers. Thus emotionally injured and cast into the frigorific outer darkness of a ravaged continent, they adopt the imperial patina of Roman procurators in narcissistic compensation. Their long suffering wives - bored to distraction in the impassibly catatonic societies of post communism - impose upon a reluctant and flummoxed population the nescient folderol of their distaff voluntary urges or exiguous artistic talents. Ever more crapulous, they aestivate and hibernate, the queens of tatty courts and shabby courtiers.

The cold war having ebbed, these emissaries of questionable provenance engage in the promotion of the narrow interests of specific industries or companies. They lobby the local administration, deploying bare threats and obloquies where veiled charm fails. They exert subtle or brutal pressure through the press. They co-opt name-dropping bureaucrats and bribe pivotal politicians. They get fired those who won't collaborate or threaten to expose their less defensible misdeeds. They are glorified delivery boys, carrying apocryphal messages to and fro. They are bloviating PR campaigners, seeking to aggrandize their meagre role and, incidentally, that of their country. They wine and dine and banter endlessly with the provincial somnolent variety of public figures, members of the venal and pinchbeck elites that now rule these tortured territories. In short - forced to deal with the bedizened miscreants that pass for businessmen and politicians in this nether world - they are transformed, assuming in the process the identity of their obdurately corrupted hosts.

Thus, they help to sway elections and hasten to endorse their results, however disputed and patently fraudulent. They intimidate the opposition, negotiate with businessmen, prod favoured politicians, spread roorbacks and perambulate their fiefdom to gather intelligence. More often than not, they cross the limpid lines between promotion and extortion, lagniappe and pelf, friendship and collusion, diplomacy and protectorate, the kosher and the criminal.

They are the target and the address of a legion of pressures and demands. Their government may ask them to help depose one coalition and help install another. Their secret services - disguised as intrusive NGOs or workers at the embassy - often get them involved in shady acts and unscrupulous practices. Real NGOs ask for their assiduous assistance and protection. Their hosts - and centuries old protocol - expect them to surreptitiously provide support while openly refrain from intervening, maintaining equipoise. Other countries protest, compete, or leak damaging reports to an often hostile media. The torpid common folk resent them for their colonial ways and hypocritical demarches. Lacking compunction, they are nobody's favourites and everybody's scapegoats at one time or another.

And they are ill-equipped to deal with these subtleties. Not of intelligence, they end where they now are and wish they weren't. Ignorant of business and entrepreneurship, they occupy the dead end, otiose and pension-orientated jobs they do. Devoid of the charm, negotiating skills and human relations required by the intricacies of their profession - they are relegated to the Augean outskirts of civilization. Dishonest and mountebank, they persist in their mortifying positions, inured to the conniving they require.

This blatantly discernible ineptitude provokes the "natives" into a wholesale rejection of the West, its values and its culture. The envoys are perceived as the cormorant reification of their remote controllers. Their voluptuary decadence is a distant echo of the West's decay, their nonage greed - a shadow of its avarice, their effrontery and hidebound peremptory nature - its mien. They are in no position to preach or teach.

The diplomats of the West are not evil. Some of them mean well. To the best of their oft limited abilities, they cadge and beg and press and convince their governments to show goodwill and to contribute to their hosts. But soon their mettle is desiccated by the vexatious realities of their new habitation. Reduced to susurrous cynicism and sardonic contempt, they perfunctorily perform their functions, a distant look in their now empty eyes. They have been assimilated, rendered useless to their dispatchers and to their hosts alike.

Credit Cards, Chargeback of

Your credit card is stolen. You place a phone call to the number provided in your tourist guide or in the local daily press. You provide your details and you cancel your card. You block it. In a few minutes, it should be transferred to the stop-list available to the authorization centres worldwide. From that moment on, no thief will be able to fraudulently use your card. You can sigh in relief. The danger is over.

But is it?

It is definitely not. To understand why, we should first review the intricate procedure involved.

In principle, the best and safest thing to do is call the authorization centre of the bank that issued your card (the issuer bank). Calling the number published in the media is second best because it connects the cardholder to a "volunteer" bank, which caters for the needs of all the issuers of a given card. Some service organizations (such as IAPA – the International Air Passengers Association) provide a similar service.

The "catering bank" accepts the call, notes down the details of the cardholder and prepares a fax containing the instruction to cancel the card. The cancellation fax is then sent on to the issuing bank. The details of all the issuing banks are found in special manuals published by the clearing and payments associations of all the banks that issue a specific card. All the financial institutions that issue Mastercards, Eurocards and a few other more minor cards in Europe are members of Europay International (EPI). Here lies the first snag: the catering bank often mistakes the identity of the issuer. Many banks share the same name or are branches of a network. Banks with identical names can exist in Prague, Budapest and Frankfurt, or Vienna, for instance. Should a fax cancelling the card be sent to the wrong bank – the card will simply not be cancelled until it is too late. By the time the mistake is discovered, the card is usually thoroughly abused and the financial means of the cardholder are exhausted.

Additionally, going the indirect route (calling an intermediary bank instead of the issuing bank) translates into a delay which could prove monetarily crucial. By the time the fax is sent, it might be no longer necessary.

If the card has been abused and fraudulent purchases or money withdrawals have been debited to the unfortunate cardholders' bank or credit card account – the cardholder can reclaim these charges. He has to clearly identify them and state in writing that they were not effected by him. A process called "chargeback" thus is set in motion.

A chargeback is a transaction disputed within the payment system. A dispute can be initiated by the cardholder when he receives his statement and rejects one or more items on it or when an issuing financial institution disputes a transaction for a technical reason (usually at the behest of the cardholder or if his account is overdrawn). A technical reason could be the wrong or no signature, wrong or no date, important details missing in the sales vouchers and so on. Despite the warnings carried on many a sales voucher ("No Refund – No Cancellation") both refunds and cancellations are daily occurrences.

To be considered a chargeback, the card issuer must initiate a well-defined dispute procedure. This it can do only after it has determined the reasons invalidating the transaction. A chrageback can only be initiated by the issuing financial institution. The cardholder himself has no standing in this matter and the chargeback rules and regulations are not accessible to him. He is confined to lodging a complaint with the issuer. This is an abnormal situation whereby rules affecting the balances and mandating operations resulting in debits and credits in the bank account are not available to the account name (owner). The issuer, at its discretion, may decide that issuing a chargeback is the best way to rectify the complaint.

The following sequence of events is, thus, fairly common:

1. The cardholder presents his card to a merchant (aka: an acceptor of payment system cards).

2. The merchant may request an authorization for the transaction, either by electronic means (a Point of Sale / Electronic Fund Transfer apparatus) or by phone (voice authorization). A merchant is obliged to do so if the value of the transaction exceeds predefined thresholds. But there are other cases in which this might be either a required or a recommended policy.

3. If the transaction is authorized, the merchant notes down the authorization reference number and gives the goods and services to the cardholder. In a face-to-face transaction (as opposed to a phone or internet/electronic transaction), the merchant must request the cardholder to sign the sale slip. He must then compare the signature provided by the cardholder to the signature specimen at the back of the card. A mismatch of the signatures (or their absence either on the card or on the slip) invalidate the transaction. The merchant will then provide the cardholder with a receipt, normally with a copy of the signed voucher.

4. Periodically, the merchant collects all the transaction vouchers and sends them to his bank (the "acquiring" bank).

5. The acquiring bank pays the merchant on foot of the transaction vouchers minus the commission payable to the credit card company. Some banks pre-finance or re-finance credit card sales vouchers in the form of credit lines (cash flow or receivables financing).

6. The acquiring bank sends the transaction to the payments system (VISA International or Europay International) through its connection to the relevant network (VisaNet, in the case of Visa, for instance).

7. The credit card company (Visa, Mastercard, Diners Club) credits the acquirer bank.

8. The credit card company sends the transaction to the issuing bank and automatically debits the issuer.

9. The issuing bank debits the cardholder's account. It issues monthly or transaction related statements to the cardholder.

10. The cardholder pays the issuing bank on foot of the statement (this is automatic, involuntary debiting of the cardholders account with the bank).

Some credit card companies in some territories prefer to work directly with the cardholders. In such a case, they issue a monthly statement, which the cardholder has to pay directly to them by money order or by bank transfer. The cardholder will be required to provide a security to the credit card company and his spending limits will be tightly related to the level and quality of the security provided by him. The very issuance of the card is almost always subject to credit history and to an approval process.

My credit card was stolen in 1998, in a crowded film festival. I placed a phone call to the number provided by my bank. The same number was also published in my tourist guide and in the local daily press. I gave my details and asked to have my card cancelled, or at least blocked. I felt safe because I knew that, in a few minutes, my card number will pop up in a stop-list available to authorization centres worldwide. From that moment on, no thief will be able to fraudulently abuse my card, I thought as I reverted to my delicious lunch, sighing in relief.

But the danger was far from over.

Though rarely advised to do so, the best and safest thing is to call the authorization centre of the bank that issued the card - i.e., the issuing bank. That being a weekend, the number I called instead was a poor second. It belonged to a "volunteer" bank, which catered to the needs of all the issuers of a given type of card - "MasterCard", "Visa", or "American Express" in this case. Some travel service organizations (e.g., IAPA – the International Air Passengers Association) provide a similar service.

Updating the stop-list is a low priority with the overworked weekend stuff of the "catering bank". Sometimes it takes hours before the list is updated. The "catering bank" sends a fax to the issuing bank, asking it to cancel the card. The details of all the issuing banks are available in special manuals. These are published by the clearing and payments associations of all the banks that issue a specific type of card. All the financial institutions that issue MasterCards, Eurocards and a few other minor cards in Europe are members of Europay International (EPI), for example.

Here lies the first snag: the catering bank often mistakes the identity of the issuer. Many issuers - especially branches of the same bank - are eponymous. Banks with identical names exist in Prague, Budapest, Frankfurt, London, Zagreb, or Vienna, for instance. In my case, they alerted the wrong bank in the wrong country. My card was never blocked. The thieves simply abused it to the limit.

Thus, going the indirect route (calling an intermediary bank instead of the issuing bank) translates into a delay which could prove monetarily crucial. By the time the fax is sent, it might be no longer necessary. To be on the safe side, standard credit card contracts in some countries apply coverage only one hour after the theft - when most of the damage has already been done. In the USA credit card liability in case of fraudulent transactions is limited to the first $50.

The cardholder can reclaim, in writing, fraudulent charges and money withdrawals. This ritualistic dispute procedure is called "chargeback". A chargeback is a transaction disputed within the payment system by the cardholder through the card issuer. It can also be initiated by the card-issuer on technical grounds, usually at the behest of the cardholder or if his account is overdrawn: wrong or no signature, wrong or no date, important details missing in the sales vouchers and so on. Despite the warnings carried on many a sales voucher ("No Refund – No Cancellation") both refunds and cancellations occur daily.

The cardholder himself has no standing in the process and is confined to lodging a complaint with the issuer. The rules and regulations governing chargebacks are internal and inaccessible to him though they often result in debits and credits to his bank account. The issuer, at its discretion, may decide that issuing a chargeback is the best way to rectify the complaint.

The typical credit card transaction involves these steps:

1. The cardholder presents his card to a merchant, the acceptor.

2. The merchant may request an authorization for the transaction, either by electronic means (a Point of Sale / Electronic Fund Transfer apparatus) or by phone (voice authorization). A merchant is obliged to do so if the value of the transaction exceeds predefined thresholds. But there are other cases in which this might be a policy either required or recommended by issuers, card companies, or clearinghouses.

3. If authorized, the merchant notes down the transaction authorization code and gives, or ships, the goods, or services to the cardholder. If the cardholder is present, he must sign the sale slip (voucher) and the merchant validates the signature by comparing it to the specimen at the back of the card. The transaction goes through only if the signatures match. The merchant then provides the cardholder with a receipt, normally with a copy of the signed voucher.

4. The merchant collects all the transaction vouchers periodically and gives them to his bank (the "acquiring" bank).

5. The acquiring bank credits the merchant's bank account with the difference between the total amount of the transactions and the commissions and fees payable to the credit card company. Some banks pre-finance or re-finance credit card sales vouchers (receivables financing) - i.e., they lend against future credit card revenues.

6. The acquiring bank forwards the slips or an electronic ledger to the payments system (VISA International, or Europay International) through its connection to the relevant network (VisaNet, in the case of Visa, for instance).

7. The credit card company (Visa, MasterCard, Diners Club) credits the acquiring bank.

8. The credit card company sends the transactions to the issuing bank and automatically debits it.

9. The issuing bank automatically debits the cardholder's account. It issues monthly or transaction related statements to the cardholder.

In some countries - mainly in Central and Eastern Europe, the Middle East, Africa, and Asia - credit card companies sometimes work directly with their cardholders who pay the companies via money order or bank transfer. The cardholder is often required to provide a security to the credit card company and his spending limits are tightly supervised. Credit history, collateral, and background checks are rigorous. Even then, the majority of the cards issued are debit - rather than credit - cards.

Andrew Greenstein's Internet business - sold in 2001 - did a great volume of credit card transactions and experienced chargebacks of between 0.5 to 3 percent. Despite its positive cashflow and good standing with the bank, it was fined by Visa, placed in its "Merchant Watch" list and forced to set aside $125,000 in a reserve account. Its fee per chargeback shot from nil to $25 on local cards and $50 per foreign chargeback.

Greenstein says:

"Over the years, I experienced bank re-negotiations, bank switches, used various online credit card processing software. I successfully negotiated our way out of additional reserve accounts, set up alternate merchant accounts with lower - sometimes virtually no - fees, and helped the company scale down its chargeback picture considerably. It was always frustrating though that even when we'd show Merchant Services & Visa dramatically reduced chargebacks, increased revenue, a large positive cashflow, years of success, letters from accountants, etc. - they'd continue to fine us over and over again, insisting that even 1.75% was 'too high for an Internet business'.

It always seemed as though they were doing it to profit - knowing full well that the company I ran had one of the rosiest chargeback pictures of all and one of the cleanest reputations around. Still, for years the company continued to suffer nicks and jabs at the whim of either Merchant Services or Visa. My years of experiences getting new accounts, changing accounts, offsetting reserves, and more - led me to create ChargebackPrevention.Com to help less knowledgeable merchants benefit from my years of 'education' in the field'."

Question: How bad is the problem of Internet credit card fraud?

Answer: Having no medium-wide statistics, I'd say that the amount of chargebacks/fraudulent orders is only increasing as more people take to the Internet and as more pranksters realize that the odds of "getting busted" are pretty low. Though frustrating to businesses, I believe that most reasonably-accomplished outfits can survive with a certain number of chargebacks even if it amounts to 3 or 4%. The problem arises when the "powers-that-be" add insult to injury by demanding a reserve account, or by arbitrarily "fining" merchants for being "bad boys." That's when Internet credit card fraud becomes a the seed that spawns a whole garden of trouble.

Question: Chargebacks allow consumers to protect themselves against fraud, faulty products, and breach of sales contracts. Would you say that consumers are abusing this protection? If so, how would you restructure the chargeback process to balance the rights and obligations of all parties?

Answer: Abuse exists in any scenario. If you ask most merchants, those few cases of torment when they knew they were being taken advantage of probably stuck in their memory and their response would be "yes, consumers are abusing this protection!".

Indeed, I can't help but recall those individual cases of obvious abuse. Still, I'd have to say that the number of people intentionally doing chargebacks to get money back is quite low. I also believe that the ONE thing Visa/MasterCard does right is to limit people in quality dispute chargebacks. When they see someone doing it excessively, they flag their account. I don't think there's a big problem of people doing it regularly, but there is a problem when consumers read articles like this one and realize, in the back of their minds, that they can chargeback. Then every slight problem with a merchant gets blown out of proportion and they try to get the product/service for free.

In my experience, however, quality dispute chargebacks are generally very easy to reverse or beat and ChargebackPrevention.Com spends a great deal of time on this - and offers many pages of information and even examples of successful rebuttal letters - teaching merchants how to diffuse this sort of chargeback.

In sum, I would say that while there are some abuses - this is the one area MC/VISA has "down pat" reasonably well. There are ways they could improve the tackling of fraud but I can't see many ways they can improve the treatment of quality disputes. Everything is well-mediated. Every once in a while you come across a grumpy anti-merchant sort of chargeback handler burnt out and tired of his or her job reviewing chargebacks all day. But such cases are few and far between. Take it from someone who has successfully reversed - or been involved in the reversal of -hundreds of these!

Question: What percentage of sales goes towards paying credit card-related expenditures: processing fees, chargebacks, fines, and reserve accounts (please explain each of these terms)?

Answer: Processing discount rates right now for phone/mail orders seem to have bottomed out around 2.2-2.3 percent depending on the variables involved. Many newer merchants pay as much as 2.57 and even 4 percent, though they can definitely negotiate a lower rate. Most merchants pay $10-$15 per chargeback but some pay as high as $25. A few merchants even pay a bogus $10-$15 fee per ticket retrieval request.

Thus, if you have a $50 sale and the customer has a gripe, you may be slapped with a $15 fee for the slip request, another $25 for the chargeback.. and then even if you reverse the chargeback - some banks charge another $25 to do it. If the customer does a second chargeback, that's another $25. So you can lose your $50 plus pay another $90 by the time you're done - in the worst case scenario with the worst merchant account conceivable!

Merchants can negotiate deals with no chargeback fees - though, generally, this increases the processing discount rate a bit - so merchants need to crunch numbers to figure out where they save the most money - with lower discount fees or with lower or no chargeback fees.

In sum, figure an average of 2.5% paid for processing discount rates, 15-40 cents per transaction (unless you negotiate a no fee per transaction deal), and $0-$25 per chargeback. Chargeback and reserve accounts happen only to "select" merchants, of course! But additional fees sometimes seen are:

- Extra charges if the merchant's batch isn't settled every 24 hours;
- Additional fees and/or augmented rates for international transactions;

- Specific per transaction fees for the type of software being used or to have "the privilege" of checking AVS or CVV2;
- Monthly statement fees - unless otherwise negotiated.

Question: Processing agents seem to benefit greatly from chargeback fees, reserve accounts, and related fines. Do they contribute to the proliferation of chargebacks? Wouldn't you say that the relationship between financial intermediaries (banks, processing agents, credit card companies) are incestuous and that the problem is structural?

Answer: In my opinion, though generally viewed as being noble and legitimate - it's one of the most corrupt businesses out there. I could never fully understand how a corporate entity is allowed to "fine" its customers. It's no wonder it's so difficult to get out of the "Merchant Watch Program". Visa certainly has no incentive to release the merchants on the list when they can get away with fining them $10,000 or more - almost at whim.

Reserve accounts at least make a little bit of sense for banks to protect themselves. But grabbing $100k or more from so many merchants and holding it for 6 months or longer - can only be increasing bank profits ever so much. Some merchant representatives seem motivated to set reserve accounts and are probably paid based on some sort of incentive program. There appear to be employees at FirstData (which now has a virtual monopoly) who do nothing else but answer calls from merchants griping about reserve accounts - and it's very difficult (but, from our experience, not impossible) to get them to act in the merchant's favor.

In the case of the e-business I developed and owned for so many years, I found the "loss prevention" people to be vindictive and senseless with little concern for anything other than their own agenda. When one loss prevention agent was shown in detail by a team of accountants that the company only makes money, turns profits, has never failed to pay a chargeback, has a positive cash flow and so on - her response was simply: "We don't care about making money, we only care about loss prevention." And that was a management-level employee.

An even better example comes to mind. FirstData has the "right" to use the letterhead of any bank they represent and to act "on their behalf", so newer merchants tend to think they're dealing w/ their own merchant bank directly. But really the two interests couldn't be more contrary!

In one case, our corporate checking account had an open $100,000 line of credit. Yet FirstData - acting in the name of the bank's merchant services - declared after 2 years that a $100,000ish reserve was necessary to offset chargebacks. FirstData didn't know or realize that our bank gave us $100,000 worth of open credit even as FirstData's "mid-level risk loss prevention" department was telling us that we're a "risky business" and need to post $100,000 immediately to offset potential losses to the bank from chargebacks!

We had the President of our bank call FirstData directly and tell them not to hold any of the company's money; informing them what a great client we were and what a great banking relationship we had. FirstData uses that bank's letterhead and claims to represent it - but it refused to release our funds despite the explicit request of the bank whose merchant services they're contracted to represent!

Question: Give us one tip or technique on how to avoid chargebacks and describe the most widespread frauds.

Answer: Even though it adds a bit of time and expense, the one technique that works best - better than CVV2 verification or any other generic technique touted by MC/Visa - is to verbally verify each order. Just pick up the phone and call each customer. Internet frauds enjoy their anonymity and are scared senseless about actually playing their act out over the telephone. Most of them aren't "real" thieves in the sense that they would shoplift from retail stores or perpetrate fraud in a non-electronic scenario. You'll find out who is real and who is fraudulent if you pick up the phone and start calling the phone numbers on your incoming order forms. At ChargebackPrevention.Com, we teach users precisely what to look for, what to say, what questions to ask over the telephone, etc.

Question: Can you comment on the current antitrust investigation against Visa and MasterCard and its potential implications? Additionally, do you believe that the aggressive marketing drives of credit card issuers, involving little or no background checks, contribute to an increase in credit card fraud?

Answer: Sorry, no comment on this aspect!

Question: Can you compare the advantages and disadvantages of "card not present" and "card present" sales? Is e-commerce hobbled by some of the procedures and safeguards required by credit card companies and clearinghouses?

Answer: Obviously, "card present" transactions are safer for merchants. If only every computer terminal could have its own magnetic swiping device! I can't help but wonder if clearinghouses are just seeing e-commerce as a "whipping boy" - constantly crying wolf - telling merchants that they have too many chargebacks and hitting them with profitable fines.

Retailers usually don't have the same chargeback problems as E-tailers when it comes to fraud. But E-tailers generally don't have the same overhead that retailers do - so we're able to comfortably survive with 3, 4, 5 percent chargebacks. But clearing houses are too gung-ho in their search for "red flags." They simply need to stop applying the same flags to every business in every case.

A company that delivers information electronically is going to have more chargebacks than one who ships to a home address. But a company with a negative cashflow is going to be more of a risk than a company with a positive one. They should really evaluate companies more deeply before charging them with so many fines and fees. Most of the advice given by clearinghouses is generic and empty and that's one of the main reasons chargebackprevention.com came to be.

Telling everyone: ship to the billing address only, use AVS, and use CVV2 may be fine and dandy but billing addresses don't apply to information-only merchants, AVS can cause problems of its own and CVV2 still confounds customers and loses legitimate sales when they fail to recite their credit card number by heart.

ChargebackPrevention.Com tries to create more of a 'happy third way' between reducing chargebacks and maintaining sales volume - something that the powers-that-be seem to care very little about. When they get chargebacks down, they reward themselves, they pat themselves on the back, they attribute it to their fines and strong-armed reserve accounts - without delving deeper. We try to teach the merchant to proactively avoid fraud, reserve accounts, and fines and to reactively deal with these issues effectively when they do occur.

Question: How will smart wallets, e-cash, PayPal and other debit/credit money substitutes affect the credit card industry?

Answer: I haven't seen much worth experimenting with. They require the customer to go through extra steps. So many online buyers are still "new to it". Some are making impulse purchases and some are just barely convinced to buy. Requiring them to go sign up for an account with PayPal and so forth is asking for extra steps, instructions, and can pull them out of "the ether", or make them back away from sales.

Only the net-savvy really know about companies like Pay Pal and trust them. The typical occasional user about to make a purchase at your site is trusting enough to give you their information. Going over to PayPal adds another party, one they haven't even always heard of as often as you or I. I would never risk clientele by asking them to sign up.

Criminality (in Countries in Transition)

The process of transition from communism to capitalism was largely hijacked either by outright criminals in budding outfits of organized crime - or by pernicious and all-pervasive kleptocracies: politicians and political parties bent on looting the state and suppressing the opposition, sometimes fatally.

In the past 16 years, industrial production in the economies in transition tumbled in real terms by more than 60 percent. The monthly salary in the poorer bits equals the daily wage of a skilled German industrial worker, or one seventh the European Union's average. Gross domestic product per capita is less than one third the EU's. Infrastructure, internal and export markets, state institutions - all crumbled with dizzying speed.

In some countries - not the least Russia - privatization amounted to a mass transfer of assets to cronies and insiders, often well-connected members of the communist nomenclature: managers, members of the security services and other penumbral figures. Laws were passed and institutions tweaked to reflect the special interests of these groupings.

"Classical" forms of crime flourished throughout the benighted region. Prostitution, gambling, drugs, smuggling, kidnapping, organ trafficking and other varieties of delinquency yielded to their perpetrators billions of dollars annually. In the impoverished economies of the east, these fantastic revenues - laundered through off shore accounts - were leveraged by criminals to garner political favors, to buy into legitimate businesses and to infiltrate civil society.

None of this is new to Western publics. Rogues and "robber barons" have always doubled as entrepreneurs. The oil, gaming and railways industries in America, for instance, owe their existence to dubious personas and questionable practices. Well into the 17th century, the British sovereign maintained a monopoly on chartering businesses and awarded the coveted licenses to loyal servants and obsequious sycophants.

Still, the ubiquity of crime in east Europe and its reach are unprecedented in European annals. In the void-like interregnum between centrally planned and free market economies only criminals, politicians, managers, and employees of the security services were positioned to benefit from the upheaval.

At the outset of transition, the underworld constituted an embryonic private sector, replete with international networks of contacts, cross-border experience, capital agglomeration and wealth formation, sources of venture (risk) capital, an entrepreneurial spirit, and a diversified portfolio of investments and revenue generating assets. Criminals were used to private sector practices: price signals, competition, joint venturing, and third party dispute settlement.

Crime - alone among all economic activities in communist societies - obeyed the laws of the free market. Criminals had to be entrepreneurial and profitable to survive. Their instincts sharpened by - often lethal - competition, they were never corrupted by central planning.

Deprived of access to state largesse, criminals invested their own capital in efficiently-run small to medium size enterprises. Attuned to the needs and wishes of their customers, criminals engaged in primitive forms of market research, through neighborhood and grassroots "pollsters" and "activists". They responded with agility and in real time to changes in the patterns of supply and demand by altering their product mix and their pricing. They have always been pioneers of bleeding-edge technologies.

Criminals are effective organizers and managers. They excel at enforcing workplace discipline with irresistible incentives and irreversible disincentives, at setting targets and at networking. The superior felonious echelons are upwardly mobile and have a clear career path. Every management fad - from territorially exclusive franchises to "stock" options - has been invented by criminals long before they triumphed in the boardroom.

In east Europe, criminals on all levels, from the organized to the petty, often substituted for the dysfunctional, or ideologically hidebound organs of the state. Consider the dispensation of justice. The criminal code of conduct and court system replaced the compromised and lethargic official judiciary. Debt collectors and enforcers stood in for venal and incompetent police forces.

Crime is a growth industry and sustains hordes of professionals: accountants and lawyers, forgers and cross border guides, weapons experts and bankers, mechanics and hit-men. Expertise, know-how and acumen, amassed over centuries of practice, are taught in the criminal universities known as penitentiaries: roads less traveled, countries more lenient, passports to be bought, sold, or forged, how-to manuals, goods and services on offer and demand.

Profit margins in crime are outlandish and lead to feverish wealth accumulation. The banking system is used both to stash the proceeds and to launder them. Tax havens, off shore financial institutions and money couriers - all form part of a global web. Thus cleansed and rendered untraceable, the money is invested in legitimate activities. In some countries - especially on the drug path, or on the trail of white slavery - crime is a major engine of economic growth.

As opposed to the visible sectors of the east's demonetized economies, criminal enterprises never run out of liquidity and thus are always keen to invest. Moreover, crime is international and cosmopolitan. It is accustomed to sophisticated export-import transactions.

Many criminals - as opposed to the vast majority of their countrymen - are polyglottal, well-traveled, aware of world prices, the international financial system and demand and supply in various markets. They are experienced negotiators. In short: criminals are well-heeled international businessmen, well-connected both abroad and with the various indigenous elites.

The Wild East in Europe is often compared to the Wild West in America a century or so ago. The Russian oligarchs, goes the soothing analogy, are local versions of Morgan, Rockefeller, Pullman and Vanderbilt. But this affinity is spurious. the United States always had a civic culture with civic values and an aspiration to, ultimately, create a harmonious and benevolent civic society. Criminality was regarded as a shameful stepping stone on the way to an orderly community of learned, civilized, law-abiding citizens.

This cannot be said about Russia, for instance. The criminal there is, if anything, admired and emulated. Even the language of legal business in countries in transition is suffused with underworld parlance. There is no - and never was - a civic tradition in the countries of eastern Europe, a Bill of Rights, a veritable Constitution, a modicum of self rule, a true abolition of classes and nomenclatures. These territories are accustomed to being governed by paranoiac and murderous tyrants akin to the current crop of delinquents. That some criminals are members of the new political, financial and industrial elites (and vice versa) - tends to support this long-rooted association.

In all the countries of the region, politicians and managers abuse the state and its simulacrum institutions in close symbiosis with felons. Patronage and sinecures extend to collaborating lawbreakers. Veritable villains gain access to state owned assets and resources in a cycle of money laundering. Law enforcement agencies and the courts are "encouraged" to turn a blind eye, or even to help criminals eliminate internal and external competition in their turf.

Criminals, in return, serve as the "long and anonymous arm" of politicians, obtaining for them illicit goods, or providing "black" services. Corruption often flows through criminal channels or via the mediation and conduit of delinquents. Within the shared sphere of the informal economy, assets are shifted among these economic players. Both players oppose attempts at reform and transparency and encourage - even engender - nationalism and racism, paranoias and grievances to recruit foot soldiers.

Fortunately, there is the irrepressible urge to become legitimate. Politicians, who grope for a new ideological cover for their opportunism, partner with legitimacy-seeking, established crime lords. Both groups benefit from a swelling economic pie. They fight against other, less successful, criminals, who wish to persist in their old ways and, thus, hamper economic growth. The battle is never won but at least it succeeds to firmly drive crime where it belongs: underground.

Crisis, Global (2007-2010)

The global crisis of 2007-9 was, actually, a confluence of unrelated problems on three continents. In the United States, investment banks were brought down by hyper-leveraged investments in ill-understood derivatives. As stock exchanges plummeted, the resulting devastation and wealth destruction spilled over into the real economy and caused a recession which is bound to be mild by historical standards.

Depending heavily on imported energy and exported goods, Europe's economy faced a marked slowdown as the region's single currency, the euro, appreciated strongly against all major currencies; as China, India, and other low-wage Asian countries became important exporters; as the price of energy products and oil skyrocketed; and as real estate bubbles burst in countries like Spain and Ireland. Additionally, European banks were heavily leveraged and indebted - far more than their counterparts across the Atlantic. Governments throughout the continent were forced to bail out one ailing institution after another, taxing further their limited counter-cyclical resources.

Simultaneously, in Asia, growth rates began to decelerate. Massive exposure to American debt, both public and private, served a vector of contagion. The weakening of traditional export markets affected adversely industries and employment. Stock exchanges tumbled.

The 2007-9 upheaval was so all-pervasive and so reminiscent of the beginnings of the Great Depression that it brought about a realignment and re-definition of the roles of the main economic actors: the state, the central banks, financial institutions of all stripes (both those regulated and in the "shadow banking" sector), the investment industries, and the various marketplaces (the stock exchanges, foremost).

1. Central Banks

The global credit crunch induced by the subprime mortgage crisis in the United States, in the second half of 2007, engendered a tectonic and paradigmatic shift in the way central banks perceive themselves and their role in the banking and financial systems.

On December 12, 2007, America's Federal Reserve, the Bank of England, the European Central Bank (ECB), the Bank of Canada and the Swiss National Bank, as well as Japan's and Sweden's central banks joined forces in a plan to ease the worldwide liquidity squeeze.

This collusion was a direct reaction to the fact that more conventional instruments have failed. Despite soaring spreads between the federal funds rate and the LIBOR (charged in interbank lending), banks barely touched money provided via the Fed's discount window. Repeated and steep cuts in interest rates and the establishment of reciprocal currency-swap lines fared no better.

The Fed then proceeded to establish a "Term Auction Facility (TAF)", doling out one-month loans to eligible banks. The Bank of England multiplied fivefold its regular term auctions for three months maturities. On December 18, the ECB lent 350 million euros to 390 banks at below market rates.

In March 2008, the Fed lent 29 billion USD to JP Morgan Chase to purchase the ailing broker-dealer Bear Stearns and hundreds of billions of dollars to investment banks through its discount window, hitherto reserved for commercial banks. The Fed agreed to accept as collateral securities tied to "prime" mortgages (by then in as much trouble as their subprime brethren).

The Fed doled the funds out through anonymous auctions, allowing borrowers to avoid the stigma attached to accepting money from a lender of last resort. Interest rates for most lines of credit, though, were set by the markets in (sometimes anonymous) auctions, rather than directly by the central banks, thus removing the central banks' ability to penalize financial institutions whose lax credit policies were, to use a mild understatement, negligent.

Moreover, central banks broadened their range of acceptable collateral to include prime mortgages and commercial paper. This shift completed their transformation from lenders of last resort. Central banks now became the equivalents of financial marketplaces, and akin to many retail banks. Fighting inflation - their erstwhile raison d'etre - has been relegated to the back burner in the face of looming risks of recession and protectionism. In September 2008, the Fed even borrowed money from the Treasury when its own resources were depleted.

As The Economist neatly summed it up (in an article titled "A dirty job, but Someone has to do it", dated December 13, 2007):

"(C)entral banks will now be more intricately involved in the unwinding of the credit mess. Since more banks have access to the liquidity auction, the central banks are implicitly subsidising weaker banks relative to stronger ones. By broadening the range of acceptable collateral, the central banks are taking more risks onto their balance sheets."

Regulatory upheaval is sure to follow. Investment banks are likely to be subjected to the same strictures, reserve requirements, and prohibitions that have applied to commercial banks since 1934. Supervisory agencies and functions will be consolidated and streamlined.

Ultimately, the state is the mother of all insurers, the master policy, the supreme underwriter. When markets fail, insurance firm recoil, and financial instruments disappoint - the government is called in to pick up the pieces, restore trust and order and, hopefully, retreat more gracefully than it was forced to enter.

The state would, therefore, do well to regulate all financial instruments: deposits, derivatives, contracts, loans, mortgages, and all other deeds that are exchanged or traded, whether publicly (in an exchange) or privately. Trading in a new financial instrument should be allowed only after it was submitted for review to the appropriate regulatory authority; a specific risk model was constructed; and reserve requirements were established and applied to all the players in the financial services industry, whether they are banks or other types of intermediaries.

2. Common Investment Schemes

The credit and banking crisis of 2007-9 has cast in doubt the three pillars of modern common investment schemes. Mutual funds (known in the UK as "unit trusts"), hedge funds, and closed-end funds all rely on three assumptions:

Assumption number one

That risk inherent in assets such as stocks can be "diversified away". If one divides one's capital and invests it in a variety of financial instruments, sectors, and markets, the overall risk of one's portfolio of investments is lower than the risk of any single asset in said portfolio.

Yet, in the last decade, markets all over the world have moved in tandem. These highly-correlated ups and downs gave the lie to the belief that they were in the process of "decoupling" and could, therefore, be expected to fluctuate independently of each other. What the crisis has revealed is that contagion transmission vectors and mechanisms have actually become more potent as barriers to flows of money and information have been lowered.

Assumption number two

That investment "experts" can and do have an advantage in picking "winner" stocks over laymen, let alone over random choices. Market timing coupled with access to information and analysis were supposed to guarantee the superior performance of professionals. Yet, they didn't.

Few investment funds beat the relevant stock indices on a regular, consistent basis. The yields on "random walk" and stochastic (random) investment portfolios often surpass managed funds. Index or tracking funds (funds who automatically invest in the stocks that compose a stock market index) are at the top of the table, leaving "stars", "seers", "sages", and "gurus" in the dust.

This manifest market efficiency is often attributed to the ubiquity of capital pricing models. But, the fact that everybody uses the same software does not necessarily mean that everyone would make the same stock picks. Moreover, the CAPM and similar models are now being challenged by the discovery and incorporation of information asymmetries into the math. Nowadays, not all fund managers are using the same mathematical models.

A better explanation for the inability of investment experts to beat the overall performance of the market would perhaps be information overload. Recent studies have shown that performance tends to deteriorate in the presence of too much information.

Additionally, the failure of gatekeepers - from rating agencies to regulators - to force firms to provide reliable data on their activities and assets led to the ascendance of insider information as the only credible substitute. But, insider or privileged information proved to be as misleading as publicly disclosed data. Finally, the market acted more on noise than on signal. As we all know, noise it perfectly randomized. Expertise and professionalism mean nothing in a totally random market.

Assumption number three

That risk can be either diversified away or parceled out and sold. This proved to be untenable, mainly because the very nature of risk is still ill-understood: the samples used in various mathematical models were biased as they relied on data pertaining only to the recent bull market, the longest in history.

Thus, in the process of securitization, "risk" was dissected, bundled and sold to third parties who were equally at a loss as to how best to evaluate it. Bewildered, participants and markets lost their much-vaunted ability to "discover" the correct prices of assets. Investors and banks got spooked by this apparent and unprecedented failure and stopped investing and lending. Illiquidity and panic ensued.

If investment funds cannot beat the market and cannot effectively get rid of portfolio risk, what do we need them for?

The short answer is: because it is far more convenient to get involved in the market through a fund than directly. Another reason: index and tracking funds are excellent ways to invest in a bull market.

3. Capital-Allocating Institutions

The main role of banks, well into the 1920, was to allocate capital to businesses (directly and through consumer credits and mortgages). Deposit-taking was a core function and the main source of funding. As far as depositors were concerned, banks guaranteed the safety and liquidity of the store of value (cash and cash-equivalents).

In the 1920, stock exchanges began to compete with banks by making available to firms other means of raising capital (IPOs - initial public offerings). This activity gradually became as important as the stock exchange's traditional competence: price discovery (effected through the structured interactions of willing buyers and sellers).

This territorial conflict led to an inevitable race to the bottom in terms of the quality of debtors and, ultimately, to the crash of 1929 and the Great Depression that ensued. Banks then were reduced to retail activities, having lost their investment services to hybrids known as "investment banks".

The invention of junk bonds in the 1980s heralded a whole new era. A parallel, unregulated financial system has emerged which catered to the needs of businesses to raise risk capital and to the needs of those who provided such funds to rid themselves of the hazards inherent in their investments. Consumer credits and mortgages, for instance, were financed by traditional banking businesses. The risks associated with such lending were securitized and sold to third parties.

As expertise evolved and experience accumulated, financial operators learned to slice the hazards, evaluate them using value-at-risk mathematical models, tailor them to the needs of specific customer profiles, hedge them with complex derivatives, and trade them in unofficial, unregulated, though highly liquid amorphous, virtual "marketplaces".

Thus, stock exchanges have begun to lose their capital allocation functions to private equity funds, hedge funds, investment banks, and pension funds. In the process, such activities have become even more opaque and less regulated than before. This lack of transparency led to pervasive counterparty distrust and difficulties in price discovery. Ultimately, when the prices of underlying assets (such as housing) began to tumble, all liquidity drained and markets seized and froze.

Thus, at the end of 2006, the global financial system was comprised of three main groups of actors: traditional retail banks whose main role was deposit taking and doling out consumer credits; exchanges whose main functions were price discovery and the provision of liquidity; and investment banks and their surrogates and special purpose vehicles whose principal job was the allocation of capital to businesses and the mitigation of risk via securitization and insurance (hedging).

Yet, these unregulated investment banks were also often under-capitalized and hyper-leveraged partnerships (at least until the late 1990s, when some of them went public). This is precisely why they had invented all manner of complex financial instruments intended to remove credit-related risks from their books by selling it to third parties. Physicists, analysts, and rating agencies all agreed that the risk attendant to these derivatives can be calculated and determined and that many of them were risk-free (as long as markets were liquid, of course).

The business strategy of the investment banks was viable. It should have worked perfectly had they not committed a primal sin: they have entered the fray not only as brokers, dealers, and mediators, but also as investors and gamblers (principals), taking on huge positions, often improperly hedged ("naked"). When these bets soured, the capital base of these institutions was wiped out, sometimes literally overnight. The very financial instruments that were meant to alleviate and reallocate risk (such as collateralized debt obligations - CDOs) have turned into hazardous substances, as investors (and investment banks) gambled on the direction of the economy, specific sectors, or firms.

In hindsight, the "shadow banks" subverted the very foundations of modern finance: they created money (modifying the money-printing monopoly of central banks); they obfuscated the process of price discovery and thus undermined the price signal (incidentally casting doubt on symmetrical asset pricing models); they interfered with the ability of cash and cash-equivalents to serve as value stores and thus shook the trust in the entire financial system; they amplified the negative consequences of unbridled speculation (that is not related to real-life economic activities and values); they leveraged the instant dissemination of information to render markets inefficient and unstable (a fact which requires a major revision of efficient market hypotheses).

This systemic dysfunctioning of financial markets led risk-averse investors to flee into safer havens: commodities, oil, metals, real estate and, finally, currencies and bonds. This was not merely a flight to quality: it was an attempt to avoid the abstract and fantastic "Alice in Wonderland" markets fostered by investment banks and to reconnect with tangible reality

With the disappearance of investment banks (those who survived became bank holding companies), traditional banks are likely to regain some of their erstwhile functions: the allocation to businesses and creditworthy consumers and homeowners of deposit-based capital. The various exchanges will also survive, but will largely be confined to price discovery and the allocation of risk capital. Some financial instruments will flourish (credit-default swaps of all types), others will vanish (CDOs).

All in all, the financial scenery of 2010 will resemble 1910's more than it will 2005's. Back to basics and home-grown truths. At least until the next cataclysm.

V. The Crisis in Historical Context

Housing and financial crises often precede, or follow the disintegration of empires. The dissolution of the Habsburg and the British empires, as well as the implosion of the USSR were all marked by the eruption and then unwinding of imbalances in various asset, banking, and financial markets.

The collapse of Communism in Europe and Asia led to the emergence of a new middle class in these territories. Flushed with enhanced earnings and access to bank credits, its members unleashed a wave of unbridled consumption (mainly of imported goods); and with a rising mountain of savings, they scoured the globe for assets to invest their capital in: from football clubs to stocks and bonds.

The savings glut and the lopsided expansion of international trade led to severe asymmetries in capital flows and to the distortion of price signals. These, in turn, encouraged leveraged speculation and arbitrage and attempts to diversify away investment risks. The former resulted in extreme volatility and the latter in opaqueness and the breakdown of trust among market players and agents.

VI. The Next Crisis: Imploding Bond Markets

Written: November 3, 2008

To finance enormous bailout packages for the financial sector (and potentially the auto and mining industries) as well as fiscal stimulus plans, governments will have to issue trillions of US dollars in new bonds. Consequently, the prices of bonds are bound to come under pressure from the supply side.

But the demand side is likely to drive the next global financial crisis: the crash of the bond markets.

As the Fed takes US dollar interest rates below 1% (and with similar moves by the ECB, the Bank of England, and

other central banks), buyers are likely to lose interest in government bonds and move to other high-quality, safe haven assets. Risk-aversion, mitigated by the evident thawing of the credit markets will cause investors to switch their portfolios from cash and cash-equivalents to more hazardous assets.
Moreover, as countries that hold trillions in government bonds (mainly US treasuries) begin to feel the pinch of the global crisis, they will be forced to liquidate their bondholdings in order to finance their needs.

In other words, bond prices are poised to crash precipitously. In the last 50 years, bond prices have collapsed by more than 35% at least on three occasions. This time around, though, such a turn of events will be nothing short of cataclysmic: more than ever, governments are relying on functional primary and secondary bond markets for their financing needs. There is no other way to raise the massive amounts of capital needed to salvage the global economy.

Croatia, Economy of

The first gay parade in Croatia's history ended in bloody clashes with Nazi-saluting skinheads and the members of a soccer fan club. Police fired teargas and arrested 26 marauders. Another 10 ended in the hospital. The 300 marchers called for increased social tolerance and legislation to protect sexual minorities. The Minister of Interior urged them to "love yourselves and fight for your rights".

Only the day before, Croatian president, Stipe Mesic, won the Crans Montana Forum Foundation award for promoting peace, democracy, and international cooperation. Quoted by the IWPR Balkans Report, Viktor Ivancic, the editor of the "Feral Tribune", an opposition weekly published in Split, bemoaned Croat intolerance: "What occurred during this peaceful march of homosexuals ... has dispelled the illusion of a humane nation."

A survey carried out earlier this year in nine countries and territories in Southeastern Europe by the International Institute for Democracy and Electoral Assistance (IDEA) showed Croats to be as worried about unemployment as their Bosnian neighbors - despite having an incomparably richer and more developed economy. Almost three quarters rated joblessness as their greatest concern. Croats tend to trust the private sector far more than they trust their politicians.

This is rather unexpected. The Western media has consistently demonized the ruling party, the HDZ, and its authoritarian and corrupt leader, Tudjman. Croatia's economic troubles - its unemployment amounted to 20 percent at the time - were squarely blamed on the HDZ's xenophobia, civil and human rights abuses, sheltering of war criminals, mismanagement, and virulent nationalism.

So unyielding was the regime's grip that even today, according to the BBC World Service, more than 80 percent of Croats tune in to HRT, the state-owned TV station, for news and entertainment - an unprecedented phenomenon in post-communist countries.

But the HDZ was replaced two years ago by a bunch of politicians described by the BBC as "far more committed to Croatia's integration into the European mainstream."

The constitution was re-written making Croatia's government less presidential and more parliamentary.

Croatia joined the World Trade Organization and, concurrent with Macedonia, negotiated a stabilization and association agreement with the European Union - now being ratified in the EU's national parliaments. As a member of the informal Vilnius group of NATO candidates, Croatia repeatedly called upon the alliance to expand aggressively in its forthcoming summit in November 2002 in Prague.

In the last 30 days alone, Croatia signed a free trade agreement with Albania and another one regarding immigration and tourism with Bulgaria. Croatia is on the verge of signing a multilateral concord with CEFTA - the central European free trade zone.

The owlish and bearded Ivica Racan, leader of the Social Democratic Party, competently led a center-left five-party coalition government, formed in January 2000, through this startling transmutation from near international pariah to the darling of multilaterals of all persuasions.

The European Investment Bank (EIB) and the EBRD have just approved yet another $61 million to construct the last two sections of the Rijeka-Zagreb motorway. This comes on the heels of massive EIB funds invested in a railway connecting the country to Bulgaria and Bosnia-Herzegovina.

This "favored nation" treatment trickles down to the private sector. The World Bank's private sector lending arm, the International Finance Corporation (IFC) concluded last month a $9.1 million small and medium enterprises loan facility with the soon-to-be-privatized Croatia Banka. Other Croat banks were recently purchased by foreign direct investors - e.g., the latest completed purchase of Riejcka Banka by Austria's second-largest bank, Erste Sparkasse.

Croatia is in the throes of a conscious effort to mend fences with its erstwhile mortal enemy, Yugoslavia. A fortnight ago, the chambers of commerce of the two countries concluded two agreements which tackle the thorny issue of claims following the succession of the former federation. Croatia has even, controversially, taken to handing to their prosecutors revered military figures indicted by the war crimes tribunal in the Hague.

US Ambassador at large for War Crimes , Pierre-Richard Prosper, in a statement broadcast on HRT, extolled Croatia as a "regional leader" in extraditing suspects. He noted the international community's growing readiness to relegate the task of judging the miscreants to indigenous Croat courts.

But Croatia's more immediate friction is with peaceful and prosperous Slovenia, an imminent EU member. On June 28, the second largest party in Racan's precarious coalition - the Croatian Social Liberal Party (HSLS) headed by the irascible Drazen Budisa - walked out on a parliamentary session, vocally refusing to ratify a treaty with the neighbor regarding a shared ownership of the disputed Krsko power plant. It was only the latest in a series of crises that rocked the coalition since the beginning of the year.

Mesic exhorted the disobedient parliamentarians to adhere to government policies. Early elections will slow the reforms - he warned through the independent Croat daily, Vecernji List. He threatened to support a minority government and to tap Racan for his current job again.

To little avail. Both Racan and HSLS were angling to precipitate a crisis - the former to get rid of the latter and the latter to unseat the former in an early ballot. Threatening to resign the following week, the prime minister resubmitted the controversial treaty ratification bill. Six HSLS deputies voted for and nine abstained.

The bill passed. The nine disgruntled renegades threatened to defect and join other parties. The opposition Democratic Centre and Croatian Democratic Union announced they will not support a government headed by a reappointed Racan. Seeing an opportunity to split the HSLS and regain his position as prime minister, Racan resigned on July 5. In a feat of divine timing, the Dalai Lama arrived, on July 7, for his first visit of the troubled country. He delivered a propitious lecture on constructive dialogs.

On July 10, Mesic, as was widely expected, appointed Racan to form the new government. He has 30 days to accomplish this. A failure will result in new elections. A letter of support bore the signatures of 84 out 150 parliamentarians. The federation of Independent Croatian Unions (NHS) urged Racan to include in his new government experts with limited political involvement - i.e., technocrats. But these important events were overshadowed by the mood altering decision of Goran Ivanisevic not to play at Wimbledon.

Racan used the grace period to pass a few crucial laws in parliament. On July 12, the august body voted to compensate Serb refugees whose real estate was expropriated to accommodate internally displaced persons. HINA, the news agency, gained independence by becoming a "public institution".

The next day, in a rite of self-mutilation, the HSLS expelled 12 party members who continued to support the government, defying the party line. These included the deputy prime minister Goran Granic, defense minister Jozo Rados, and two other incumbent ministers Hrvoje Kraljevic and Andro Vlahusic.

The country was slightly distracted by a historically significant reconciliation between the former warring parties in Sarajevo. On July 15, the leaders of Bosnia-Herzegovina, Croatia, and Yugoslavia issued the "Sarajevo Declaration" pledging amicable cooperation on an impressive range of subjects: property rights, trade, the fight against terrorism and organized crime, social protection, the return of refugees, economic cooperation. Washington applauded.

But this harmonious spirit did not traverse Croatia or infect Slovenia. In the city of Karlovac in Croatia, the ruling coalition expelled the HSLS. And Slovenia's Minister of the Environment refused to pay compensation for free electricity it failed to deliver to Croatia as part of the controversial nuclear power pact. The Slovene Constitutional Court is taking its time in rendering a decision on the legal status of the Krsko agreement, which remains non-ratified by Slovenia's legislature.

Racan probably has little appetite to continue to rule at the mercy of capricious independents and the pleasure of party fragments. Even if he succeeds to form a new government, it is likely to be a lame duck one. He may yet pull a "Chirac" on the startled electorate and bet the family house by asking Mesic to declare early elections. And as opposed to the French president, he may yet pull it off.

It was a normal week in Croatia. A mass grave was discovered in the east, generals were being indicted by the Hague, the new Yugoslav ambassador apologized for crimes committed against Croats by his compatriots, Bosnian officials coped with a restive Croat population in their patchwork country.

The CIA comments on Croatioa's Balkan geography delicately. Croatia, it says in its "World Factbook 2001", "...controls most land routes from Western Europe to (the) Aegean Sea and (the) Turkish Straits". With a population of 4.5 million and a land mass of c. 56,500 sq. km. - Croatia is more than twice as big as Slovenia. It is almost as ethnically homogeneous - 78% are ethnic Croat and Catholic. The Croats are highly literate and skilled, the legacy of centuries of Austro-Hungarian (especially Habsburg) rule. Croatia's (mostly industrial) output per capita was almost as high as Slovenia's in the former Yugoslavia (and a good one third higher than the Federal average). Yet, nowadays, Croatia trails Slovenia by every economic measure. Its GDP per capita is half the latter's. Why this discrepancy?

While Slovenia was always export and services oriented, Croatia languished under a bloated and venal industrial central planning bureaucracy. Four years of savage internecine fighting (avoided by Slovenia), almost a million internally displaced people, and the overnight transformation of close economic allies and target markets into mortal and bitter enemies - all took their toll. Croatia's Western-aided transition from heavy and mineral industries into "lighter" tourism and oil processing was successfully completed earlier this year, following a mild recession in 2000. The economy grew by 3% last year as more than 70% of the labour force found work in services (compared to 30% in industry and agriculture combined).

Yet, the implosion of world travel and tourism following the September 11 atrocities, threatens this newfangled economic foundation as well. Successive Croat governments failed to tackle structural reforms decisively, the victims of fractious and contentious party politics and trade union extortion. Only recently has the wage bill of the central government been trimmed (by 5%) and social transfers rationalized - though the full implementation of these measures has been put off, by an obstinate parliament, to 2002. The collective agreement with state and public workers signed earlier this month froze salaries - and net employment - at this year's levels. IMF style social engineering resulted in unrest and pet mutinies within the administration. Earlier this month, the director of the Croatian Health Insurance Institute blamed lack of drugs and a deteriorating health care service on cuts in health funds (and payment arrears, the result of a gigantic deficit).

Croatia's rating card is mixed at best. Its inflation rate is down to 4-5%, its GDP growth has recovered to 4%, but it has a serious fiscal deficit, not ameliorated by a hitherto botched privatization. Croatia resorted to persistent foreign borrowing to amortize its payment arrears. In a Letter of Intent to the IMF dated October 31, 2001, Croatia undertook to slash its budget deficit to a still unsustainable 5.3% of GDP this year (and 4.25% next year), mostly by the socially expedient cutting of capital investment. In effect, Croatia has reneged on its earlier commitments to attain fiscal rectitude by reducing subsidies, wages, and transfers. Nevertheless, the IMF professed itself to be content with Croatia's performance, commending it for exceeding targets agreed in its latest March 2001 standby arrangement. The World Bank has lately approved a Structural Adjustment Loan (SAL) of $202 million. Croatia is one of the Bank's darlings, with $780 million committed and $550 million disbursed (mostly on transportation infrastructure, urban development, and finance-related projects).

Of Croatia's smallish labour force - 1.7 million strong - c. 300,000 are unemployed. Of c. 13,000 new jobs created in November - the majority were in state administration and the public sector. Moreover, Croatia is unique in that half of the unemployed are either skilled or highly skilled. One in twenty five has a university degree (compared to 3%, the world average and 1% in the likes of Macedonia). Brain drain, though not as severe as in Macedonia or Yugoslavia, is still detrimental to Croatia's future.

Croatia's monetary position is better. The Croat National Bank (CNB) has come close to meeting its targets regarding foreign exchange reserves and net domestic assets and has pursued a vigorous banking reform program coupled with credit expansion to the fledgling private sector. Spreads on Croat eurobonds have narrowed despite widespread aversion towards emerging markets debt. Public trust in the economy is evidenced by robust growth in retail sales, business investment, and private consumption. Domestic banks are repatriating capital. The economy is being remonetized - interest rates are lower, bank deposits in both domestic and foreign currencies higher, bank lending is surging, and the monetary base expanded. The CNB had to intervene repeatedly to prevent an appreciation of the kuna - a highly unusual circumstance in countries in transition. The CNB may yet have to resort to contractionary policies next year should this tsunami of demand for money not abate. The current account deficit increased to c. 3.5% of GDP - the result of massive last minute privileged purchase of cars by war veterans. But, the deficit trend is a more sustainable 2-2.5%.

The introduction of the euro would stretch the resources of the banking system further - the DM is an unofficial second currency in Croatia. Erste Bank from Austria has shipped tones of euro coins and notes to Croatian banks last week alone. Since Croats hold most of their DM savings in cash, the exchange operation is likely to be drawn out and complicated. The EU, for fear of money laundering through euro conversions, already demanded from Croat banks detailed reports on any cash transaction involving more than 14,000 euros.

Minor geopolitical irritants still mar the future: a dispute with Italy regarding war time property, with Slovenia regarding land and maritime borders, with Yugoslavia regarding a UN administered peninsula, with Bosnia regarding everything - from port facilities to the composition of commissions common to both countries. Croatia is also an auxiliary drug smuggling route for both East Asian heroin and South American cocaine, which makes the EU vocally unhappy. True, a third of Croatia's exports still goes to the likes of Bosnia-Herzegovina, Slovenia, and Macedonia. But it has developed major new export markets in Germany, Italy, and Austria and has signed a Stabilization and Association Agreement with the

EU on December. The trade related provisions will apply from January 1, 2002. Croatia has every intention of applying for accession as early as 2003. It cannot afford to allow any part of its economy or society interact with the sleazier sides of the Balkan. It needs to extract itself from its geography - and the sooner, the better.

Currency Unions

I. The History of Monetary Unions

"Before long, all Europe, save England, will have one money". This was written by William Bagehot, the Editor of "The Economist", the renowned British magazine, 120 years ago when Britain, even then, was heatedly debating whether to adopt a single European Currency or not.

A century later, the euro is finally here (though without British participation). Having braved numerous doomsayers and Cassandras, the currency - though much depreciated against the dollar and reviled in certain quarters (especially in Britain) - is now in use in both the eurozone and in eastern and southeastern Europe (the Balkan). In most countries in transition, it has already replaced its much sought-after predecessor, the Deutschmark. The euro still feels like a novelty - but it is not. It was preceded by quite a few monetary unions in both Europe and outside it.

What lessons does history teach us? What pitfalls should we avoid and what features should we embrace?

People felt the need to create a uniform medium of exchange as early as in Ancient Greece and Medieval Europe. Those proto-unions did not have a central monetary authority or monetary policy, yet they functioned surprisingly well in the uncomplicated economies of the time.

The first truly modern example would be the monetary union of Colonial New England.

The four kinds of paper money printed by the New England colonies (Connecticut, Massachusetts Bay, New Hampshire and Rhode Island) were legal tender in all four until 1750. The governments of the colonies even accepted them for tax payments. Massachusetts - by far the dominant economy of the quartet - sustained this arrangement for almost a century. The other colonies became so envious that they began to print additional notes outside the union. Massachusetts - facing a threat of devaluation and inflation - redeemed for silver its share of the paper money in 1751. It then retired from the union, instituted its own, silver-standard (mono-metallic), currency and never looked back.

A far more important attempt was the Latin Monetary Union (LMU). It was dreamt up by the French, obsessed, as usual, by their declining geopolitical fortunes and monetary prowess. Belgium already adopted the French franc when it became independent in 1830. The LMU was a natural extension of this franc zone and, as the two teamed up with Switzerland in 1848, they encouraged others to join them. Italy followed suit in 1861. When Greece and Bulgaria acceded in 1867, the members established a currency union based on a bimetallic (silver and gold) standard.

The LMU was considered sufficiently serious to be able to flirt with Austria and Spain when its Foundation Treaty was officially signed in 1865 in Paris. This despite the fact that its French-inspired rules seemed often to sacrifice the economic to the politically expedient, or to the grandiose.

The LMU was an official subset of an unofficial "franc area" (monetary union based on the French franc). This is similar to the use of the US dollar or the euro in many countries today. At its peak, eighteen countries adopted the Gold franc as their legal tender (or peg). Four of them (the founding members of the LMU: France, Belgium, Italy and Switzerland) agreed on a gold to silver conversion rate and minted gold and silver coins which were legal tender in all of them. They voluntarily limited their money supply by adopting a rule which forbade them to print more than 6 franc coins per capita.

Europe (especially Germany and the United Kingdom) was gradually switching at the time to the gold standard. But the members of the Latin Monetary Union paid no attention to its emergence. They printed ever increasing quantities of gold and silver coins, which constituted legal tender across the Union. Smaller denomination (token) silver coins, minted in limited quantity, were legal tender only in the issuing country (because they had a lower silver content than the Union coins).

The LMU had no single currency (akin to the euro). The national currencies of its member countries were at parity with each other. The cost of conversion was limited to an exchange commission of 1.25%.

Government offices and municipalities were obliged to accept up to 100 Francs of non-convertible and low intrinsic value tokens per transaction. People lined to convert low metal content silver coins (100 Francs per transaction each time) to buy higher metal content ones.

With the exception of the above-mentioned per capita coinage restriction, the LMU had no uniform money supply policies or management. The amount of money in circulation was determined by the markets. The central banks of the member countries pledged to freely convert gold and silver to coins and, thus, were forced to maintain a fixed exchange rate between the two metals (15 to 1) ignoring fluctuating market prices.

Even at its apex, the LMU was unable to move the world prices of these metals. When silver became overvalued, it was exported (at times smuggled) within the Union, in violation of its rules. The Union had to suspend silver convertibility and thus accept a humiliating de facto gold standard. Silver coins and tokens remained legal tender, though. The unprecedented financing needs of the Union members - a result of the First World War - delivered the coup de grace. The LMU was officially dismantled in 1926 - but expired long before that.

The LMU had a common currency but this did not guarantee its survival. It lacked a common monetary policy monitored and enforced by a common Central Bank - and these deficiencies proved fatal.

In 1867, twenty countries debated the introduction of a global currency in the International Monetary Conference. They decided to adopt the gold standard (already used by Britain and the USA) following a period of transition. They came up with an ingenious scheme. They selected three "hard" currencies, with equal gold content so as to render them interchangeable, as their legal tender.

Regrettably for students of the dismal science, the plan came to naught.

Another failed experiment was the Scandinavian Monetary Union (SMU), formed by Sweden (1873), Denmark (1873) and Norway (1875). It was a by-now familiar scheme. All three recognized each others' gold coinage as well as token coins as legal tender. The daring innovation was to accept the members' banknotes (1900) as well.

As Scandinavian schemes go, this one worked too perfectly. No one wanted to convert one currency to another. Between 1905 and 1924, no exchange rates among the three currencies were available. When Norway became independent, the irate Swedes dismantled the moribund Union in an act of monetary tit-for-tat.

The SMU had an unofficial central bank with pooled reserves. It extended credit lines to each of the three member countries. As long as gold supply was limited, the Scandinavian Kronor held its ground. Then governments started to finance their deficits by dumping gold during World War I (and thus erode their debts by fostering inflation through a string of inane devaluations). In an unparalleled act of arbitrage, central banks then turned around and used the depreciated currencies to scoop up gold at official (cheap) rates.

When Sweden refused to continue to sell its gold at the officially fixed price - the other members declared effective economic war. They forced Sweden to purchase enormous quantities of their token coins. The proceeds were used to buy the much stronger Swedish currency at an ever cheaper price (as the price of gold collapsed).

Sweden found itself subsidizing an arbitrage against its own economy. It inevitably reacted by ending the import of other members' tokens. The Union thus ended. The price of gold was no longer fixed and token coins were no more convertible.

The East African Currency Area is a fairly recent debacle. An equivalent experiment, involving the CFA franc, is still going on in the Francophile part of Africa.

The parts of East Africa ruled by the British (Kenya, Uganda and Tanganyika and, in 1936, Zanzibar) adopted in 1922 a single common currency, the East African shilling. The newly independent countries of East Africa remained part of the Sterling Area (i.e., the local currencies were fully and freely convertible into British Pounds). Misplaced imperial pride coupled with outmoded strategic thinking led the British to infuse these emerging economies with inordinate amounts of money. Despite all this, the resulting monetary union was surprisingly resilient. It easily absorbed the new currencies of Kenya, Uganda and Tanzania in 1966, making them legal tender in all three and convertible to Pounds.

Ironically, it was the Pound which gave way. Its relentless depreciation in the late 60s and early 70s, led to the disintegration of the Sterling Area in 1972. The strict monetary discipline which characterized the union - evaporated. The currencies diverged - a result of a divergence of inflation targets and interest rates. The East African Currency Area was formally ended in 1977.

Not all monetary unions ended so tragically. Arguably, the most famous of the successful ones is the Zollverein (German Customs Union).

The nascent German Federation was composed, at the beginning of the 19th century, of 39 independent political units. They all busily minted coins (gold, silver) and had their own - distinct - standard weights and measures. The decisions of the much lauded Congress of Vienna (1815) did wonders for labour mobility in Europe but not so for trade. The baffling number of (mostly non-convertible) different currencies did not help.

The German principalities formed a customs union as early as 1818. The three regional groupings (the Northern, Central and Southern) were united in 1833. In 1828, Prussia harmonized its customs tariffs with the other members of the Federation, making it possible to pay duties in gold or silver. Some members hesitantly experimented with new fixed exchange rate convertible currencies. But, in practice, the union already had a single currency: the Vereinsmunze.

The Zollverein (Customs Union) was established in 1834 to facilitate trade by reducing its costs. This was done by compelling most of the members to choose between two monetary standards (the Thaler and the Gulden) in 1838. Much as the Bundesbank was to Europe in the second half of the twentieth century, the Prussian central bank became the effective Central Bank of the Federation from 1847 on. Prussia was by far the dominant member of the union, as it comprised 70% of the population and land mass of the future Germany.

The North German Thaler was fixed at 1.75 to the South German Gulden and, in 1856 (when Austria became informally associated with the Union), at 1.5 Austrian Florins. This last collaboration was to be a short lived affair, Prussia and Austria having declared war on each other in 1866.

Bismarck (Prussia) united Germany (Bavarian objections notwithstanding) in 1871. He founded the Reichsbank in 1875 and charged it with issuing the crisp new Reichsmark. Bismarck forced the Germans to accept the new currency as the only legal tender throughout the first German Reich. Germany's new single currency was in effect a monetary union. It survived two World Wars, a devastating bout of inflation in 1923, and a monetary meltdown after the Second World War. The stolid and trustworthy Bundesbank succeeded the Reichsmark and the Union was finally vanquished only by the bureaucracy in Brussels and its euro.

This is the only case in history of a successful monetary union not preceded by a political one. But it is hardly representative. Prussia was the regional bully and never shied away from enforcing strict compliance on the other members of the Federation. It understood the paramount importance of a stable currency and sought to preserve it by introducing various consistent metallic standards. Politically motivated inflation and devaluation were ruled out, for the first time. Modern monetary management was born.

Another, perhaps equally successful, and still on-going union - is the CFA franc Zone.

The CFA (stands for French African Community in French) franc has been in use in the French colonies of West and Central Africa (and, curiously, in one formerly Spanish colony) since 1945. It is pegged to the French franc. The French Treasury explicitly guarantees its conversion to the French franc (65% of the reserves of the member states are kept in the safes of the French Central Bank). France often openly imposes monetary discipline (that it sometimes lacks at home!) directly and through its generous financial assistance. Foreign reserves must always equal 20% of short term deposits in commercial banks. All this made the CFA an attractive option in the colonies even after they attained independence.

The CFA franc zone is remarkably diverse ethnically, lingually, culturally, politically, and economically. The currency survived devaluations (as large as 100% vis a vis the French Franc), changes of regimes (from colonial to independent), the existence of two groups of members, each with its own central bank (the West African Economic and Monetary Union and the Central African Economic and Monetary Community), controls of trade and capital flows - not to mention a host of natural and man made catastrophes.

The euro has indirectly affected the CFA as well. "The Economist" reported recently a shortage of small denomination CFA franc notes. "Recently the printer (of CFA francs) has been too busy producing euros for the market back home" - complained the West African central bank in Dakar. But this is the minor problem. The CFA franc is at risk due to internal imbalances among the economies of the zone. Their growth rates differ markedly. There are mounting pressures by some members to devalue the common currency. Others sternly resist it.

"The Economist" reports that the Economic Community of West African States (ECOWAS) - eight CFA countries plus Nigeria, Ghana, Guinea, the Gambia, Cape Verde, Sierra Leone, and Liberia - is considering its own monetary union. Many of the prospective members of this union fancy the CFA franc even less than the EU fancies their capricious and graft-ridden economies. But an ECOWAS monetary union could constitute a serious - and more economically coherent - alternative to the CFA franc zone.

A neglected monetary union is the one between Belgium and Luxembourg. Both maintain their idiosyncratic currencies - but these are at parity and serve as legal tender in both countries since 1921. The monetary policy of both countries is dictated by the Belgian Central Bank and exchange regulations are overseen by a joint agency. The two were close to dismantling the union at least twice (in 1982 and 1993) - but relented.

II. The Lessons

Europe has had more than its share of botched and of successful currency unions. The Snake, the EMS, the ERM, on the one hand - and the British Pound, the Deutschmark, and the ECU, on the other.

The currency unions which made it have all survived because they relied on a single monetary authority for managing the currency.

Counter-intuitively, single currencies are often associated with complex political entities which occupy vast swathes of land and incorporate previously distinct -and often politically, socially, and economically disparate - units. The USA is a monetary union, as was the late USSR.

All single currencies encountered opposition on both ideological and pragmatic grounds when they were first introduced.

The American constitution, for instance, did not provide for a central bank. Many of the Founding Fathers (e.g., Madison and Jefferson) refused to countenance one. It took the nascent USA two decades to come up with a semblance of a central monetary institution in 1791. It was modeled after the successful Bank of England. When Madison became President, he purposefully let its concession expire in 1811. In the forthcoming half century, it revived (for instance, in 1816) and expired a few times.

The United States became a monetary union only following its traumatic Civil War. Similarly, Europe's monetary union is a belated outcome of two European civil wars (the two World Wars). America instituted bank regulation and supervision only in 1863 and, for the first time, banks were classified as either national or state-level.

This classification was necessary because by the end of the Civil War, notes - legal and illegal tender - were being issued by no less than 1562 private banks - up from only 25 in 1800. A similar process occurred in the principalities which were later to constitute Germany. In the decade between 1847 and 1857, twenty five private banks were established there for the express purpose of printing banknotes to circulate as legal tender. Seventy (!) different types of currency (mostly foreign) were being used in the Rhineland alone in 1816.

The Federal Reserve System was founded only following a tidal wave of banking crises in 1908. Not until 1960 did it gain a full monopoly of nation-wide money printing. The monetary union in the USA - the US dollar as a single legal tender printed exclusively by a central monetary authority - is, therefore, a fairly recent thing, not much older than the euro.

It is common to confuse the logistics of a monetary union with its underpinnings. European bigwigs gloated over the smooth introduction of the physical notes and coins of their new currency. But having a single currency with free and guaranteed convertibility is only the manifestation of a monetary union - not one of its economic pillars.

History teaches us that for a monetary union to succeed, the exchange rate of the single currency must be realistic (for instance, reflect the purchasing power parity) and, thus, not susceptible to speculative attacks. Additionally, the members of the union must adhere to one monetary policy.

Surprisingly, history demonstrates that a monetary union is not necessarily predicated on the existence of a single currency. A monetary union could incorporate "several currencies, fully and permanently convertible into one another at irrevocably fixed exchange rates". This would be like having a single currency with various denominations, each printed by another member of the Union.

What really matters are the economic inter-relationships and power plays among union members and between the union and other currency zones and currencies (as expressed through the exchange rate).

Usually the single currency of the Union is convertible at given (though floating) exchange rates subject to a uniform exchange rate policy. This applies to all the territory of the single currency. It is intended to prevent arbitrage (buying the single currency in one place and selling it in another). Rampant arbitrage - ask anyone in Asia - often leads to the need to impose exchange controls, thus eliminating convertibility and inducing panic.

Monetary unions in the past failed because they allowed variable exchange rates, (often depending on where - in which part of the monetary union - the conversion took place).

A uniform exchange rate policy is only one of the concessions members of a monetary union must make. Joining always means giving up independent monetary policy and, with it, a sizeable slice of national sovereignty. Members relegate the regulation of their money supply, inflation, interest rates, and foreign exchange rates to a central monetary authority (e.g., the European Central Bank in the eurozone).

The need for central monetary management arises because, in economic theory, a currency is never just a currency. It is thought of as a transmission mechanism of economic signals (information) and expectations (often through monetary policy and its outcomes).

It is often argued that a single fiscal policy is not only unnecessary, but potentially harmful. A monetary union means the surrender of sovereign monetary policy instruments. It may be advisable to let the members of the union apply fiscal policy instruments autonomously in order to counter the business cycle, or cope with asymmetric shocks, goes the argument. As long as there is no implicit or explicit guarantee of the whole union for the indebtedness of its members - profligate individual states are likely to be punished by the market, discriminately.

But, in a monetary union with mutual guarantees among the members (even if it is only implicit as is the case in the eurozone), fiscal profligacy, even of one or two large players, may force the central monetary authority to raise interest rates in order to pre-empt inflationary pressures.

Interest rates have to be raised because the effects of one member's fiscal decisions are communicated to other members through the common currency. The currency is the medium of exchange of information regarding the present and future health of the economies involved. Hence the notorious "EU Stability Pact", recently so flagrantly abandoned in the face of German budget deficits.

Monetary unions which did not follow the path of fiscal rectitude are no longer with us.

In an article I published in 1997 ("The History of Previous European Currency Unions"), I identified five paramount lessons from the short and brutish life of previous - now invariably defunct - monetary unions:

A. To prevail, a monetary union must be founded by one or two economically dominant countries ("economic locomotives"). Such driving forces must be geopolitically important, maintain political solidarity with other members, be willing to exercise their clout, and be economically involved in (or even dependent on) the economies of the other members.

B. Central institutions must be set up to monitor and enforce monetary, fiscal, and other economic policies, to coordinate activities of the member states, to implement political and technical decisions, to control the money aggregates and seigniorage (i.e., rents accruing due to money printing), to determine the legal tender and the rules governing the issuance of money.

C. It is better if a monetary union is preceded by a political one (consider the examples of the USA, the USSR, the UK, and Germany).

D. Wage and price flexibility are sine qua non. Their absence is a threat to the continued existence of any union. Unilateral transfers from rich areas to poor are a partial and short-lived remedy. Transfers also call for a clear and consistent fiscal policy regarding taxation and expenditures. Problems like unemployment and collapses in demand often plague rigid monetary unions. The works of Mundell and McKinnon (optimal currency areas) prove it decisively (and separately).

E. Clear convergence criteria and monetary convergence targets.

The current European Monetary Union is far from heeding the lessons of its ill fated predecessors. Europe's labour and capital markets, though recently marginally liberalized, are still more rigid than 150 years ago. The euro was not preceded by an "ever closer (political or constitutional) union". It relies too heavily on fiscal redistribution without the benefit of either a coherent monetary or a consistent fiscal area-wide policy. The euro is not built to cope either with asymmetrical economic shocks (affecting only some members, but not others), or with the vicissitudes of the business cycle.

This does not bode well. This union might well become yet another footnote in the annals of economic history.

Current Account

Only four months ago, the IMF revised its global growth figures upward. It has since recanted but at the time its upbeat Managing Director, Horst Koehler, conceded defeat in a bet he made with America's outspoken and ever-exuberant Treasury Secretary, Paul O'Neill. He promised to treat him to a free dinner.

Judging by his economic worldview, O'Neill is a great believer in free dinners. Nowhere is this more evident than in his cavalier public utterances regarding America's current account deficit. As opposed to other, smaller countries, America's deficits have far reaching consequences and constitute global, rather than domestic, imbalances. The more integrated in the global marketplace a country is - the harsher the impact of American profligacy on its economy.

In a paper dated October 2001 and titled "The International Dollar Standard and Sustainability of the US Current Account Deficit", the author, Ronald McKinnon of Stanford University, concluded:

"Because the world is on a dollar standard, the United States is unique in having a virtually unlimited international line of credit which is largely denominated in its own currency, i.e., dollars. In contrast, foreign debtor countries must learn to live with currency mismatches where their banks' and other corporate international liabilities are dollar denominated but their assets are denominated in the domestic currency. As these mismatches cumulate, any foreign country is ultimately forced to repay its debts in order to avoid a run on its currency. But however precarious and over-leveraged the financing of individual American borrowers—including American banks, which intermediate such borrowing internationally—might be, they are invulnerable to dollar devaluation. In effect, America's collective current-account deficits are sustainable indefinitely."

In another paper, with Paul Davidson of the University of Tennessee, the authors went as far as suggesting that America's interminable deficit maintains the liquidity of the international trading system. A reduction in the deficit, by this logic, would lead to a global liquidity crunch.

Others cling to a mirror image of this argument. An assortment of anti-globalizers, non-governmental organizations, think tanks, and academics have accused the USA of sucking dry the pools of international savings painstakingly generated by the denizens of mostly developing countries. Technically, this is true. US Treasury bonds and notes compete on scarce domestic savings with businesses in countries from Japan to Russia and trounce them every time.

Savers - and governments - prefer to channel their funds to acquire US government obligations - dollar bills, T-bills, T-notes, equities, corporate bonds, and government bonds - rather than invest in their precarious domestic private sector. The current account deficit - at well over 4 percent of American GDP - absorbs 6 percent of global gross savings and a whopping three quarters of the world's non-domestic savings flows. By the end of last year, foreign investors held $1.7 trillion in US stocks, $1.2 trillion each in corporate debt and treasury obligations - 12 percent, 24 percent, and 42 percent of the outstanding quantities of these securities, respectively.

The November 2000 report of the Trade Deficit Review Commission, appointed by Congress in 1998, concluded that America's persistent trade deficit was brought on by - as Cato Institute's Daniel Griswold summarizes it - "high trade barriers abroad, predatory import pricing, declining competitiveness of core U.S. industries and low wages and poor working conditions in less-developed countries (as well as low) levels of national savings, (high rates of) investment, and economic growth - and exchange rate movements."

Griswold noted, though, that "during years of rising deficits, the growth of real GDP (in the USA) averaged 3.5% per year, compared to 2.6% during years of shrinking deficits ... the unemployment rate has, on average, fallen by 0.4% (compared to a similar rise) ...

manufacturing output grew an average of 4.6% a year ... (compared to an) average growth rate of one percent ... poverty rate fell an average of 0.2% from the year before ... (compared to a rise of) an average of 0.3%."

A less sanguine Kenneth Rogoff, the IMF's new Chief Economist wrote in "The Economist" in April: "When countries run sustained current-account deficits up in the range of 4 and 5% of GDP, they eventually reverse, and the consequences, particularly in terms of the real exchange rate, can be quite significant."

Rogoff alluded to the surreal appreciation of the dollar in the last few years. This realignment of exchange rates rendered imports to the USA seductively cheap and led to "unsustainable" trade and current account deficits. The IMF concluded, in its "World Economic Outlook", published on September 25, that America's deficit serves to offset - actually, finance - increased consumption and declining private savings rather than productive investment.

Greenspan concurred earlier this year in "USA Today": "Countries that have gone down this path invariably have run into trouble, and so would we." An International Finance Discussion Paper released by the Fed in December 2000 found, as "The Economist" put it, that "deficits usually began to reverse when they exceeded 5% of GDP. And this adjustment was accompanied by an average fall in the nominal exchange rate of 40%, along with a sharp slowdown in GDP growth."

Never before has the current account deficit continued to expand in a recession. Morgan Stanley predict an alarming shortfall of 6 percent of GDP by the end of next year. The US is already the world's largest debtor having been its largest creditor only two decades ago.

Such a disorientating swing has been experienced only by Britain following the Great War. In five years, US net obligations to the rest of the world will grow from one eighth of its GDP in 1997 to two fifths of a much larger product, according to Goldman Sachs. By 2006, a sum of $2 billion dollars per day would be required to cover this yawning shortfall.

Rogoff - and many other scholars - foresee a sharp contraction in American growth, consumption and, consequently, imports coupled with a depreciation in the dollar's exchange rate against the currencies of its main trading partners. In the absence of offsetting demand from an anemic Europe and a deflation-struck Japan, an American recession may well translate into a global depression. Only in 2003, the unwinding of these imbalances is projected by the IMF to shave 3 percentage points off America's growth rate.

But are the twin - budget and current account - deficits the inevitable outcomes of American fiscal dissipation and imports run amok - or a simple reflection of America's unrivalled attractiveness to investors, traders, and businessmen the world over?

Echoing Nigel Lawson, Britain's chancellor of the exchequer in the 1980's, O'Neill is unequivocal. The current deficit is not worrisome. It is due to a "stronger relative level of economic activity in the United States" - he insisted in a speech he gave this month to Vanderbilt University's Owen Business School. Foreigners want to invest in the US more than anywhere else. The current account deficit - a mere accounting convention - simply encapsulates this overwhelming allure.

This is somewhat disingenuous. In the last three years, most of the net inflows of foreign capital into the spendthrift US are in the form of debt to be repaid. This mounting indebtedness did not increase the stock of income-producing capital. Instead, it was shortsightedly and irresponsibly expended in an orgy of unbridled consumption.

For the first time in a long time, America's savings rate turned negative. Americans borrowed at home and abroad to embark on a fervid shopping spree. Even worse, the part of the deficit that was invested rather than consumed largely went to finance the dotcom boom turned bust. Wealth on unimaginable scale was squandered in this fraud-laced bubble. America's much hyped productivity growth turned out to have been similar to Europe's over the last decade.

Luckily for the US - and the rest of the world - its fiscal stance during the Clinton years has been impeccable and far stronger than Europe's, let alone Japan's. The government's positive net savings - the budget surplus - nicely balanced the inexorable demand by households and firms for foreign goods and capital. This is why this fiscal year's looming budget deficit - c. $200 billion - provokes such heated debate and anxiety.

Is there a growing reluctance of foreigners to lend to the US and to finance its imports and investment needs? To judge by the dollar's slump in world markets, yes. But a recent spate of bad economic news in Europe and Japan may restore the global appetite for dollar-denominated assets.

This would be a pity and a blessing. On the one hand, only a flagging dollar can narrow the trade deficit by rendering American exports more competitive in world markets - and imports to the USA more expensive than their domestic imperfect substitutes. But, as the late Rudi Dornbusch pointed out in August 2001:

"There are two kinds of Treasury Secretaries those like Robert Rubin who understand that a strong dollar helps get low interest rates and that the low rates make for a long and broad boom. And (those) like today's Paul O'Neil. They think too much about competitiveness and know too little about capital markets...

Secretary of the Treasury Paul O'Neil, comes from manufacturing and thinks like a manufacturer (who) have a perspective on the economy that is from the rabbit hole up. They think a weak dollar is good for exports and a hard dollar hurts sales and market share. Hence they wince any time they face a strong dollar and have wishy-washy answers to any dollar policy question."

The truth, as usual, is somewhere in the middle. Until recently, the dollar was too strong - as strong, in trade-related terms, as it was in the 1980's. Fred Bergsten, head of the Institute for International Economics, calculated in his testimony to the Senate Banking Committee on May 1, that America's trade deficit soars by $10 billion for every percentage rise in the dollar's exchange rate.

American manufacturers shifted production to countries with more competitive terms of trade - cheaper manpower and local inputs. The mighty currency encouraged additional - mostly speculative- capital flows into dollar-denominated assets, exacerbating the current account deficit.

A strong dollar keeps the lid on inflation - mainly by rendering imports cheaper. It, thus, provides the central bank with more leeway to cut interest rates. Still, the strength of the dollar is only one of numerous inputs - and far from being the most important one - in the monetary policy. Even a precipitous drop in the dollar is unlikely to reignite inflation in an economy characterized by excess capacity, falling prices, and bursting asset bubbles.

A somewhat cheaper dollar, the purported - but never proven - "wealth effect" of crumbling stock markets, the aggressive reduction in interest rates, and the wide availability of easy home equity financing should conspire to divert demand from imports to domestic offerings. Market discipline may yet prove to be a sufficient and efficient cure.

But, the market's self-healing powers aside, can anything be done - can any policy be implemented - to reverse the deteriorating balance of payments?

In a testimony he gave to the Senate in May, O'Neill proffered one of his inimitable metaphors:

"All the interventions that have been modeled would do damage to the U.S. economy if we decided to reduce the size of the current account deficit. And so I don't find it very appealing to say that we are going to cut off our arm because some day we might get a disease in it."

This, again, is dissimulation. This administration - heated protestations to the contrary notwithstanding - resorted to blatant trade protectionism in a belated effort to cope with an avalanche of cheap imports. Steel quotas, farm and export subsidies, all manner of trade remedies failed to stem the tide of national red ink.

The dirty secret is that everyone feeds off American abandon. A sharp drop in its imports - or in the value of the dollar - can spell doom for more than one country and more than a couple of industries. The USA being the global economy's sink of last resort - absorbing one quarter of world trade - other countries have an interest to maintain and encourage American extravagance. Countries with large exports to the USA are likely to reacts with tariffs, quotas, and competitive devaluations to any change in the status quo. The IMF couches the awareness of a growing global addiction in its usual cautious terms:

"The possibility of an abrupt and disruptive adjustment in the U.S. dollar remains a concern, for both the United States and the rest of the world ... The question is not whether the U.S. deficit will be sustained at present levels forever - it will not - but more when and how the eventual adjustment takes place ... While this would likely be manageable in the short term it could adversely affect the sustainability of recovery later on."

Another embarrassing truth is that a strong recovery in Europe or Japan may deplete the pool of foreign capital available to the USA. German and Japanese Investors may prefer to plough their money into a re-emergent Germany, or a re-awakening Japan - especially if the dollar were to plunge. America requires more than $1 billion a day to maintain its current levels of government spending, consumption, and investment.

There is another - much hushed - aspect of American indebtedness. It provides other trading blocks and countries - for example, Japan and the oil producing countries - with geopolitical leverage over the United States and its policies. America - forced to dedicate a growing share of its national income to debt repayment - is "in growing hock" to its large creditors.

Last month, Arab intellectuals and leaders called upon their governments to withdraw their investments in the USA. This echoed of the oil embargo of yore. Ernest Preeg of the Manufacturers Alliance was quoted by the Toronto Star as saying: "China, for example, could blackmail the United States by threatening to dump its vast holdings of U.S. dollars, forcing up U.S. interest rates and undermining the U.S. stock market. Chinese military officials, he claimed, had included this kind of tactic in their studies of non-conventional defence strategies."

These scenarios are disparaged by analysts who point out that America's current account deficit is mostly in private hands. Households and firms should be trusted to act rationally and, in aggregate, repay their debts. Still, it should not be forgotten that the Asian crisis of 1997-8 was brought on by private profligacy. Firms borrowed excessively, spent inanely, and invested unwisely. Governments ran surpluses. As the IMF puts it: "To err is human and this is as true of private sector investors as anyone else."

Cyrillic Alphabet, Economic Impact of

In November 2002, Citibank became the first American bank to open a retail operation in Russia, replete with phone and Internet banking. It offered middle-class Russian clients in Moscow and St. Petersburg both ruble and dollar accounts, overdraft and loan facilities in both currencies, and even debit - though no credit - cards. Murky laws regarding ownership of real estate had initially preclude mortgages. Citibank already managed some corporate business in Russia with a modest asset portfolio of c. $1 billion.

According to the Russian headquarters of the bank, the price tag of opening the branch reached "several million dollars". Most of it was to convert the bank's global systems to the 33-letters Cyrillic alphabet. This is an illustration of the hidden business costs incurred by preferring the idiosyncratic Slavic script to the widely used Latin one.

The peoples of eastern Europe have little left except their character set. Their industry dilapidated, their politics venal and acrimonious, their standard of living dismal, their society disintegrating, and their national identities often fragile - they cling fiercely to their "historical" myths and calligraphic lettering, the last vestiges of long-gone grandeur. Bulgarians, Greeks, and Macedonians still argue rancorously about the ethnic affiliation of the 9th century inventors of the Cyrillic symbols - the eponymous Saint Cyril and his brother, Saint Methodius.

Russian news agencies reported that on November 15, 2002 the Duma passed an amendment to the Law on the Languages of the Peoples of the Russian Federation, making the Cyrillic alphabet mandatory, though not exclusive. The use of other scripts is hence subject to the enactment case-by-case federal laws.

Many of Russia's numerous constituent republics and countless ethnic minorities are unhappy. The Tatars, for instance, have been using the Latin script since September 2001. Cyrillic characters in Tatarstan are due to be phased out in 2011. The republic of Karelia, next to the Finnish border, has been using Latin letters exclusively and would also be adversely affected.

Prominent Tatars - and the Moscow-based Center for Journalism in Extreme Situations - have taken to calling the amendment a violation of human rights and of the constitution. This, surely, is somewhat overdone. The new statute is easy to circumvent. A loophole in the law would allow, for instance, the use of non-Cyrillic alphabets for non-state languages.

The economic implications of an obscure script were well grasped by Kemal Ataturk, the founder of modern Turkey. He was fond of saying that "the cornerstone of education is an easy system of reading and writing. The key to this is the new Turkish alphabet based on the Latin script." In 1928, he replaced the cumbersome Arabic script with a Latinized version of Turkish. Literacy shot up and access to a wealth of educational and cultural material was secured.

Yet, many Slav scholars point out that other countries - like Israel, Japan and China - have chosen to tenaciously preserve their ancient alphabets. It did not seem to affect their economic ascendance.

Moreover, scriptural conversion is bound to be as costly as preserving the old letters: the transcription of archives and contracts; the reprinting of textbooks and periodicals; the recoding of software and electronic documents; the purchase of new typeset machines; the training of printers, authors, journalists, judges, teachers, bureaucrats, the populace; the changing of road signs and computer keyboards; the re-posting of Web sites and the development of fonts. And this is a - very - partial list.

To burnish his nationalist credentials, during the election campaign in Bulgaria in 2001, the incumbent president, Petar Stoyanov, distanced himself from a suggestion made by professor Otto Kronsteiner, an Austrian professor of Bulgarian studies, who advocates swapping the Cyrillic character set for the Latin one.

Similarly, Macedonian negotiators insisted, during the negotiations leading to the August 2001 Ohrid Framework Agreement which terminated the Albanian uprising, on maintaining the Macedonian language and the Cyrillic alphabet as the only official ones.

The Prime Minister of Macedonia, Nikola Gruevski, often engages in ostentatious religious and nationalistic posturing. Wounded by Greek intransigence over the name issue (should the Republic of Macedonia be allowed to use its constitutional name or not) and by Bulgaria's insistence that Macedonians are merely culturally-inferior Bulgarians, Macedonians react well to his message.

Thus, in April 2008, MIA, the Macedonian Information Agency, embarked on yet another campaign, titled: "I preserve what is mine - while I write using Cyrillic alphabet - I exist!".

But the dominance of English is forcing even the most fervent nationalists to adopt. Moldova has reinstated Romanian and its Latin alphabet as the state language in 1989. Even the Inuit of Russia, Canada, Greenland and Alaska are discussing a common alphabet for their 7000-years old Inuktitut language.

According to the Khabar news agency, Kazakhstan, following the footsteps of Uzbekistan and Turkmenistan, is in the throes of reverting to Latin script. Kazakh officials cited the trouble-free use of computers and the Internet as a major advantage of dumping the Cyrillic alphabet.

It would also insulate Kazakhstan from the overbearing Russians next door. But this is a two-edged sword. In August 2001, the Azeri government suspended the publication of the weekly Impulse for refusing to switch from Soviet-era Cyrillic to Latin.

The periodical's hapless owner protested that no one is able to decipher the newly introduced Latin script. Illiteracy has surged as a result and Russian citizens of Azerbaijan feel alienated and discriminated against. Recently Latinized former satellites of the Soviet Union seem to have been severed from the entire body of Russian culture, science and education.

Fervid protestations to the contrary notwithstanding, Cyrillic lettering is a barrier. NASA published in 2001 the logbooks of the astronauts aboard the International Space Station. The entries for Nov 25, 2000 and January read: "Sergei (Krikalev) discusses some problems with the way (Microsoft) Windows is handling Cyrillic fonts ... Sergei is still having difficulties with his e-mail. After the mail sync, he still has 'outgoing' mail left instead of everything in the 'sent' folder."

It took Microsoft more than two years to embark on a localization process of the Windows XP Professional operating system and the Office Suite in Serbia where the Cyrillic alphabet is still widely used. Even so, the first version was in Latin letters. Cyrillic characters were introduced "in the next version". A Cyrillic version has been available in Bulgaria since October 2001 after protracted meetings between Bulgarian officials and Microsoft executives.

The Board for the Standardization of the Serbian Language and the Serbian National Library, aware of the Cyrillic impediment are studying "ways of increasing the use of Serbian language and the Cyrillic alphabet in modern communications, especially the Internet".

But the dual use of Latin and Cyrillic scripts - at least in official documents - is spreading. Bosnia-Herzegovina has recently decided to grant its citizens the freedom to choose between the two on their secure identity cards. The triumph of the Latin script seems inevitable, whether sanctioned by officialdom or not.

D

Decision Support Systems

Many companies in developing countries have a very detailed reporting system going down to the level of a single product, a single supplier, a single day. However, these reports – which are normally provided to the General Manager - should not, in my view, be used by them at all. They are too detailed and, thus, tend to obscure the true picture. A General Manager must have a bird's eye view of his company. He must be alerted to unusual happenings, disturbing financial data and other irregularities.

As things stand now, the following phenomena could happen:

a. That the management will highly leverage the company by assuming excessive debts burdening the cash flow of the company and / or
b. That a false Profit and Loss (PNL) picture will emerge - both on the single product level - and generally. This could lead to wrong decision making, based on wrong data.
c. That the company will pay excessive taxes on its earnings and / or
d. That the inventory will not be fully controlled and appraised centrally and / or
e. That the wrong cash flow picture will distort the decisions of the management and lead to wrong (even to dangerous) decisions.

To assist in overcoming the above, there are four levels of reporting and flows of data which every company should institute:

The first level is the annual budget of the company which is really a business plan. The budget allocates amounts of money to every activity and / or department of the firm.

As time passes, the actual expenditures are compared to the budget in a feedback loop. During the year, or at the end of the fiscal year, the firm generates its financial statements: the income statement, the balance sheet, the cash flow statement.

Put together, these four documents are the formal edifice of the firm's finances. However, they can not serve as day to day guides to the General Manager.

The second tier of financial audit and control is when the finance department (equipped with proper software – Solomon IV is the most widely used in the West) is able to produce pro forma financial statements monthly.

These financial statements, however inaccurate, provide a better sense of the dynamics of the operation and should be constructed on the basis of Western accounting principles (GAAP and FASBs, or IAS).

But the Manager should be able to open this computer daily and receive two kinds of data, fully updated and fully integrated:

1. Daily financial statements;
2. Daily ratios report.

The daily financial statements

The Manager should have access to continuously updated statements of income, cash flow, and a balance sheet. The most important statement is that of the cash flow. The manager should be able to know, at each and every stage, what his real cash situation is - as opposed to the theoretical cash situation which includes accounts payable and account receivable in the form of expenses and income.

These pro forma financial statements should include all the future flows of money - whether invoiced or not. This way, the Manager will be able to type a future date into his computer and get the financial reports and statements relating to that date.

In other words, the Manager will not be able to see only a present situation of his company, but its future situation, fully analysed and fully updated.

Using today's technology - a wireless-connected laptop – managers are able to access all these data from anywhere in the world, from home, while traveling, and so on.

The daily ratios report

This is the most important part of the decision support system.

It enables the Manager to instantly analyse dozens of important aspects of the functioning of his company. It allows him to compare the behaviour of these parameters to historical data and to simulate the future functioning of his company under different scenarios.

It also allows him to compare the performance of his company to the performance of his competitors, other firms in his branch and to the overall performance of the industry that he is operating in.

The Manager can review these financial and production ratios. Where there is a strong deviation from historical patterns, or where the ratios warn about problems in the future – management intervention may be required.

Instead of sifting through mountains of documents, the Manager will only have to look at four computer screens in the morning, spot the alerts, read the explanations offered by the software, check what is happening and better prepare himself for the future.

Examples of the ratios to be included in the decision system

a. ***SUE measure*** - deviation of actual profits from expected profits;
b. ***ROE*** - the return on the adjusted equity capital;
c. ***Debt to equity*** ratios;
d. ***ROA*** - the return on the assets;
e. The ***financial average***;
f. ***ROS*** - the profit margin on the sales;
g. ***ATO*** - asset turnover, how efficiently assets are used;
h. ***Tax burden and interest burden*** ratios;
i. ***Compounded leverage***;
j. ***Sales to fixed assets*** ratios;
k. ***Inventory turnover*** ratios;

l. ***Days receivable and days payable***;
m. ***Current ratio, quick ratio, interest coverage ratio*** and other liquidity and coverage ratios;
n. ***Valuation price*** ratios;
and many others.

The effects of using a decision system

A decision system has great impact on the profits of the company. It forces the management to rationalize the depreciation, inventory and inflation policies. It warns the management against impending crises and problems in the company. It specially helps in following areas:

1. The management knows exactly how much credit it could take, for how long (for which maturities) and in which interest rate. It has been proven that without proper feedback, managers tend to take too much credit and burden the cash flow of their companies.

2. A decision system allows for careful financial planning and tax planning. Profits go up, non cash outlays are controlled, tax liabilities are minimized and cash flows are maintained positive throughout.

3. As a result of all the above effects the value of the company grows and its shares appreciate.

4. The decision system is an integral part of financial management in the West. It is completely compatible with western accounting methods and derives all the data that it needs from information extant in the company.

So, the establishment of a decision system does not hinder the functioning of the company in any way and does not interfere with the authority and functioning of the financial department.

Decision Support Systems cost as little as 20,000 USD (all included: software, hardware, and training). They are one of the best investments that a firm can make.

Deposit Insurance

No country was exempt, all suffered collapsing or near-collapsing banking systems. India had to nationalize the fourteen biggest banks - and, later on, tens of private, smaller ones - in 1969.

This was done to avert a major financial catastrophe. No one can enumerate all the banking crises in England. As late as 1991 it had a 10 billion USD collapse (the BCCI bank).

In 1973-4, during the "secondary banking crisis", the government had to launch operation "Lifeboat" to save 60 banks. They failed because the Bank of England deregulated the credit markets and freed it to competition.

As we review this scorched earth of ruined banks, six patterns emerge concerning the compensation offered by the state to the adversely affected clients.

The USA established a Federal Deposit Insurance Corporation (FDIC) as early as 1933.

Every depositor in every American bank is insured and the participation of the banks in the FDIC is obligatory.

The FDIC covers deposits of up to 100,000 USD per person per bank.

The savings and loans associations (SLAs) were insured in a separate agency, the FSLIC.

When a wave of bankruptcies engulfed the SLAs in 1985-7, the FSLIC went bust and was unable to meet the demands of the panicky depositors.

The USA reorganized the whole system but it also decided to compensate the depositors and savers in the SLAs. To do that, it initially injected - using budget contingency funds - 10.8 billion USD. Then, a special agency was set up (the RTC). This agency established RefCorp, a corporation whose sole purpose was to issue bonds to the public and sell them in the various stock exchanges throughout the USA. The proceeds of the of the sale were used to beef up the failing SLAs and to make their balance sheets much healthier.

It is important to note that nothing explicit was promised to the depositors. The government made vague and late statements about its willingness to support the ailing institutions. This was enough to calm the panic and to re-establish trust between the depositors and the SLAs.

RefCorp bonds were not backed by a federal guarantee. Still, the fact that RefCorp was a federal entity, associated with the administration was enough to give it a federal credit rating.

People believed in the sincerity of the commitment of the government and in the long term repayment prospects of the bonds. They bought 300 billion worth and the money was immediately injected to heal the bankrupt institutions. Using long term debt - which was not even part of its obligations - the government was able to stabilize the financial system and to fully compensate depositors for their money.

A similar approach was adopted by Israel to cope with its 1983 banking crisis. The whole banking system collapsed as a result of a failure of a pyramid scheme involving the banks' shares. The government was faced with civil unrest and decided to compensate those who bought the shares in the stock exchange.

At first, the banks were nationalized and trading in their shares in the stock exchange was suspended to prevent panic selling. The government, having become the owner of the banks, declared a share buyback scheme. Owners of bank shares were permitted to sell them to the government in three specific dates over a period of 9 years (originally, the share buyback scheme was for a period of 6 years with two exit dates but it was prolonged). The price at which the government agreed to buy the shares back from the public was the price on the last day that the shares were traded prior to the collapse (5/10/83) and it was linked to the exchange rate of the Shekel-USD. The government used funds allocated within the national budget to buy the shares back. This means that it used taxpayers money to financially save a select group of shareholders. But there was no public outcry: so many people were involved in these pyramid schemes for so long that all the citizens stood to benefit from this generous handout. When the last shares were bought in 1992 the total damage became evident: no less than 6 billion USD (minus what the government could get when it were to sell the banks that it owned).

1994 was arguably the worst year for banks in South America since 1982. Banks collapsed all over that region.

It started with Venezuela in January 1994. One of the major banks there, Banco Latino, failed, dragging with it 7 others. The Government decided to fully compensate all the depositors and savers in these banks. It has created a special fund to which revenues from the sale of oil were transferred. Obviously, this money was taken away from the budget and was compensated for by extra taxation. The whole economy was horribly effected: inflation shot up uncontrollably, a credit crunch ensued and business bankruptcies proliferated. Venezuela entered one of the worst economic periods in its history with rampant unemployment and a virtual state of economic depression. It cost the country 12 billion USD to extract its banking system from the throes of imminent evaporation - an amount equal to 22% of its annual GDP.

And this was nothing compared to the Brazilian predicament. Brazil is divided to geographically huge states, each with its own development bank. These banks are really commercial banks. They have hundreds of branches spread across the states, they take deposits and make loans to business firms and to individuals. But their main debtors are the administrations of the states. When Banespa, the Sao Paolo state development bank collapsed, it was owed 19 billion USD by the state government, not to mention other bad loans. This bank had 1,500 branches and millions of depositors. It would have been political suicide to just let it die away. In December 1994, the Central Bank took over the day to day management of the bank and installed its own people in it. The bank was later completely nationalized. Moreover, the other state development banks began to wobble, together with a sizeable chunk of the private banking sector - 27 banks in total. This was really ominous and the government came up with a creative solution: instead of saving the banks - it saved the big clients of the banks. Sao Paolo received 66 billion USD in federal credits which assisted it in re-financing and in re-scheduling its debts, especially its debts towards Banespa. The bank was saved, the state was saved, the federal budget was 66 billions poorer - and this was only the beginning. In certain cases, the loan (asset) portfolios were so bad and unrecoverable that the government had to inject money to the bank itself - because there were no more clients to inject money to. Banco do Brazil received 7.8 billion USD on condition that it writes off loans from its books. Another 13.6 billion USD were given to private banks. The government also cajoled banks into merging or into finding foreign partners. The depositors were completely compensated but only a few of the 27 saved banks are of any interest to foreign investors. After all, a bank without assets is hardly a bank at all.

The most vicious of all banking affairs in this part of the world occurred in Paraguay a year later. The Treasure of the Central Bank, no less, was found using the Central Bank funds to run a lucrative money lending operation. He lent 3 million of the bank's funds before he was caught. Needless to sat that he pocketed the interest payments. In April 1995, the Governor of the Central Bank there decided that things were getting too hot for him and he fled the country altogether. The public was in panic. No one knew what happened to the reserves of the commercial banks which were deposited with the Central Banks. Banks with no reserves are very shaky and dangerous institutions. So, depositors and savers queued in front of the banks to draw their money. It was a matter of a very short time before the banks became insolvent and closed down their operations, albeit "temporarily". Four banks and 16 savings houses collapsed that year and four more banks - the next. The bank supervision discovered mountains and oceans of black money on which the banks paid high rates of interest. The legal "white" money - a much smaller amount altogether - bore a lower rate of interest.

The government adopted a politically brave decision: it would compensate only those depositors which deposited money on which they paid taxes ("legal money"). Even so, the damage was great (in Paraguayan terms): 450 million USD. Those depositors who received excess interest payments on their undeclared funds - lost both their funds and the interest accruing thereon. Moreover, the government forced the owners of the banks to increase the equity capital. The system was saved, though the basic malaise was not cured and the banking system is still obscure, secretive, nepotistic and highly dangerous.

A course very similar to that chosen by Macedonia was adopted by the government of Japan.

In 1990, the Tokyo Stock Exchange began its long 50% decline. People lost trillions of USD.

As a result, they had no money to continue to pay the outlandish prices which were demanded by sellers of real estate property. So, real estate prices went down by as much as 80% in the Tokyo area - and by a bit less elsewhere in Japan. Real estate property served as the main security on huge portfolios of loans which were provided by banks through Junsen, financing corporations set up especially to provide mortgage collateralised loans.

The logical - and inevitable - result was the collapse of seven important Junsen, followed by a chain reaction of banks ceasing to function.

The Japanese government set up a special agency, the HLAC, which "cleaned" the books of the banks by taking over the non-performing loans. This move was very similar to what the Macedonian government did with the Ägencija za Sanacija na Bankiti" - clean off the balance sheets of the banks, make them healthier and then supervise them heavily. No one knows how much the government of Japan has doled out to save the banks (actually, the depositors money). Rumours have it that about 1.8 billion were invested in the rescue operation of 1 junsen, the Nichiei Junsen.

Different countries bring different cultures and different solutions to the same problems.

Yet, there is one thing common to all: depositors are usually almost fully compensated using state money on and off budget. Some countries spread the payments over longer periods of time - other do not even dare raise the possibility and they take over the liabilities (and the assets) of the failing banking system. Some sell bonds to raise the money - other us taxpayers money. But they all succumb to the ultimate political imperative: survival.

Derivatives, Pricing of

The Royal Swedish Academy of Sciences has decided to award the Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel 1997, to Professor Robert C. Merton, Harvard University, and to Professor Myron S. Scholes, Stanford University, jointly. The prize was awarded for a new method to determine the value of derivatives.

This sounds like a trifle achievement - but it is not. It touches upon the very heart of the science of Economics: the concept of Risk. Risk reflects the effect on the value of an asset where there is an option to change it (the value) in the future.

We could be talking about a physical assets or a non-tangible asset, such as a contract between two parties. An asset is also an investment, an insurance policy, a bank guarantee and any other form of contingent liability, corporate or not.

Scholes himself said that his formula is good for any situation involving a contract whose value depends on the (uncertain) future value of an asset.

The discipline of risk management is relatively old. As early as 200 years ago households and firms were able to defray their risk and to maintain a level of risk acceptable to them by redistributing risks towards other agents who were willing and able to assume them. In the financial markets this is done by using derivative securities options, futures and others. Futures and forwards hedge against future (potential - all risks are potentials) risks. These are contracts which promise a future delivery of a certain item at a certain price no later than a given date. Firms can thus sell their future production (agricultural produce, minerals) in advance at the futures market specific to their goods. The risk of future price movements is re-allocated, this way, from the producer or manufacturer to the buyer of the contract. Options are designed to hedge against one-sided risks; they represent the right, but not the obligation, to buy or sell something at a pre-determined price in the future. An importer that has to make a large payment in a foreign currency can suffer large losses due to a future depreciation of his domestic currency. He can avoid these losses by buying call options for the foreign currency on the market for foreign currency options (and, obviously, pay the correct price for them).

Fischer Black, Robert Merton and Myron Scholes developed a method of correctly pricing derivatives. Their work in the early 1970s proposed a solution to a crucial problem in financing theory: what is the best (=correctly or minimally priced) way of dealing with financial risk. It was this solution which brought about the rapid growth of markets for derivatives in the last two decades. Fischer Black died in August 1995, in his early fifties. Had he lived longer, he most definitely would have shared the Nobel Prize.

Black, Merton and Scholes can be applied to a number of economic contracts and decisions which can be construed as options. Any investment may provide opportunities (options) to expand into new markets in the future. Their methodology can be used to value things as diverse as investments, insurance policies and guarantees.

Valuing Financial Options

One of the earliest efforts to determine the value of stock options was made by Louis Bachelier in his Ph.D. thesis at the Sorbonne in 1900. His formula was based on unrealistic assumptions such as a zero interest rate and negative share prices.

Still, scholars like Case Sprenkle, James Boness and Paul Samuelson used his formula. They introduced several now universally accepted assumptions: that stock prices are normally distributed (which guarantees that share prices are positive), a non-zero (negative or positive) interest rate, the risk aversion of investors, the existence of a risk premium (on top of the risk-free interest rate). In 1964, Boness came up with a formula which was very similar to the Black-Scholes formula. Yet, it still incorporated compensation for the risk associated with a stock through an unknown interest rate.

Prior to 1973, people discounted (capitalized) the expected value of a stock option at expiration. They used arbitrary risk premiums in the discounting process. The risk premium represented the volatility of the underlying stock.

In other words, it represented the chances to find the price of the stock within a given range of prices on expiration. It did not represent the investors' risk aversion, something which is impossible to observe in reality.

The Black and Scholes Formula

The revolution brought about by Merton, Black and Scholes was recognizing that it is not necessary to use any risk premium when valuing an option because it is already included in the price of the stock. In 1973 Fischer Black and Myron S. Scholes published the famous option pricing Black and Scholes formula. Merton extended it in 1973.

The idea was simple: a formula for option valuation should determine exactly how the value of the option depends on the current share price (professionally called the "delta" of the option). A delta of 1 means that a $1 increase or decrease in the price of the share is translated to a $1 identical movement in the price of the option.

An investor that holds the share and wants to protect himself against the changes in its price can eliminate the risk by selling (writing) options as the number of shares he owns. If the share price increases, the investor will make a profit on the shares which will be identical to the losses on the options. The seller of an option incurs losses when the share price goes up, because he has to pay money to the people who bought it or give to them the shares at a price that is lower than the market price - the strike price of the option. The reverse is true for decreases in the share price. Yet, the money received by the investor from the buyers of the options that he sold is invested. Altogether, the investor should receive a yield equivalent to the yield on risk free investments (for instance, treasury bills).

Changes in the share price and drawing nearer to the maturity (expiration) date of the option changes the delta of the option. The investor has to change the portfolio of his investments (shares, sold options and the money received from the option buyers) to account for this changing delta.

This is the first unrealistic assumption of Black, Merton and Scholes: that the investor can trade continuously without any transaction costs (though others amended the formula later).

According to their formula, the value of a call option is given by the difference between the expected share price and the expected cost if the option is exercised. The value of the option is higher, the higher the current share price, the higher the volatility of the share price (as measured by its standard deviation), the higher the risk-free interest rate, the longer the time to maturity, the lower the strike price, and the higher the probability that the option will be exercised.

All the parameters in the equation are observable except the volatility , which has to be estimated from market data. If the price of the call option is known, the formula can be used to solve for the market's estimate of the share volatility.

Merton contributed to this revolutionary thinking by saying that to evaluate stock options, the market does not need to be in equilibrium. It is sufficient that no arbitrage opportunities will arise (namely, that the market will price the share and the option correctly). So, Merton was not afraid to include a fluctuating (stochastic) interest rate in HIS treatment of the Black and Scholes formula.

His much more flexible approach also fitted more complex types of options (known as synthetic options - created by buying or selling two unrelated securities).

Theory and Practice

The Nobel laureates succeeded to solve a problem more than 70 years old.

But their contribution had both theoretical and practical importance. It assisted in solving many economic problems, to price derivatives and to valuation in other areas. Their method has been used to determine the value of currency options, interest rate options, options on futures, and so on.

Today, we no longer use the original formula. The interest rate in modern theories is stochastic, the volatility of the share price varies stochastically over time, prices develop in jumps, transaction costs are taken into account and prices can be controlled (e.g. currencies are restricted to move inside bands in many countries).

Specific Applications of the Formula: Corporate Liabilities

A share can be thought of as an option on the firm. If the value of the firm is lower than the value of its maturing debt, the shareholders have the right, but not the obligation, to repay the loans. We can, therefore, use the Black and Scholes to value shares, even when are not traded. Shares are liabilities of the firm and all other liabilities can be treated the same way.

In financial contract theory the methodology has been used to design optimal financial contracts, taking into account various aspects of bankruptcy law.

Investment evaluation Flexibility is a key factor in a successful choice between investments. Let us take a surprising example: equipment differs in its flexibility - some equipment can be deactivated and reactivated at will (as the market price of the product fluctuates), uses different sources of energy with varying relative prices (example: the relative prices of oil versus electricity), etc. This kind of equipment is really an option: to operate or to shut down, to use oil or electricity).

The Black and Scholes formula could help make the right decision.

Guarantees and Insurance Contracts

Insurance policies and financial (and non financial) guarantees can be evaluated using option-pricing theory. Insurance against the non-payment of a debt security is equivalent to a put option on the debt security with a strike price that is equal to the nominal value of the security. A real put option would provide its holder with the right to sell the debt security if its value declines below the strike price.

Put differently, the put option owner has the possibility to limit his losses.

Option contracts are, indeed, a kind of insurance contracts and the two markets are competing.

Complete Markets

Merton (1977) extend the dynamic theory of financial markets. In the 1950s, Kenneth Arrow and Gerard Debreu (both Nobel Prize winners) demonstrated that individuals, households and firms can abolish their risk: if there exist as many independent securities as there are future states of the world (a quite large number). Merton proved that far fewer financial instruments are sufficient to eliminate risk, even when the number of future states is very large.

Practical Importance

Option contracts began to be traded on the Chicago Board Options Exchange (CBOE) in April 1973, one month before the formula was published.

It was only in 1975 that traders had begun applying it - using programmed calculators. Thousands of traders and investors use the formula daily in markets throughout the world. In many countries, it is mandatory by law to use the formula to price stock warrants and options. In Israel, the formula must be included and explained in every public offering prospectus.

Today, we cannot conceive of the financial world without the formula.

Investment portfolio managers use put options to hedge against a decline in share prices. Companies use derivative instruments to fight currency, interest rates and other financial risks. Banks and other financial institutions use it to price (even to characterize) new products, offer customized financial solutions and instruments to their clients and to minimize their own risks.

Some Other Scientific Contributions

The work of Merton and Scholes was not confined to inventing the formula.

Merton analysed individual consumption and investment decisions in continuous time. He generalized an important asset pricing model called the CAPM and gave it a dynamic form. He applied option pricing formulas in different fields.

He is most known for deriving a formula which allows stock price movements to be discontinuous.

Scholes studied the effect of dividends on share prices and estimated the risks associated with the share which are not specific to it. He is a great guru of the efficient marketplace ("The Invisible Hand of the Market").

Devaluation

A Minister of Finance is morally right to lie about a forthcoming devaluation and a woman has the right to lie about her age. This is the common wisdom.

Why do governments devalue?

They do it mainly to improve the balance of trade. A devaluation means that more local currency is needed to purchase imports and exporters get more local currency when they convert the export proceeds (the foreign exchange that they get for their exports). In other words: imports become more expensive - and exporters earn more money. This is supposed to discourage imports - and to encourage exports and, in turn, to reduce trade deficits.

At least, this is the older, conventional thinking. A devaluation is supposed to improve the competitiveness of exporters in their foreign markets. They can even afford to reduce their prices in their export markets and to finance this reduction from the windfall profits that they get from the devaluation. In professional jargon we say that a devaluation "improves the terms of trade".

But before we examine the question whether all this is true in the case of Macedonia - let us study a numerical example.

Let us assume that we have a national economy with for types of products:

Imported, Exported, Locally Produced Import Substitutes, Locally consumed Exportable Products. In an economy in equilibrium all four will be identically priced, let us say at 2700 Denars (= 100 DEM) each.

When the exchange rate is 27 MKD/DM, the total consumption of these products will not be influenced by their price. Rather, considerations of quality, availability, customer service, market positioning, status symbols and so on will influence the consumption decision.

But this will all change when the exchange rate is 31 MKD/DM following a devaluation.

The Imported product will now be sold locally at 3100. The Importer will have to pay more MKD to get the same amount of DM that he needs to pay the foreign manufacturer of the product that he is importing.

The Exported products will now fetch the exporter the same amount of income in foreign exchange. Yet, when converted to MKD - he will receive 400 MKD more than before the devaluation. He could use this money to increase his profits - or to reduce the price of his product in the foreign markets and sell more (which will also increase his profits).

The Locally Produced Import Substitutes will benefit: they will still be priced at 2700 - while the competition (Imports) will have to increase the price to 3100 not to lose money!

The local consumption of products which can, in principle, be exported - will go down. The exporter will prefer to export them and get more MKD for his foreign exchange earnings.

These are the subtle mechanisms by which exports go up and imports go down following a devaluation.

In Macedonia, the situation is less clear. There is a great component of imported raw materials in the exported industrial products. The price of this component will increase. The price of capital assets (machinery, technology, intellectual property, software) will also increase and make it more difficult for local businesses to invest in their future. Still, it is safe to say that the overall effect of the devaluation will favour exporters and exports and reduce imports marginally.

Unfortunately, most of the imports are indispensable at any price (inelastic demand curve): raw materials, capital assets, credits, even cars. People buy cars not only to drive them - but also in order to preserve the value of their money. Cars in Macedonia are a commodity and a store of value and these functions are difficult to substitute.

But this is all in an idealized country which really exists nowhere. In reality, devaluation tends to increase inflation (=the general price level) and thus have an adverse macro-economic effect. Six mechanisms operate immediately following a devaluation:

1. The price of imported products goes up.

2. The price of goods and services, denominated in foreign exchange goes up. An example: prices of apartments and residential and commercial rentals is fixed in DEM. These prices increase (in terms of MKD) by the percentage of devaluation - immediately! The same goes for consumer goods, big (cars) and small (electronics).

3. Exporters get more MKD for their foreign exchange (and this has an inflationary effect).

4. People can convert money that they saved in foreign exchange - and get more MKD for it. A DEVALUATION IS A PRIZE GIVEN TO SPECULATORS AND TO BLACK MARKET OPERATORS.

5. Thus, the cost of living increases. People put pressure on their employees to increase their salaries. Unfortunately, there is yet no example in history in which governments and employers were completely successful in fending off such pressures. Usually, they give in, wholly or partially.
   Certain countries tried to contain such wage pressures and the wage driven inflation which is a result of wage increases.
   The government, employee trade unions and representatives of employers' unions - sign "economic pacts or package deals".
   The government undertakes not to raise fees for public services, the employers agree not to fire people or not to reduce wages and employee trade

unions agree not to demand wage hikes and not to strike.
Such economic pacts have been very successful in stabilizing inflation in many countries, from Israel to Argentina.
Still, some of the devaluation inevitably seeps into the wages. The government can effectively control only such employees as are in its direct employment. It cannot dictate to the private sector.

6. Inflation gradually erodes the competitive advantage awarded to the exporters by the devaluation which preceded it. So devaluations have a tendency to create a cancerous chain reaction: devaluation-inflation followed by more devaluation and yet by more inflation.

Arguably, the worst effect of a devaluation is the psychological one.

Macedonia has succeeded where many other countries failed: it created an atmosphere of macro-economic stability. It is a fact that the differential between the official and non-official exchange rates was very small (about 3.5%). This was a sign of trust in the macro-economic management. This devaluation had the effects of drugs: it could prove stimulating to the economic body in the short term - but it might be harmful to it in the longer term.

These risks are worth taking under two conditions:

1. That the devaluation is part of a comprehensive economic program intended to stimulate the economy and mainly the export sector.

2. That the devaluation is part of a long term macro-monetary plan with clear, OPENLY DECLARED, goals. In other words: the government and the Central Bank should have designed a multi-year plan, stating clearly their inflation objectives and by how much they are going to devalue the currency (MKD) over and above the inflation target. This is much preferable to "shock therapy": keeping the devaluation secret until the last minute and then declaring it overnight, taking everyone by surprise. The instinctive reaction is: "But if the government announces its intentions in advance - people and speculators will rush to take advantage of these plans. For instance, they will buy foreign exchange and put pressure on the government to devalue by dilapidating its foreign currency reserves".

If so, why didn’t it happen in Israel, Argentina, Chile and tens of other countries? In all these countries, the government announced inflation and devaluation targets well in advance. Surprisingly, it had the following effects:

1. The business sector was able to plan its operations years in advance, to price its products properly, to protect itself by buying financial hedge contracts. Suddenly, the business environment became safe and predictable. This had an extremely favourable micro-economic effect.

2. The currency stabilized and displayed qualities normally associated with "hard currencies". For instance, the New Israeli Shekel, which no one wanted to touch and which was immediately converted to US dollars (to protect the value) -

became a national hit. It appreciated by 50% (!) against the dollar, people sold their dollars and bought Shekels - and all this with an inflation of 18% per year! It became a truly convertible currency - because people could predict its value over time.

3. The consistency, endurance and resilience of the governments in implementing their macro-economoic agendas - made the populace regain their trust. Citizens began to believe their governments again. The openness of the government, the transparency of its operations and the fact that it kept its word - meant a lot in restoring the right, trusting relationship which should prevail between subjects and their administration.

That strict measures are taken to prevent the metamorphosis of the devaluation into inflation. The usual measures include a freeze on all wages, a reduction of the budget deficit, even temporary anti-import protective barriers to defend the local industries and to reduce inflationary pressures.

Granted, the government of Macedonia and its Central Bank are not entirely autonomous in setting the economic priorities and in deciding which measures to adopt and to what extent. They have to attune themselves to "advice" (not to say dictates or conditions) given by the likes of the IMF. If they fail to do so, the IMF and the World Bank will cut Macedonia off the bloodlines of international credits. The situation is, at times, very close to coercion.

Still, Macedonia could use successful examples in other countries to argue its case. It could have made this devaluation a turning point for the economy. It could have reached a nationwide consensus to work towards a better economic future within a national "Economic Agenda". It is still not to late to do so. A devaluation should be an essential part of any economic program. It could still be the cornerstone in an export driven, employment oriented, economy stimulating edifice.

Countries devalue their currencies only when they have no other way to correct past economic mistakes - whether their own or mistakes committed by their predecessors.

The ills of a devaluation are still at least equal to its advantages.

True, it does encourage exports and discourage imports to some extents and for a limited period of time. As the devaluation is manifested in a higher inflation, even this temporary relief is eroded. In a previous article in this paper I described WHY governments resort to such a drastic measure. This article will deal with HOW they do it.

A government can be forced into a devaluation by an ominous trade deficit. Thailand, Mexico, the Czech Republic - all devalued strongly, willingly or unwillingly, after their trade deficits exceeded 8% of the GDP. It can decide to devalue as part of an economic package of measures which is likely to include a freeze on wages, on government expenses and on fees charged by the government for the provision of public services. This, partly, has been the case in Macedonia. In extreme cases and when the government refuses to respond to market signals of economic distress - it may be forced into devaluation. International and local speculators will buy foreign exchange from the government until its reserves are depleted and it has no money even to import basic staples and other necessities.

Thus coerced, the government has no choice but to devalue and buy back dearly the foreign exchange that it has sold to the speculators cheaply.

In general, there are two known exchange rate systems: the floating and the fixed.

In the floating system, the local currency is allowed to fluctuate freely against other currencies and its exchange rate is determined by market forces within a loosely regulated foreign exchange domestic (or international) market. Such currencies need not necessarily be fully convertible but some measure of free convertibility is a sine qua non.

In the fixed system, the rates are centrally determined (usually by the Central Bank or by the Currency Board where it supplants this function of the Central Bank). The rates are determined periodically (normally, daily) and revolve around a "peg" with very tiny variations.

Life being more complicated than any economic system, there are no "pure cases".

Even in floating rate systems, Central banks intervene to protect their currencies or to move them to an exchange rate deemed favourable (to the country's economy) or "fair". The market's invisible hand is often handcuffed by "We-Know-Better" Central Bankers. This usually leads to disastrous (and breathtakingly costly) consequences. Suffice it to mention the Pound Sterling debacle in 1992 and the billion dollars made overnight by the arbitrageur-speculator Soros - both a direct result of such misguided policy and hubris.

Floating rates are considered a protection against deteriorating terms of trade.

If export prices fall or import prices surge - the exchange rate will adjust itself to reflect the new flows of currencies. The resulting devaluation will restore the equilibrium.

Floating rates are also good as a protection against "hot" (speculative) foreign capital looking to make a quick killing and vanish. As they buy the currency, speculators will have to pay more expensively, due to an upward adjustment in the exchange rates. Conversely, when they will try to cash their profits, they will be penalized by a new exchange rate.

So, floating rates are ideal for countries with volatile export prices and speculative capital flows. This characterizes most of the emerging economies (also known as the Third World).

It looks surprising that only a very small minority of these states has them until one recalls their high rates of inflation. Nothing like a fixed rate (coupled with consistent and prudent economic policies) to quell inflationary expectations. Pegged rates also help maintain a constant level of foreign exchange reserves, at least as long as the government does not stray from sound macro-economic management. It is impossible to over-estimate the importance of the stability and predictability which are a result of fixed rates: investors, businessmen and traders can plan ahead, protect themselves by hedging and concentrate on long term growth.

It is not that a fixed exchange rate is forever. Currencies - in all types of rate determination systems - move against one another to reflect new economic realities or expectations regarding such realities. Only the pace of changing the exchange rates is different.

Countries have invented numerous mechanisms to deal with exchange rates fluctuations.

Many countries (Argentina, Bulgaria) have currency boards. This mechanism ensures that all the local currency in circulation is covered by foreign exchange reserves in the coffers of the Central bank. All, government, and Central Bank alike - cannot print money and must operate within the straitjacket.

Other countries peg their currency to a basket of currencies. The composition of this basket is supposed to reflect the composition of the country's international trade. Unfortunately, it rarely does and when it does, it is rarely updated (as is the case in Israel). Most countries peg their currencies to arbitrary baskets of currencies in which the dominant currency is a "hard, reputable" currency such as the US dollar. This is the case with the Thai baht.

In Slovakia the basket is made up of two currencies only (40% dollar and 60% DEM) and the Slovak crown is free to move 7% up and down, around the basket-peg.

Some countries have a "crawling peg". This is an exchange rate, linked to other currencies, which is fractionally changed daily. The currency is devalued at a rate set in advance and made known to the public (transparent). A close variant is the "crawling band" (used in Israel and in some countries in South America). The exchange rate is allowed to move within a band, above and below a central peg which, in itself depreciates daily at a preset rate.

This pre-determined rate reflects a planned real devaluation over and above the inflation rate.

It denotes the country's intention to encourage its exports without rocking the whole monetary boat. It also signals to the markets that the government is bent on taming inflation.

So, there is no agreement among economists. It is clear that fixed rate systems have cut down inflation almost miraculously. The example of Argentina is prominent: from 27% a month (1991) to 1% a year (1997)!!!

The problem is that this system creates a growing disparity between the stable exchange rate - and the level of inflation which goes down slowly. This, in effect, is the opposite of devaluation - the local currency appreciates, becomes stronger. Real exchange rates strengthen by 42% (the Czech Republic), 26% (Brazil), even 50% (Israel until lately, despite the fact that the exchange rate system there is hardly fixed). This has a disastrous effect on the trade deficit: it balloons and consumes 4-10% of the GDP.

This phenomenon does not happen in non-fixed systems. Especially benign are the crawling peg and the crawling band systems which keep apace with inflation and do not let the currency appreciate against the currencies of major trading partners. Even then, the important question is the composition of the pegging basket. If the exchange rate is linked to one major currency - the local currency will appreciate and depreciate together with that major currency. In a way the inflation of the major currency is thus imported through the foreign exchange mechanism. This is what happened in Thailand when the dollar got stronger in the world markets.

In other words, the design of the pegging and exchange rate system is the crucial element.

In a crawling band system - the wider the band, the less the volatility of the exchange rate. This European Monetary System (EMS - ERM), known as "The Snake", had to realign itself a few times during the 1990s and each time the solution was to widen the bands within which the exchange rates were allowed to fluctuate. Israel had to do it twice. On June 18^{th}, the band was doubled and the Shekel can go up and down by 10% in each direction.

But fixed exchange rates offer other problems. The strengthening real exchange rate attracts foreign capital. This is not the kind of foreign capital that countries are looking for. It is not Foreign Direct Investment (FDI). It is speculative, hot money in pursuit of ever higher returns. It aims to benefit from the stability of the exchange rate - and from the high interest rates paid on deposits in local currency.

Let us study an example: if a foreign investor were to convert 100,000 DEM to Israeli Shekels last year and invest them in a liquid deposit with an Israeli bank - he will have ended up earning an interest rate of 12% annually. The exchange rate did not change appreciably - so he would have needed the same amount of Shekels to buy his DEM back. On his Shekel deposit he would have earned between 12-16%, all net, tax free profit.

No wonder that Israel's foreign exchange reserves doubled themselves in the preceding 18 months. This phenomenon happened all over the globe, from Mexico to Thailand.

This kind of foreign capital expands the money supply (it is converted to local currency) and - when it suddenly evaporates - prices and wages collapse. Thus it tends to exacerbate the natural inflationary-deflationary cycles in emerging economies. Measures like control on capital inflows, taxing them are useless in a global economy with global capital markets.

They also deter foreign investors and distort the allocation of economic resources.

The other option is "sterilization": selling government bonds and thus absorbing the monetary overflow or maintaining high interest rates to prevent a capital drain. Both measures have adverse economic effects, tend to corrupt and destroy the banking and financial infrastructure and are expensive while bringing only temporary relief.

Where floating rate systems are applied, wages and prices can move freely. The market mechanisms are trusted to adjust the exchange rates. In fixed rate systems, taxes move freely. The state, having voluntarily given up one of the tools used in fine tuning the economy (the exchange rate) - must resort to fiscal rigor, tightening fiscal policy

(=collect more taxes) to absorb liquidity and rein in demand when foreign capital comes flowing in.

In the absence of fiscal discipline, a fixed exchange rate will explode in the face of the decision makers either in the form of forced devaluation or in the form of massive capital outflows.

After all, what is wrong with volatile exchange rates? Why must they be fixed, save for psychological reasons? The West has never prospered as it does nowadays, in the era of floating rates. Trade, investment - all the areas of economic activity which were supposed to be influenced by exchange rate volatility - are experiencing a continuous big bang. That daily small fluctuations (even in a devaluation trend) are better than a big one time devaluation in restoring investor and business confidence is an axiom. That there is no such thing as a pure floating rate system (Central Banks always intervene to limit what they regard as excessive fluctuations) - is also agreed on all economists.

That exchange rate management is no substitute for sound macro- and micro-economic practices and policies - is the most important lesson. After all, a currency is the reflection of the country in which it is legal tender. It stores all the data about that country and their appraisal. A currency is a unique package of past and future with serious implications on the present.

Development (and Interethnic Relations)

"Sustainable Development" is a worn out cliché - but not where it matters the most: in developing countries. There, unconstrained "development" has led to inter-ethnic strife, environmental doom, and economic mayhem. In the post Cold War era, central governments have lost clout and authority to their provincial and regional counterparts, whether peacefully (devolution in many European and Latin American countries) - or less so (in Africa, for instance). As power shifts to municipalities and regional administrations, they begin to examine development projects more closely, prioritize them, and properly assess their opportunity costs. The multinationals, which hitherto enjoyed a free hand in large swathes of the third world, are unhappy.

The outcome of this tectonic shift is a series of unrequited conflicts from Indonesia to Morocco. The former is now a federation of 32 provinces, each with its own (often contradictory) laws, taxes, and licenses. They tend to ignore promises made by the central government - and the central government tends to live and let live. Some multinationals are in denial. They confront the local authorities and the authorities, in turn, legislate to prevent them from doing business (as in the case of Cemex, the Mexican cement company, described in "The Economist"). Others adapt, collaborate with the locals, establish foundations and endowments, invest in local infrastructure and in preserving the environment. Most crucially, bribes that once went exclusively to Jakarta-based officials, are now split with local politicians.

But sometimes the consequences are more serious than the reallocation of backhanders. When a corrupt central government colludes with multinationals against the indigenous population of an exploited region - all hell breaks loose.

Consider Nigeria and Morocco.

A. Nigeria

Nigeria is an explosive cocktail of more than 250 nations and languages with different (and often hostile) histories, cultures, enmities, and alliances. It is decrepit. Its people are destitute and unemployed, the crime rate is ghastly, the army and police are murderous (as are numerous civilian "vigilante" groups), the authorities powerless, corruption rampant, famines frequent. Most of its oil (its only important export) is produced in the Niger Delta, home to the Ogoni and Ijaw ethnic minorities. The Ijaw are also actively suppressed (and massacred) in Bayelsa state.

When the Ogoni protested against the environmental ruination wrought by oil drilling - nine of them were hanged in 1995. But this brutality did little to quell their complaints, including the fact that almost none of the $7-10 billion in annual oil proceeds was re-invested in the region's economy. This largely economic conflict (brewing since 1993) has now, inevitably, become inter-ethnic and inter-religious. It is now an integral part of the national politics of a Nigeria fracturing along ethnic and religious (Christian vs. fundamentalist Islamist) fault lines.

Multinational oil firms in Nigeria have a strong interest to maintain a functioning political center, with law, order, and a respected, multi-ethnic police force. Yet, in their efforts to stabilize Nigeria, they shot themselves in both feet, repeatedly.

All previous regimes in Nigeria - civilian and military - enjoyed the tacit support (diplomatic and financial) of the big oil multinationals, among them Agip, Mobil, Chevron, Royal Dutch/Shell, and Elf Aquitaine (now Total-FinaElf). The oil companies maintain their own armies ("security") - including helicopters and heavy armor. They rarely openly intervene in local protests and conflicts. But their pronounced silence in the face of numerous massacres, unlawful detentions, murders, beatings, and other human rights abuses by the very army and police with whom they often share their equipment and manpower, forced Human Rights Watch to issue this unusual statement: "Multinational oil companies are complicit in abuses committed by the Nigerian military and police." Oil multinationals are also a major source of corruption in Nigeria.

Moreover, many observers conclude that the multinationals' claims to have bettered their ways by applying adequate environmental protection (against frequent oil spills and dumping of industrial waste), improving public health, observing human rights standards, and developing better relations with affected communities - are nothing but elaborate spin doctoring.

The creation of the dysfunctional "Niger Delta Development Commission" by the government in 2000 only enhanced this perception. Armed guards, employed by oil companies, continue to wound, or kill young protesters. NGOs impotently complained to the World Bank about the decision of its arm, the International Finance Corporation (IFC), to establish the Niger Delta Contractor Revolving Credit Facility in conjunction with Shell. The IFC did not bother to talk to a single local community about a scheme, which is supposed to provide Nigerian sub-contractors of Shell with credit intended to relieve poverty. Shell, of course, is utterly distrusted by the denizens of the Delta.

"Essential Action and Global Exchange" has issued a seminal report titled "Oil for Nothing - Multinational Corporations, Environmental Destruction, Death and Impunity in the Niger Delta" (January 2000). They describe gas flaring, acid rain, pipeline leaks, health problems, loss of biodiversity, loss of land and other resources, malnourishment, prostitution, rape, and fatherless children. Oil companies, says the report, refuse to compensate the locals, or clean up, break their promises, lie to the Western media, finance agents provocateurs to provoke protesters and break up peaceful demonstrations.

But this may be going too far. American oil firms and Royal Dutch/Shell have collaborated fully with NGO's since the public outcry following the execution of Ken Saro-Wiwa, a prominent Nigerian environmentalist and author in 1995 (though not so their Italian and French counterparts). Activists in the Niger Delta often resort to kidnapping, smashing oil installations, and even attacking off-shore rigs. Security guards are a necessity, not a luxury.

Shell alone has poured $200 million into the local economy, administered by its "development teams" in collaboration with recipient communities. "The Economist" reports that less than a third of the 408 projects have been a success. Micro-credit schemes run by women did best. Some of the projects were the outcome of extortion by kidnappers - others dreamt up in corporate headquarters with little regard to local circumstances. But Shell is really trying hard.

The Nigerian government has asked the Supreme Court in 2001 to rule how should off-shore oil revenues be divided between the federal authorities and the 36 states (only 6 of which, in the southeast, produce oil). The 1999 constitution calls for 13% of all onshore oil revenues to be allotted to the states. But it is mum about offshore oil (the bulk of Nigeria's production). At the time, northern states have threatened to withhold agricultural produce from the south should the Supreme Court plump in favor of the oil producing states. Justice, in this case, may well provoke the disintegration of Nigeria.

B. Morocco

The ubiquitous Kofi Annan, Secretary General of the UN, decided, in mid February 2002, the fate of oil exploration off the disputed coast of Western Sahara. A US chemicals and oil exploration firm (Kerr-McGee), in conjunction with the French Total-FinaElf, have signed much derided reconnaissance agreements, pertaining to the disputed region, with Morocco in October 2001.

Morocco has occupied West Sahara since 1975. It has moved hundreds of thousands of troops and civilians to the area in an effort to dilute the remaining autochthonous population. A fortified wall was constructed along the entire border and it was mined. Morocco persistently obstructs the implementation of a referendum about independence it agreed to with the Polisario in 1991. The original inhabitants of this region, the Sahrawis, have set up a government in exile in a tent city in Algeria. The Polisario, the Sahrawis freedom movement, is weakened by decades of warfare and diplomatic failure. The Sahrawi self-styled "president" wrote to UN envoy, James Baker III, and to President Bush, to warn them of the consequences of this "provocation". The Sahrawis also demanded from the EU to cancel the "illicit and illegal" contract between Total-FinaElf and Morocco.

The reconnaissance agreements are part of a concerted Moroccan policy to relieve the country of its wrenching dependence on oil imports. Morocco's annual oil bill is close to $1 billion. Late King Mohammed VI himself was behind this strategic move. In August 2001, on his birthday, he announced a major discovery (since discredited) in Talsint, 100 km. (60 miles) from the Algerian border (he called it "God's gift to Morocco"). More than 10 exploration licenses have been granted in 2001 alone - 25% of the total. The law has been modified to allow for a 10-year tax break and to limit the government's stake in new oil ventures to 25%.

But major finds are the exception in an otherwise disappointing quest which dates back to 1920. Spain and Morocco both claim the waters opposite Morocco's coast. The Moroccan government exchanged verbal blows with its Spanish counterpart after it granted prospecting licenses to a Spanish firm opposite the Moroccan coast.

As opposed to Morocco, Western Sahara is estimated to contain what the US Geological Survey of World Energy calls substantial gas and oil fields. "Upstream" reports that previous attempts to find oil, in the 1960's, in collaboration with Franco's Spanish government, floundered. Gulf Oil, WB Grace, Texaco, and Standard Oil withdrew as political tensions increased. Other, lesser, American firms developed tiny fields there. Later, in the late 70's both Shell and British Petroleum abandoned exploration, having reached the conclusion that extraction is justified only if oil prices climb to $40 a barrel.

The Sahrawis quote a UN resolution (A/res/46/64 dated December 11, 1991) which says that "the exploitation and plundering of colonial and non-self-governing territories by foreign economic interests, in violation of the relevant resolutions of the United Nations is a grave threat to the integrity and prosperity of those Territories."

Thus, once again, oil companies find themselves supporting an oppressive and brutal (but ostensibly "stable") regime against local communities with political and ethnic grievances. It seems to be a pattern. Oil companies cosied up to homicidal dictators in Burma, East Timor, Iran, Iraq and Nigeria, to mention but a few. As most Sahrawis are now in refugee camps in Algeria, they are unlikely to benefit from any potential find. Future oil revenues are likely to buttress Moroccan rule and enrich members of the Moroccan elite. The (undisputedly Moroccan) Talsint concession is co-owned, according to the BBC, by relatives of the King and the chief of police.

The politically incorrect Operations Manager of Lone Star, the joint American-Moroccan Talsint exploration company, was quoted by the BBC as wondering (about the internally displaced people of Talsint): "Why should the people of Talsint get more money in their pockets? It's just by chance they're living on top of what appears to be valuable oil and gas reserves."

Such sentiments go a long way towards explaining why oil firms are so hated and why they so often contribute to instability, abuses, and poverty, despite their best interests. Perhaps they better divert the millions they throw at local communities - to educating their staff. Sometimes, development is best begun at home.

Diasporas

Barry Chiswick and Timothy Hatton demonstrated ("International Migration and the Integration of Labour Markets", published by the NBER in its "Globalisation in Historical Perspective") that, as the economies of poor countries improve, emigration increases because people become sufficiently wealthy to finance the trip.

Poorer countries invest an average of $50,000 of their painfully scarce resources in every university graduate - only to witness most of them emigrate to richer places. The haves-not thus end up subsidizing the haves by exporting their human capital, the prospective members of their dwindling elites, and the taxes they would have paid had they stayed put. The formation of a middle class is often irreversibly hindered by an all-pervasive brain drain.

Politicians in some countries decry this trend and deride those emigrating. In a famous interview on state TV, the late prime minister of Israel, Yitzhak Rabin, described them as "a fallout of the jaded". But in many impoverished countries, local kleptocracies welcome the brain drain as it also drains the country of potential political adversaries.

Emigration also tends to decrease competitiveness. It increase salaries at home by reducing supply in the labour market (and reduces salaries at the receiving end, especially for unskilled workers). Illegal migration has an even stronger downward effect on wages in the recipient country - illegal aliens tend to earn less than their legal compatriots. The countries of origin, whose intellectual elites are depleted by the brain drain, are often forced to resort to hiring (expensive) foreigners. African countries spend more than $4 billion annually on foreign experts, managers, scientists, programmers, and teachers.

Still, remittances by immigrants to their relatives back home constitute up to 10% of the GDP of certain countries - and up to 40% of national foreign exchange revenues. The World Bank estimates that Latin American and Caribbean nationals received $15 billion in remittances in 2000 - ten times the 1980 figure. This may well be a gross underestimate. Mexicans alone remitted $6.7 billion in the first 9 months of 2001 (though job losses and reduced hours may have since adversely affected remittances). The IADB thinks that remittances will total $300 billion in the next decade (Latin American immigrants send home c. 15% of their wages).

Official remittances (many go through unmonitored money transfer channels, such as the Asian Hawala network) are larger than all foreign aid combined. "The Economist" calculates that workers' remittances in Latin America and the Caribbean are three times as large as aggregate foreign aid and larger than export proceeds. Yet, this pecuniary flood is mostly used to finance the consumption of basics: staple foods, shelter, maintenance, clothing. It is non-productive capital.

Only a tiny part of the money ends up as investment. Countries - from Mexico to Israel, and from Macedonia to Guatemala - are trying to tap into the considerable wealth of their diasporas by issuing remittance-bonds, by offering tax holidays, one-stop-shop facilities, business incubators, and direct access to decision makers - as well as matching investment funds.

Migrant associations are sprouting all over the Western world, often at the behest of municipal authorities back home. The UNDP, the International Organization of Migration (IOM), as well as many governments (e.g., Israel, China, Venezuela, Uruguay, Ethiopia), encourage expatriates to share their skills with their counterparts in their country of origin. The thriving hi-tech industries in Israel, India, Ireland, Taiwan, and South Korea were founded by returning migrants who brought with them not only capital to invest and contacts - but also entrepreneurial skills and cutting edge technologies.

Thailand established in 1997, within the National Science and Technology Development Agency, a 2.2 billion baht project called "Reverse the Brain Drain". Its aim is to "use the 'brain' and 'connections' of Thai professionals living overseas to help in the Development of Thailand, particularly in science and technology."

The OECD ("International Mobility of the Highly Skilled") believes that:

"More and more highly skilled workers are moving abroad for jobs, encouraging innovation to circulate and helping to boost economic growth around the globe."

But it admits that a "greater co-operation between sending and receiving countries is needed to ensure a fair distribution of benefits".

The OECD noted, in its "Annual Trends in International Migration, 2001" that (to quote its press release):

"Fears of a "brain drain" from developing to technologically advanced countries may be exaggerated, given that many professionals do eventually return to their country of origin. To avoid the loss of highly qualified workers, however, developing countries need to build their own innovation and research facilities ... China, for example, has recently launched a program aimed at developing 100 selected universities into world-class research centers. Another way to ensure return ... could be to encourage students to study abroad while making study grants conditional on the student's return home."

The key to a pacific and prosperous future lies in a multilateral agreement between brain-exporting, brain-importing, and transit countries. Such an agreement should facilitate the sharing of the benefits accruing from migration and "brain exchange" among host countries, countries of origin, and transit countries. In the absence of such a legal instrument, resentment among poorer nations is likely to grow even as the mushrooming needs of richer nations lead them to snatch more and more brains from their already woefully depleted sources.

The following steps are considered to be the **"minimum package"** in the strengthening of relationships between countries of origin and national diasporas:

1. The granting to the diaspora of unlimited or, at the very least, restricted voting rights in the Motherland (e.g., Macedonia)

2. The institutionalized involvement of political structures representing the diaspora in the politics of the Motherland (e.g., Israel) and vice versa (for instance, the Jewish Congress and the Jewish Agency).

3. Holding common sports events (e.g., the Maccabia or Maccabead Games as a Jewish Olympiad with participants from all over the world); the exchange and transfer of students and professionals between the diaspora and the Motherland.

4. The establishment of a fund for the purchase of land, the restoration of national treasures to the Motherland, reforestation and preservation of nationally or historically significant sites (e.g., the Jewish Keren Hayesod and Keren Kayemet le-Israel)

5. The solicitation of donations, scholarships, and sponsorships from wealthy individuals in the diaspora

6. Emphasis on cultural activities and the promotion of the national language (e.g., various Francophone activities by France)

7. Selling bonds and stocks exclusively to the diaspora (e.g., the Israeli Bonds) and the creation of various investment funds and vehicles to encourage greater economic involvement of the diaspora in the Motherland.

8. Leveraging the nation's common history, religious affiliation, and cultural roots to further national cohesion and political lobbying and support.

9. Encouraging remittances with the implementation of a special, lenient tax regime, the issuance of remittance-bonds, and by providing foreign investors with tax holidays, one-stop-shop facilities, business incubators, and direct access to decision makers.

10. Fostering knowledge-based networks of local and foreign (diaspora-based exapts) businessmen, scientists, and experts; forming migrant associations to share contacts and business opportunities and otherwise socially network; encouraging returning citizens and providing them with tax concessions, loans, and employment opportunities (e.g., Israel, China, Venezuela, Uruguay, Ethiopia).

Digital Publishing

UNESCO's somewhat arbitrary definition of "book" is:

"Non-periodical printed publication of at least 49 pages excluding covers."

The emergence of electronic publishing was supposed to change all that. Yet a bloodbath of unusual proportions has taken place in the last few months. Time Warner's iPublish and MightyWords (partly owned by Barnes and Noble) were the last in a string of resounding failures which cast in doubt the business model underlying digital content. Everything seemed to have gone wrong: the dot.coms dot bombed, venture capital dried up, competing standards fractured an already fragile marketplace, the hardware (e-book readers) was clunky and awkward, the software unwieldy, the e-books badly written or already in the public domain.

Terrified by the inexorable process of disintermediation (the establishment of direct contact between author and readers, excluding publishers and bookstores) and by the ease with which digital content can be replicated - publishers resorted to draconian copyright protection measures (euphemistically known as "digital rights management"). This further alienated the few potential readers left. The opposite model of "viral" or "buzz" marketing (by encouraging the dissemination of free copies of the promoted book) was only marginally more successful.

Moreover, e-publishing's delivery platform, the Internet, has been transformed beyond recognition since March 2000.

From an open, somewhat anarchic, web of networked computers - it has evolved into a territorial, commercial, corporate extension of "brick and mortar" giants, subject to government regulation. It is less friendly towards independent (small) publishers, the backbone of e-publishing. Increasingly, it is expropriated by publishing and media behemoths. It is treated as a medium for cross promotion, supply chain management, and customer relations management. It offers only some minor synergies with non-cyberspace, real world, franchises and media properties. The likes of Disney and Bertelsmann have swung a full circle from considering the Internet to be the next big thing in New Media delivery - to frantic efforts to contain the red ink it oozed all over their otherwise impeccable balance sheets.

But were the now silent pundits right all the same? Is the future of publishing (and other media industries) inextricably intertwined with the Internet?

The answer depends on whether an old habit dies hard. Internet surfers are used to free content. They are very reluctant to pay for information (with precious few exceptions, like the "Wall Street Journal"'s electronic edition). Moreover, the Internet, with 3 billion pages listed in the Google search engine (and another 15 billion in "invisible" databases), provides many free substitutes to every information product, no matter how superior. Web based media companies (such as Salon and Britannica.com) have been experimenting with payment and pricing models. But this is besides the point. Whether in the form of subscription (Britannica), pay per view (Questia), pay to print (Fathom), sample and pay to buy the physical product (RealRead), or micropayments (Amazon) - the public refuses to cough up.

Moreover, the advertising-subsidized free content Web site has died together with Web advertising. Geocities - a community of free hosted, ad-supported, Web sites purchased by Yahoo! - is now selectively shutting down Web sites (when they exceed a certain level of traffic) to convince their owners to revert to a monthly hosting fee model. With Lycos in trouble in Europe, Tripod may well follow suit shortly. Earlier this year, Microsoft has shut down ListBot (a host of discussion lists). Suite101 has stopped paying its editors (content authors) effective January 15th. About.com fired hundreds of category editors. With the ugly demise of Themestream, WebSeed is the only content aggregator which tries to buck the trend by relying (partly) on advertising revenue.

Paradoxically, e-publishing's main hope may lie with its ostensible adversary: the library. Unbelievably, e-publishers actually tried to limit the access of library patrons to e-books (i.e., the lending of e-books to multiple patrons). But, libraries are not only repositories of knowledge and community centres. They are also dominant promoters of new knowledge technologies. They are already the largest buyers of e-books. Together with schools and other educational institutions, libraries can serve as decisive socialization agents and introduce generations of pupils, students, and readers to the possibilities and riches of e-publishing. Government use of e-books (e.g., by the military) may have the same beneficial effect.

As standards converge (Adobe's Portable Document Format and Microsoft's MS Reader LIT format are likely to be the winners), as hardware improves and becomes ubiquitous (within multi-purpose devices or as standalone higher quality units), as content becomes more attractive (already many new titles are published in both print and electronic formats), as more versatile information taxonomies (like the Digital Object Identifier) are introduced, as the Internet becomes more gender-neutral, polyglot, and cosmopolitan - e-publishing is likely to recover and flourish.

This renaissance will probably be aided by the gradual decline of print magazines and by a strengthening movement for free open source scholarly publishing. The publishing of periodical content and academic research (including, gradually, peer reviewed research) may be already shifting to the Web. Non-fiction and textbooks will follow. Alternative models of pricing are already in evidence (author pays to publish, author pays to obtain peer review, publisher pays to publish, buy a physical product and gain access to enhanced online content, and so on). Web site rating agencies will help to discriminate between the credible and the in-credible. Publishing is moving - albeit kicking and screaming - online.

THE CURRENT WORRIES

1. Content Suppliers

The Ethos of Free Content

Content Suppliers is the underprivileged sector of the Internet. They all lose money (even sites which offer basic, standardized goods - books, CDs), with the exception of sites proffering sex or tourism. No user seems to be grateful for the effort and resources invested in creating and distributing content. The recent breakdown of traditional roles (between publisher and author, record company and singer, etc.) and the direct access the creative artist is gaining to its paying public may change this attitude of ingratitude but hitherto there are scarce signs of that. Moreover, it is either quality of presentation (which only a publisher can afford) or ownership and (often shoddy) dissemination of content by the author. A really qualitative, fully commerce enabled site costs up to 5,000,000 USD, excluding site maintenance and customer and visitor services. Despite these heavy outlays, site designers are constantly criticized for lack of creativity or for too much creativity. More and more is asked of content purveyors and creators. They are exploited by intermediaries, hitch hiker sand other parasites. This is all an off-shoot of the ethos of the Internet as a free content area.

Most of the users like to surf (browse, visit sites) the net without reason or goal in mind. This makes it difficult to apply to the web traditional marketing techniques.

What is the meaning of "targeted audiences" or "market shares" in this context? If a surfer visits sites which deal with aberrant sex and nuclear physics in the same session - what to make of it?

Moreover, the public and legislative backlash against the gathering of surfer's data by Internet ad agencies and other web sites - has led to growing ignorance regarding the profile of Internet users, their demography, habits, preferences and dislikes.

"Free" is a key word on the Internet: it used to belong to the US Government and to a bunch of universities. Users like information, with emphasis on news and data about new products. But they do not like to shop on the net - yet. Only 38% of all surfers made a purchase during 1998.

It would seem that users will not pay for content unless it is unavailable elsewhere or qualitatively rare or made rare. One way to "rarefy" content is to review and rate it.

2. **Quality-Rated Content**

There is a long term trend of clutter-breaking website-rating and critique. It may have a limited influence on the consumption decisions of some users and on their willingness to pay for content. Browsers already sport "What's New" and "What's Hot" buttons. Most Search Engines and directories recommend specific sites. But users are still cautious. Studies discovered that nouser, no matter how heavy, has consistently re-visited more than 200 sites, a minuscule number. Some recommendation services often produce random - at times, wrong - selections for their users. There are also concerns regarding privacy issues. The backlash against Amazon's "readers circles" is an example. Web Critics, who work today mainly for the printed press, publish their wares on the net and collaborate with intelligent software which hyperlinks to web sites, recommends them and refers users to them. Some web critics (guides) became identified with specific applications - really, expert systems -which incorporate their knowledge and experience. Most volunteer-based directories (such as the "Open Directory" and the late "Go" directory) work this way.

The flip side of the coin of content consumption is investment in content creation, marketing, distribution and maintenance.

3. **The Money**

Where is the capital needed to finance content likely to come from?

Again, there are two schools:

According to the first, sites will be financed through advertising - and so will search engines and other applications accessed by users.

Certain ASPs (Application Service Providers which rent out access to application software which resides on their servers) are considering this model.

The recent collapse in online advertising rates and click-through rates raised serious doubts regarding the validity and viability of this model. Marketing gurus, such as Seth Godin went as far as declaring "interruption marketing" (=ads and banners) dead.

The second approach is simpler and allows for the existence of non-commercial content.

It proposes to collect negligible sums (cents or fractions of cents) from every user for every visit ("micro-payments"). These accumulated cents will enable the site-owners to update and to maintain them and encourage entrepreneurs to develop new content and invest in it. Certain content aggregators (especially of digital textbooks) have adopted this model (Questia, Fathom).

The adherents of the first school point to the 5 million USD invested in advertising during 1995 and to the 60 million or so invested during 1996.

Its opponents point exactly at the same numbers: ridiculously small when contrasted with more conventional advertising modes. The potential of advertising on the net is limited to 1.5 billion USD annually in 1998, thundered the pessimists. The actual figure was double the prediction but still woefully small and inadequate to support the internet's content development. Compare these figures to the sale of Internet software (4 billion), Internet hardware (3 billion), Internet access provision (4.2 billion in 1995 alone!).

Even if online advertising were to be restored to its erstwhile glory days, other bottlenecks remain. Advertising encourages the consumer to interact and to initiate the delivery of a product to him. This - the delivery phase - is a slow and enervating epilogue to the exciting affair of ordering online. Too many consumers still complain of late delivery of the wrong or defective products.

The solution may lie in the integration of advertising and content. The late Pointcast, for instance, integrated advertising into its news broadcasts, continuously streamed to the user's screen, even when inactive (it had an active screen saver and ticker in a "push technology"). Downloading of digital music, video and text (e-books) leads to the immediate gratification of consumers and increases the efficacy of advertising.

Whatever the case may be, a uniform, agreed upon system of rating as a basis for charging advertisers, is sorely needed. There is also the question of what does the advertiser pay for? The rates of many advertisers (Procter and Gamble, for instance) are based not on the number of hits or impressions (=entries, visits to a site). - but on the number of the times that their advertisement was hit (page views), or clicked through.

Finally, there is the paid subscription model - a flop to judge by the experience of the meagre number of sites of venerable and leading newspapers that are on a subscription basis. Dow Jones (Wall Street Journal) and The Economist. Only two.

All this is not very promising. But one should never forget that the Internet is probably the closest thing we have to an efficient market. As consumers refuse to pay for content, investment will dry up and content will become scarce (through closures of web sites). As scarcity sets in, consumer may reconsider.

Your article deals with the future of the Internet as a medium. Will it be able to support its content creation and distribution operations economically?

If the Internet is a budding medium - then we should derive great benefit from a study of the history of its predecessors.

The Future History of the Internet as a Medium

The internet is simply the latest in a series of networks which revolutionized our lives. A century before the internet, the telegraph, the railways, the radio and the telephone have been similarly heralded as "global" and transforming. Every medium of communications goes through the same evolutionary cycle:

Anarchy

The Public Phase

At this stage, the medium and the resources attached to it are very cheap, accessible, under no regulatory constraints. The public sector steps in : higher education institutions, religious institutions, government, not for profit organizations, non governmental organizations (NGOs), trade unions, etc. Be deviled by limited financial resources, they regard the new medium as a cost effective way of disseminating their messages.

The Internet was not exempt from this phase which ended only a few years ago. It started with a complete computer anarchy manifested in ad hoc networks, local networks, networks of organizations (mainly universities and organs of the government such as DARPA, a part of the defence establishment, in the USA). Non commercial entities jumped on the bandwagon and started sewing these networks together (an activity fully subsidized by government funds). The result was a globe encompassing network of academic institutions. The American Pentagon established the network of all networks, the ARPANET. Other government departments joined the fray, headed by the National Science Foundation (NSF) which withdrew only lately from the Internet.

The Internet (with a different name) became semi-public property - with access granted to the chosen few.

Radio took precisely this course. Radio transmissions started in the USA in 1920. Those were anarchic broadcasts with no discernible regularity. Non commercial organizations and not for profit organizations began their own broadcasts and even created radio broadcasting infrastructure (albeit of the cheap and local kind) dedicated to their audiences. Trade unions, certain educational institution sand religious groups commenced "public radio" broadcasts.

The Commercial Phase

When the users (e.g., listeners in the case of the radio, or owners of PCs and modems in the case of the Internet) reach a critical mass - the business sector is alerted. In the name of capitalist ideology (another religion, really) it demands "privatization" of the medium. This harps on very sensitive strings in every Western soul: the efficient allocation of resources which is the result of competition. Corruption and inefficiency are intuitively associated with the public sector ("Other People's Money" - OPM). This, together with the ulterior motives of members of the ruling political echelons (the infamous American Paranoia), a lack of variety and of catering to the tastes and interests of certain audiences and the automatic equation of private enterprise with democracy lead to a privatization of the young medium.

The end result is the same: the private sector takes over the medium from "below" (makes offers to the owners or operators of the medium that they cannot possibly refuse) - or from "above" (successful lobbying in the corridors of power leads to the appropriate legislation and the medium is "privatized"). Every privatization - especially that of a medium - provokes public opposition. There are (usually founded) suspicions that the interests of the public are compromised and sacrificed on the altar of commercialization and rating. Fears of monopolization and cartelization of the medium are evoked - and proven correct in due course. Otherwise, there is fear of the concentration of control of the medium in a few hands. All these things do happen - but the pace is so slow that the initial fears are forgotten and public attention reverts to fresher issues.

A new Communications Act was enacted in the USA in 1934. It was meant to transform radio frequencies into a national resource to be sold to the private sector which was supposed to use it to transmit radio signals to receivers. In other words: the radio was passed on to private and commercial hands. Public radio was doomed to be marginalized.

The American administration withdrew from its last major involvement in the Internet in April 1995, when the NSF ceased to finance some of the networks and, thus, privatized its hitherto heavy involvement in the net.

A new Communications Act was legislated in 1996. It permitted "organized anarchy". It allowed media operators to invade each other's territories. Phone companies were allowed to transmit video and cable companies were allowed to transmit telephony, for instance. This was all phased over a long period of time - still, it was a revolution whose magnitude is difficult to gauge and whose consequences defy imagination. It carries an equally momentous price tag - official censorship. "Voluntary censorship", to be sure, somewhat toothless standardization and enforcement authorities, to be sure - still, a censorship with its own institutions to boot. The private sector reacted by threatening litigation - but, beneath the surface it is caving in to pressure and temptation, constructing its own censorship codes both in the cable and in the internet media.

Institutionalization

This phase is the next in the Internet's history, though, it seems, few realize it.

It is characterized by enhanced activities of legislation. Legislators, on all levels, discover the medium and lurch at it passionately. Resources which were considered "free", suddenly are transformed to "national treasures not to be dispensed with cheaply, casually and with frivolity".

It is conceivable that certain parts of the Internet will be "nationalized" (for instance, in the form of a licensing requirement) and tendered to the private sector. Legislation will be enacted which will deal with permitted and disallowed content (obscenity ? incitement ? racial or gender bias ?) No medium in the USA (not to mention the wide world) has eschewed such legislation. There are sure to be demands to allocate time (or space, or software, or content, or hardware) to "minorities", to "public affairs", to "community business". This is a tax that the business sector will have to pay to fend off the eager legislator and his nuisance value.

All this is bound to lead to a monopolization of hosts and servers. The important broadcast channels will diminish in number and be subjected to severe content restrictions. Sites which will refuse to succumb to these requirements - will be deleted or neutralized. Content guidelines (euphemism for censorship) exist, even as we write, in all major content providers (CompuServe, AOL, Yahoo!-Geocities, Tripod, Prodigy).

The Bloodbath

This is the phase of consolidation. The number of players is severely reduced. The number of browser types will settle on 2-3 (Netscape, Microsoft and Opera?). Networks will merge to form privately owned mega-networks. Servers will merge to form hyper-servers run on supercomputers in "server farms". The number of ISPs will be considerably cut. 50 companies ruled the greater part of the media markets in the USA in 1983. The number in 1995 was 18. At the end of the century they will number 6.

This is the stage when companies - fighting for financial survival - strive to acquire as many users/listeners/viewers as possible. The programming is shall owed to the lowest (and widest) common denominator. Shallow programming dominates as long as the bloodbath proceeds.

From Rags to Riches

Tough competition produces four processes:

1. **A Major Drop in Hardware Prices**

This happens in every medium but it doubly applies to a computer-dependent medium, such as the Internet.

Computer technology seems to abide by "Moore's Law" which says that the number of transistors which can be put on a chip doubles every 18 months. As a result of this miniaturization, computing power quadruples every 18 months and an exponential series ensues. Organic-biological-DNA computers, quantum computers, chaos computers - prompted by vast profits and spawned by inventive genius will ensure the continued applicability of Moore's Law.

The Internet is also subject to "Metcalf's Law".

It says that when we connect N computers to a network - we get an increase of N to the second power in its computing processing power. And these N computers are more powerful every year, according to Moore's Law. The growth of computing powers in networks is a multiple of the effects of the two laws. More and more computers with ever increasing computing power get connected and create an exponential 16 times growth in the network's computing power every 18 months.

2. **Content Related Fees**

This was prevalent in the Net until recently. Even potentially commercial software can still be downloaded for free. In many countries television viewers still pay for television broadcasts - but in the USA and many other countries in the West, the basic package of television channels comes free of charge.

As users / consumers form a habit of using (or consuming) the software - it is commercialized and begins to carry a price tag. This is what happened with the advent of cable television: contents are sold for subscription or per usage (Pay Per View - PPV) fees.

Gradually, this is what will happen to most of the sites and software on the Net. Those which survive will begin to collect usage fees, access fees, subscription fees, downloading fees and other, appropriately named, fees. These fees are bound to be low - but it is the principle that counts. Even a few cents per transaction may accumulate to hefty sums with the traffic which characterizes some web sites on the Net (or, at least its more popular locales).

3. **Increased User Friendliness**

As long as the computer is less user friendly and less reliable (predictable) than television - less of a black box - its potential (and its future) is limited. Television attracts 3.5 billion users daily. The Internet stands to attract - under the most exuberant scenario - less than one tenth of this number of people. The only reasons for this disparity are (the lack of) user friendliness and reliability. Even browsers, among the most user friendly applications ever - are not sufficiently so. The user still needs to know how to use a keyboard and must possess some basic acquaintance with the operating system. The more mature the medium, the more friendly it becomes. Finally, it will be operated using speech or common language. There will be room left for user "hunches" and built in flexible responses.

4. **Social Taxes**

Sooner or later, the business sector has to mollify the God of public opinion with offerings of political and social nature. The Internet is an affluent, educated, yuppie medium. It requires literacy and numeracy, live interest in information and its various uses (scientific, commercial, other), a lot of resources (free time, money to invest in hardware, software and connect time). It empowers - and thus deepens the divide between the haves and have-nots, the developed and the developing world, the knowing and the ignorant, the computer illiterate.

In short: the Internet is an elitist medium. Publicly, this is an unhealthy posture. "Internetophobia" is already discernible. People (and politicians) talk about how unsafe the Internet is and about its possible uses for racial, sexist and pornographic purposes. The wider public is in a state of awe.

So, site builders and owners will do well to begin to improve their image: provide free access to schools and community centres, bankroll internet literacy classes, freely distribute contents and software to educational institutions, collaborate with researchers and social scientists and engineers. In short: encourage the view that the Internet is a medium catering to the needs of the community and the underprivileged, a mostly altruist endeavour. This also happens to make good business sense by educating and conditioning a future generation of users. He who visited a site when a student, free of charge - will pay to do so when made an executive. Such a user will also pass on the information within and without his organization. This is called media exposure. The future will, no doubt, will be witness to public Internet terminals, subsidized ISP accounts, free Internet classes and an alternative "non-commercial, public" approach to the Net. This may prove to be one more source of revenue to content creator sand distributors.

Disintermediation

The recent decision of the Supreme Court of the USA (in June 2005) was hailed as a victory for the music and motion picture industries. Peer-to-peer (P2P) networks, such as Grokster, were held responsible for encouraging and making possible the violation of copyright by allowing users to download illicit music tracks and films off other users' computers.

Prior to this seminal ruling, publishers, distributors and some creators pursued individual downloaders in court, closed down Napster, an earlier file-sharing network with a central directory, and introduced digital right management bits of copy-inhibiting software into their products. They even invested in or collaborated with legal media download online services, such as Apple's iTunes.

Still, are content brokers - publishers, distributors, and record companies - a thing of the past?

In one word: disintermediation.

The gradual removal of layers of content brokering and intermediation - mainly in manufacturing marketing - is the continuation of a long term trend. Consider music for instance. Streaming audio on the internet ("soft radio"), or downloadable MP3 files may render the CD obsolete - but they were preceded by radio music broadcasts. But the novelty is that the Internet provides a venue for the marketing of niche products and reduces the barriers to entry previously imposed by the need to invest in costly "branding" campaigns and manufacturing and distribution activities.

This trend is also likely to restore the balance between artists and the commercial exploiters of their products. The very definition of "artist" will expand to encompass all creative people. One will seek to distinguish oneself, to "brand" oneself and to auction one's services, ideas, products, designs, experience, physique, or biography, etc. directly to end-users and consumers. This is a return to pre-industrial times when artisans ruled the economic scene. Work stability will suffer and work mobility will increase in a landscape of shifting allegiances, head hunting, remote collaboration, and similar labour market trends.

But distributors, publishers, and record companies are not going to vanish. They are going to metamorphose. This is because they fulfil a few functions and provide a few services whose importance is only enhanced by the "free for all" Internet culture.

Content intermediaries grade content and separate the qualitative from the ephemeral and the atrocious. The deluge of self-published and vanity published e-books, music tracks and art works has generated few masterpieces and a lot of trash. The absence of judicious filtering has unjustly given a bad name to whole segments of the industry (e.g., small, or web-based publishers). Consumers - inundated, disappointed and exhausted - will pay a premium for content rating services. Though driven by crass commercial considerations, most publishers and record companies do apply certain quality standards routinely and thus are positioned to provide these rating services reliably.

Content brokers are relationship managers. Consider distributors: they provide instant access to centralized, continuously updated, "addressbooks" of clients (stores, consumers, media, etc.). This reduces the time to market and increases efficiency. It alters revenue models very substantially. Content creators can thus concentrate on what they do best: content creation, and reduce their overhead by outsourcing the functions of distribution and relationships management. The existence of central "relationship ledgers" yields synergies which can be applied to all the clients of the distributor. The distributor provides a single address that content re-sellers converge on and feed off. Distributors, publishers and record companies also provide logistical support: warehousing, consolidated sales reporting and transaction auditing, and a single, periodic payment.

Yet, having said all that, content intermediaries still over-charge their clients (the content creators) for their services. This is especially true in an age of just-in-time inventory and digital distribution. Network effects mean that content brokers have to invest much less in marketing, branding and advertising once a product's first mover advantage is established. Economic laws of increasing, rather than diminishing, returns mean that every additional unit sold yields a HIGHER profit - rather than a declining one. The pie is getting bigger.

Hence, the meteoric increase in royalties publishers pay authors from sales of the electronic versions of their work (anywhere from Random House's 35% to 50% paid by smaller publishers). As this tectonic shift reverberates through the whole distribution chain, retail outlets are beginning to transact directly with content creators. The borders between the types of intermediaries are blurred.

Barnes and Noble (the American bookstores chain) has, in effect, become a publisher. Many publishers have virtual storefronts. Many authors sell directly to their readers, acting as publishers. The introduction of "book ATMs" - POD (Print On Demand) machines, which will print every conceivable title in minutes, on the spot, in "book kiosks" - will give rise to a host of new intermediaries. Intermediation is not gone. It is here to stay because it is sorely needed. But it is in a state of flux. Old maxims break down. New modes of operation emerge. Functions are amalgamated, outsourced, dispensed with, or created from scratch. It is an exciting scene, full with opportunities.

Divorce

"Even in modern times, in most cases husbands and wives differ in their potential for acquiring property. In separation of property, husbands and wives owning property and dealing with each other will be in the same position as unmarried adults.

There are, however, grounds for distinguishing marital property questions from ordinary property questions, because persons who cohabit on a domestic basis share a common standard of living and usually also the benefits of each other's property. A major element in many marriages is the raising of children, and the traditional female role, requiring her full-time presence in the home, places the married woman at a disadvantage so far as earning money and acquiring property are concerned. It is inconsistent of society to encourage a woman to take the domestic role of wife and mother, with its lower money and property potential, but in property matters to treat her as if she were a single person. It is also inconsistent to place upon the husband the sole responsibility for maintaining his wife and children, if his wife has regular employment outside the home. When the marriage is dissolved, if the wife has not been regularly employed and now enters the labour market on a full-time basis, she may be at a considerable disadvantage as far as salary and pension rights are concerned."

Encyclopaedia Britannica, 1997 Edition

When a man and a woman dissolve a marriage, matters of common matrimonial property are often settled by dividing between them the property accumulated by one or both of them during the marriage. How the property is divided depends on the law prevailing in their domicile and upon the existence of a prenuptial contract.

The question is legally exceedingly intricate and requires specific expertise that far exceeds anything this author has to offer. It is the economic angle that is intriguing. Divorce in modern times constitutes one of the biggest transfers of wealth in the annals of Mankind. Amounts of cash and assets which dwarf anything OPEC had in its heyday – pass between spouses yearly. Most of the beneficiaries are women. Because the earning power of men is almost double that of women (depending on the country) – most of the wealth accumulated by any couple is directly traceable to the husband's income. A divorce, therefore, constitutes a transfer of part of the husband's wealth to his wife. Because the disparities that accumulate over years of income differentials are great – the wealth transferred is enormous.

A husband that makes an average of US $40,000 net annually throughout his working years – is likely to save c. $1,000 annually (net savings in the USA prior to 1995 averaged 2.5% of disposable income). This is close to US $8,000 in 7 years – with accumulated returns and assuming no appreciation in the prices of financial assets. His wife stands to receive half of these savings (c. $4,000) if the marriage is dissolved after 7 years. Had she started to work together with her husband and continued to do so for 7 years as well – on average, she will have earned 60% of his income. Assuming an identical savings rate for her, she would have saved only US $5,000 and her husband would be entitled to US $2,500 of it. Thus, a net transfer of US $1,500 in cash from husband to wife is one of the likely outcomes of the divorce of this very representative couple.

There is also the transfer of tangible and intangible assets from husband to wife. A couple of 7 years in the West typically owns $100,000 in assets. Upon divorce, by splitting the assets right down the middle, the man actually transfers to the woman about $10,000 in assets.

An average of 45% of the couples in the Western hemisphere end up divorcing. A back-of-the-envelope calculation demonstrates the monstrous magnitude of this phenomenon. Divorce is, by and large, the most powerful re-distributive mechanism in modern society. Women belong to an economically underprivileged class, are still highly dependent on systems of male patronage and, therefore, are the great beneficiaries of any social, progressive, mechanisms of redistribution. Income taxes, social security, other unilateral transfers, single parent benefits – all accrue mostly to women. The same goes for the "divorce dividend" – the economic windfall profit which is the result of a reasonably standard divorce.

But economic players are assumed to be rational. Why would a man be a willing party to such an ostensibly disadvantageous arrangement? Who would give up money and assets for no apparent economic benefits? Dividing the matrimonial property in the above mentioned illustrative case is the equivalent of a monthly transfer of US $150 in cash and assets from the husband to the wife throughout their 7 years of marriage.

What is this payment for? Presumably, for services rendered by the woman in-house, in child rearing, as a companion, and in the conjugal bed. This must be the residual value of these services to the man after discounting services that he provides to the woman (including rent for the use of his excess property, sexual services, protection, companionship to the extent that he can provide it, etc.). This is also the marginal value added of these services. It is safe to say that the services that the woman renders to the man exceed the value of the services that he provides her – by at least the amount of US $150 per month. This excess value accrues to the woman upon divorce.

But this makes only little sense. Consider the woman's ostensible contribution to the couple in the form of children.

Children are an economic liability. They are not revenue generating assets. They do absorb income and convert it to property. But the children's property does not belong to the parents. It is outside the ownership, control, and pleasure of both members of the couple. Every dollar invested by the parents in their offspring's education – is an asset to the off-spring - and a liability for the parents. Why should a man stimulate a woman (by providing her with US $150 a month as an incentive) to bring children to the world, raise them, and provide them with a disproportionate portion of the parents' resources?

The children compete with their father for these scarce resources. It is an economic Oedipus complex. When a woman maintains the house, she preserves its value and both members of the couple enjoy it. When she prepares dinner for her mate or engages in lively talk, or has sex – these are services rendered for which the male should be content to pay. But when she raises children -–this both reduces the quality of services that the man can expect to receive from her (by taxing her resources) – and diminishes the couple's assets (by transferring them to people outside the marital partnership).

There is only one plausible explanation to this apparently self-defeating economic behaviour. Rearing children is an investment with anticipated future rewards (i.e., returns). There is a hidden expectation that this investment will be richly rewarded (i.e., that it will provide reasonable returns). Indeed, in the not too distant past, children used to support their parents financially, cohabitate, or pay for their prolonged stay in convalescence centres and old age homes. Parents regarded their children as the living equivalent of an annuity. "When I grow old" – they would say – "my children will support me and I will not be left alone." Such an economic arrangement is also common with insurance companies, pension funds and other savings institutions: invest now, reap a monthly cheque in your old age. This is the essence of social security. Children were perceived by their parents to be an elaborate form of insurance policy.

Today, things have changed. Higher mobility and the deterioration in familial cohesion rendered this quid pro quo dubious. No parent can rely on future financial support from his children. That would constitute wishful thinking and an imprudent investment policy.

As a result, a rise in the number of divorces is discernible. The existence of children no longer seems to impede or prevent divorces. It seems that, contrary to a widespread misconception, children play no statistically significant role in preserving marriages. People divorce despite their children. And the divorce rate is skyrocketing, as is common knowledge.

The less economically valuable the services rendered by women internally and the more their earning power increases – the more are the monthly transfers from men to women eroded. Added impetus is given to prenuptial property contracts, and to separation of acquests and other forms of matrimonial property. Women try to keep all their income to themselves and not involve it in the matrimonial property. Men prefer this arrangement as well, because they feel that they are not getting services from women to an extent sufficient to justify a regular monthly redistribution of their common wealth in the women's favor. As the economic basis for marriage is corroded – so does the institution of marriage flounder. Marriage is being transformed unrecognizably and assumes an essentially non-economic form, devoid of most of the financial calculations of yore.

Due Diligence

A business which wants to attract foreign investments must present a business plan. But a business plan is the equivalent of a visit card. The introduction is very important - but, once the foreign investor has expressed interest, a second, more serious, more onerous and more tedious process commences: Due Diligence.

"Due Diligence" is a legal term (borrowed from the securities industry). It means, essentially, to make sure that all the facts regarding the firm are available and have been independently verified. In some respects, it is very similar to an audit. All the documents of the firm are assembled and reviewed, the management is interviewed and a team of financial experts, lawyers and accountants descends on the firm to analyze it.

First Rule:

The firm must appoint ONE due diligence coordinator. This person interfaces with all outside due diligence teams. He collects all the materials requested and oversees all the activities which make up the due diligence process.

The firm must have ONE VOICE. Only one person represents the company, answers questions, makes presentations and serves as a coordinator when the DD teams wish to interview people connected to the firm.

Second Rule:

Brief your workers. Give them the big picture. Why is the company raising funds, who are the investors, how will the future of the firm (and their personal future) look if the investor comes in. Both employees and management must realize that this is a top priority. They must be instructed not to lie. They must know the DD coordinator and the company's spokesman in the DD process.

The DD is a process which is more structured than the preparation of a Business Plan. It is confined both in time and in subjects: Legal, Financial, Technical, Marketing, Controls.

The Marketing Plan

Must include the following elements:

- A brief history of the business (to show its track performance and growth).
- Points regarding the political, legal (licences) and competitive environment.
- A vision of the business in the future.
- Products and services and their uses.
- Comparison of the firm's products and services to those of the competitors.
- Warranties, guarantees and after-sales service.
- Development of new products or services.
- A general overview of the market and market segmentation.
- Is the market rising or falling (the trend: past and future).
- What customer needs do the products / services satisfy.
- Which markets segments do we concentrate on and why.
- What factors are important in the customer's decision to buy (or not to buy).

- A list of the direct competitors and a short description of each.
- The strengths and weaknesses of the competitors relative to the firm.
- Missing information regarding the markets, the clients and the competitors.
- Planned market research.
- A sales forecast by product group.
- The pricing strategy (how is pricing decided).
- Promotion of the sales of the products (including a description of the sales force, sales-related incentives, sales targets, training of the sales personnel, special offers, dealerships, telemarketing and sales support). Attach a flow chart of the purchasing process from the moment that the client is approached by the sales force until he buys the product.
- Marketing and advertising campaigns (including cost estimates) - broken by market and by media.
- Distribution of the products.
- A flow chart describing the receipt of orders, invoicing, shipping.
- Customer after-sales service (hotline, support, maintenance, complaints, upgrades, etc.).
- Customer loyalty (example: churn rate and how is it monitored and controlled).

Legal Details

- Full name of the firm.
- Ownership of the firm.
- Court registration documents.
- Copies of all protocols of the Board of Directors and the General Assembly of Shareholders.

* Signatory rights backed by the appropriate decisions.
* The charter (statute) of the firm and other incorporation documents.
* Copies of licences granted to the firm.
* A legal opinion regarding the above licences.
* A list of lawsuit that were filed against the firm and that the firm filed against third parties (litigation) plus a list of disputes which are likely to reach the courts.
* Legal opinions regarding the possible outcomes of all the lawsuits and disputes including their potential influence on the firm.

Financial Due Diligence

Last 3 years income statements of the firm or of constituents of the firm, if the firm is the result of a merger. The statements have to include:

* Balance Sheets;
* Income Statements;
* Cash Flow statements;
* Audit reports (preferably done according to the International Accounting Standards, or, if the firm is looking to raise money in the USA, in accordance with FASB);
* Cash Flow Projections and the assumptions underlying them.

Controls

* Accounting systems used;
* Methods to price products and services;

- Payment terms, collections of debts and ageing of receivables;
- Introduction of international accounting standards;
- Monitoring of sales;
- Monitoring of orders and shipments;
- Keeping of records, filing, archives;
- Cost accounting system;
- Budgeting and budget monitoring and controls;
- Internal audits (frequency and procedures);
- External audits (frequency and procedures);
- The banks that the firm is working with: history, references, balances.

Technical Plan

- Description of manufacturing processes (hardware, software, communications, other);
- Need for know-how, technological transfer and licensing required;
- Suppliers of equipment, software, services (including offers);
- Manpower (skilled and unskilled);
- Infrastructure (power, water, etc.);
- Transport and communications (example: satellites, lines, receivers, transmitters);
- Raw materials: sources, cost and quality;
- Relations with suppliers and support industries;
- Import restrictions or licensing (where applicable);
- Sites, technical specification;
- Environmental issues and how they are addressed;
- Leases, special arrangements;
- Integration of new operations into existing ones (protocols, etc.).

A successful due diligence is the key to an eventual investment. This is a process much more serious and important than the preparation of the Business Plan.

E

Earnings Yield

In American novels, well into the 1950's, one finds protagonists using the future stream of dividends emanating from their share holdings to send their kids to college or as collateral. Yet, dividends seemed to have gone the way of the Hula-Hoop. Few companies distribute erratic and ever-declining dividends. The vast majority don't bother. The unfavorable tax treatment of distributed profits may have been the cause.

The dwindling of dividends has implications which are nothing short of revolutionary. Most of the financial theories we use to determine the value of shares were developed in the 1950's and 1960's, when dividends were in vogue. They invariably relied on a few implicit and explicit assumptions:

1. That the fair "value" of a share is closely correlated to its market price;

2. That price movements are mostly random, though somehow related to the aforementioned "value" of the share. In other words, the price of a security is supposed to converge with its fair "value" in the long term;

3. That the fair value responds to new information about the firm and reflects it - though how efficiently is debatable. The strong efficiency market hypothesis assumes that new information is fully incorporated in prices instantaneously.

But how is the fair value to be determined?

A discount rate is applied to the stream of all future income from the share - i.e., its dividends. What should this rate be is sometimes hotly disputed - but usually it is the coupon of "riskless" securities, such as treasury bonds. But since few companies distribute dividends - theoreticians and analysts are increasingly forced to deal with "expected" dividends rather than "paid out" or actual ones.

The best proxy for expected dividends is net earnings. The higher the earnings - the likelier and the higher the dividends. Thus, in a subtle cognitive dissonance, retained earnings - often plundered by rapacious managers - came to be regarded as some kind of deferred dividends.

The rationale is that retained earnings, once re-invested, generate additional earnings. Such a virtuous cycle increases the likelihood and size of future dividends. Even undistributed earnings, goes the refrain, provide a rate of return, or a yield - known as the earnings yield. The original meaning of the word "yield" - income realized by an investor - was undermined by this Newspeak.

Why was this oxymoron - the "earnings yield" - perpetuated?

According to all current theories of finance, in the absence of dividends - shares are worthless. The value of an investor's holdings is determined by the income he stands to receive from them. No income - no value. Of course, an investor can always sell his holdings to other investors and realize capital gains (or losses). But capital gains -

though also driven by earnings hype - do not feature in financial models of stock valuation.

Faced with a dearth of dividends, market participants - and especially Wall Street firms - could obviously not live with the ensuing zero valuation of securities. They resorted to substituting future dividends - the outcome of capital accumulation and re-investment - for present ones. The myth was born.

Thus, financial market theories starkly contrast with market realities.

No one buys shares because he expects to collect an uninterrupted and equiponderant stream of future income in the form of dividends. Even the most gullible novice knows that dividends are a mere apologue, a relic of the past. So why do investors buy shares? Because they hope to sell them to other investors later at a higher price.

While past investors looked to dividends to realize income from their shareholdings - present investors are more into capital gains. The market price of a share reflects its discounted expected capital gains, the discount rate being its volatility. It has little to do with its discounted future stream of dividends, as current financial theories teach us.

But, if so, why the volatility in share prices, i.e., why are share prices distributed? Surely, since, in liquid markets, there are always buyers - the price should stabilize around an equilibrium point.

It would seem that share prices incorporate expectations regarding the availability of willing and able buyers, i.e., of investors with sufficient liquidity. Such expectations are influenced by the price level - it is more difficult to find buyers at higher prices - by the general market sentiment, and by externalities and new information, including new information about earnings.

The capital gain anticipated by a rational investor takes into consideration both the expected discounted earnings of the firm and market volatility - the latter being a measure of the expected distribution of willing and able buyers at any given price. Still, if earnings are retained and not transmitted to the investor as dividends - why should they affect the price of the share, i.e., why should they alter the capital gain?

Earnings serve merely as a yardstick, a calibrator, a benchmark figure. Capital gains are, by definition, an increase in the market price of a security. Such an increase is more often than not correlated with the future stream of income to the firm - though not necessarily to the shareholder. Correlation does not always imply causation. Stronger earnings may not be the cause of the increase in the share price and the resulting capital gain. But whatever the relationship, there is no doubt that earnings are a good proxy to capital gains.

Hence investors' obsession with earnings figures. Higher earnings rarely translate into higher dividends. But earnings - if not fiddled - are an excellent predictor of the future value of the firm and, thus, of expected capital gains. Higher earnings and a higher market valuation of the firm make investors more willing to purchase the stock at a higher price - i.e., to pay a premium which translates into capital gains.

The fundamental determinant of future income from share holding was replaced by the expected value of share-ownership. It is a shift from an efficient market - where all new information is instantaneously available to all rational investors and is immediately incorporated in the price of the share - to an inefficient market where the most critical information is elusive: how many investors are willing and able to buy the share at a given price at a given moment.

A market driven by streams of income from holding securities is "open". It reacts efficiently to new information. But it is also "closed" because it is a zero sum game. One investor's gain is another's loss. The distribution of gains and losses in the long term is pretty even, i.e., random. The price level revolves around an anchor, supposedly the fair value.

A market driven by expected capital gains is also "open" in a way because, much like less reputable pyramid schemes, it depends on new capital and new investors. As long as new money keeps pouring in, capital gains expectations are maintained - though not necessarily realized.

But the amount of new money is finite and, in this sense, this kind of market is essentially a "closed" one. When sources of funding are exhausted, the bubble bursts and prices decline precipitously. This is commonly described as an "asset bubble".

This is why current investment portfolio models (like CAPM) are unlikely to work. Both shares and markets move in tandem (contagion) because they are exclusively swayed by the availability of future buyers at given prices.

This renders diversification inefficacious. As long as considerations of "expected liquidity" do not constitute an explicit part of income-based models, the market will render them increasingly irrelevant.

APPENDIX: Introduction to the book "Facts and Fictions in the Securities Industry" (2009)

The securities industry worldwide is constructed upon the quicksand of self-delusion and socially-acceptable confabulations. These serve to hold together players and agents whose interests are both disparate and diametrically opposed. In the long run, the securities markets are zero-sum games and the only possible outcome is win-lose.

The first "dirty secret" is that a firm's market capitalization often stands in inverse proportion to its value and valuation (as measured by an objective, neutral, disinterested party). This is true especially when agents (management) are not also principals (owners).

Owing to its compensation structure, invariably tied to the firms' market capitalization, management strives to maximize the former by manipulating the latter. Very often, the only way to affect the firm's market capitalization in the short-term is to sacrifice the firm's interests and, therefore, its value in the medium to long-term (for instance, by doling out bonuses even as the firm is dying; by speculating on leverage; and by cooking the books).

The second open secret is that all modern financial markets are Ponzi (pyramid) schemes. The only viable exit strategy is by dumping one's holdings on future entrants. Fresh cash flows are crucial to sustaining ever increasing prices. Once these dry up, markets collapse in a heap.

Thus, the market prices of shares and, to a lesser extent debt instruments (especially corporate ones) are determined by three cash flows:

(i) The firm's future cash flows (incorporated into valuation models, such as the CAPM or FAR)

(ii) Future cash flows in securities markets (i.e., the ebb and flow of new entrants)

(iii) The present cash flows of current market participants

The confluence of these three cash streams translates into what we call "volatility" and reflects the risks inherent in the security itself (the firm's idiosyncratic risk) and the hazards of the market (known as alpha and beta coefficients).

In sum, stocks and share certificates do not represent ownership of the issuing enterprise at all. This is a myth, a convenient piece of fiction intended to pacify losers and lure "new blood" into the arena. Shareholders' claims on the firm's assets in cases of insolvency, bankruptcy, or liquidation are of inferior, or subordinate nature.

Stocks are shares are merely options (gambles) on the three cash flows enumerated above. Their prices wax and wane in accordance with expectations regarding the future net present values of these flows. Once the music stops, they are worth little.

E-books (Electronic Books)

One of the first acts of the French National Assembly in 1789 was to issue this declaration: "The free communication of thought and opinion is one of the most precious rights of man; every citizen may therefore speak, write and print freely." UNESCO still defines "book" as "non-periodical printed publication of at least 49 pages excluding covers".

Yet, have the innovations of the last five years transformed the concept of "book" irreversibly?

The now defunct BookTailor used to sell its book-customization software mainly to travel agents. Subscribers assembled their own, private edition tome from a library of electronic content. The emerging idiosyncratic anthology was either printed and bound on demand or packaged as an e-book.

Consider what this simple business model does to entrenched and age-old notions such as "original" and "copies", copyright, and book identifiers. Is the "original" the final, user-customized book - or its sources? Should such one-copy print runs be eligible to unique identifiers (for instance, unique ISBN's)? Does the user possess any rights in the final product, compiled by him? Do the copyrights of the original authors still apply?

Members of the BookCrossing.com community register their books in a central database, obtain a BCID (BookCrossing ID Number) and then give the book to someone, or simply leave it lying around to be found. The volume's successive owners provide BookCrossing with their coordinates. This innocuous model subverts the legal concept of ownership and transforms the book from a passive, inert object into a catalyst of human interactions. In other words, it returns the book to its origins: a dialog-provoking time capsule.

Their proponents protest that e-books are not merely an ephemeral rendition of their print predecessors - they are a new medium, an altogether different reading experience.

Consider these options: hyperlinks within the e-book to Web content and reference tools; embedded instant shopping and ordering; divergent, user-interactive, decision driven plotlines; interaction with other e-books using Bluetooth or some other wireless standard; collaborative authoring, gaming and community activities; automatically or periodically updated content; multimedia capabilities; databases of bookmarks, records of reading habits, shopping habits, interaction with other readers, and plot-related decisions; automatic and embedded audio conversion and translation capabilities; full wireless piconetworking and scatternetworking capabilities; and more.

In an essay titled "The Processed Book", Joseph Esposito expounds on five important capabilities of e-books: as portals or front ends to other sources of information, as self-referencing texts, as platforms being "fingered" by other resources, as input processed by machines, and e-books serving as nodes in networks.

E-books, counter their opponents, have changed little beyond format and medium. Audio books are more revolutionary than e-books because they no longer use visual symbols. Consider the scrolling protocols - lateral and vertical. The papyrus, the broadsheet newspaper, and the computer screen are three examples of the vertical kind. The e-book, the microfilm, the vellum, and the print book are instances of the lateral scroll. Nothing new here.

E-books are a throwback to the days of the papyrus. The text is placed on one side of a series of connected "leaves". Parchment, by comparison, was multi-paged, easily browseable, and printed on both sides of the leaf. It led to a revolution in publishing and, ultimately, to the print book. All these advances are now being reversed by the e-book, bemoan the antagonists.

The truth, as always, is somewhere in mid-ground between derision and fawning.

The e-book retains one innovation of the parchment - the hypertext. Early Jewish and Christian texts as well as Roman legal scholarship were inscribed or, later, printed, with numerous inter-textual links. The Talmud, for instance, comprises a main text (the Mishna) surrounded by references to scholarly interpretations (exegesis).

Whether on papyrus, vellum, paper, or PDA - all books are portable. The book is like a perpetuum mobile. It disseminates its content virally, by being circulated, and is not diminished or altered in the process. Though physically eroded, it can be copied faithfully. It is permanent and, subject to faithful replication, immutable.

Admittedly, e-texts are device-dependent (e-book readers or computer drives). They are format-specific. Changes in technology - both in hardware and in software - render many e-books unreadable. And portability is hampered by battery life, lighting conditions, or the availability of appropriate infrastructure (e.g., of electricity).

The printing press technology shattered the content monopoly. In 50 years (1450-1500), the number of books in Europe swelled from a few thousand to more than 9 million. And, as McLuhan noted, it shifted the emphasis from the oral mode of content distribution (i.e., "communication") to the visual mode.

E-books are only the latest application of age-old principles to new "content-containers". Every such transmutation yields a surge in content creation and dissemination. The incunabula - the first printed books - made knowledge accessible (sometimes in the vernacular) to scholars and laymen alike and liberated books from the tyranny of monastic scriptoria and "libraries".

E-books are promising to do the same.

In the foreseeable future, "Book ATMs" placed in remote corners of the Earth would be able to print on demand (POD) any book selected from publishing backlists and front lists comprising millions of titles. Vanity publishers and self-publishing allow authors to overcome editorial barriers to entry and to bring out their work affordably.

The Internet is the ideal e-book distribution channel. It threatens the monopoly of the big publishing houses. Ironically, early publishers rebelled against the knowledge monopoly of the Church. The industry flourished in non-theocratic societies such as the Netherlands and England - and languished where religion reigned (the Islamic world, and Medieval Europe).

With e-books, content is once more a collaborative effort, as it has been well into the Middle Ages. Knowledge, information, and narratives were once generated through the interactions of authors and audience (remember Socrates). Interactive e-books, multimedia, discussion lists, and collective authorship efforts restore this great tradition.

Authors are again the publishers and marketers of their work as they have been well into the 19th century when many books debuted as serialized pamphlets in daily papers or magazines or were sold by subscription. Serialized e-books hark back to these intervallic traditions. E-books may also help restore the balance between best-sellers and midlist authors and between fiction and non-fiction. E-books are best suited to cater to neglected niche markets.

E-books, cheaper than even paperbacks, are the quintessential "literature for the millions". Both erstwhile reprint libraries and current e-book publishers specialize in inexpensive books in the public domain (i.e., whose copyright expired). John Bell (competing with Dr. Johnson) put out "The Poets of Great Britain" in 1777-83. Each of the 109 volumes cost six shillings (compared to the usual guinea or more). The Railway Library of novels (1,300 volumes) costs 1 shilling apiece only eight decades later. The price proceeded to dive throughout the next century and a half. E-books and POD resume this trend.

The plunge in book prices, the lowering of barriers to entry aided by new technologies and plentiful credit, the proliferation of publishers, and the cutthroat competition among booksellers was such that price regulation (cartel) had to be introduced. Net publisher prices, trade discounts, and list prices are all anti-competitive practices of 19th century Europe. Still, this lamentable period also gave rise to trade associations, publishers organizations, literary agents, author contracts, royalties agreements, mass marketing, and standardized copyrights.

The Internet is often perceived to be nothing more than a glorified - though digitized - mail order catalogue. But e-books are different. Legislators and courts have yet to establish if e-books are books at all. Existing contracts between authors and publishers may not cover the electronic rendition of texts. E-books also offer serious price competition to more traditional forms of publishing and are, thus, likely to provoke a realignment of the entire industry.

Rights may have to be re-assigned, revenues re-distributed, contractual relationships reconsidered. Hitherto, e-books amounted to little more that re-formatted renditions of the print editions. But authors are increasingly publishing their books primarily or exclusively as e-books thus undermining both hardcovers and paperbacks.

Luddite printers and publishers resisted - often violently - every phase in the evolution of the trade: stereotyping, the iron press, the application of steam power, mechanical typecasting and typesetting, new methods of reproducing illustrations, cloth bindings, machine-made paper, ready-bound books, paperbacks, book clubs, and book tokens.

Without exception, they eventually relented and embraced the new technologies to considerable commercial advantage. Similarly, publishers were initially hesitant and reluctant to adopt the Internet, POD, and e-publishing. It is not surprising that they came around.

Printed books in the 17th and 18th centuries were derided by their contemporaries as inferior to their laboriously hand-made antecedents and to the incunabula. These complaints are reminiscent of current criticisms of the new media (Internet, e-books): shoddy workmanship, shabby appearance, and rampant piracy.

The first decades following the invention of the printing press, were, as the Encyclopedia Britannica puts it "a restless, highly competitive free for all ... (with) enormous vitality and variety (often leading to) careless work". There were egregious acts of piracy - for instance, the illicit copying of the Aldine Latin "pocket books", or the all-pervasive book-bootlegging in England in the 17th century, a direct outcome of over-regulation and coercive copyright monopolies.

Shakespeare's work was repeatedly replicated by infringers of emerging intellectual property rights. Later, the American colonies became the world's centre of industrialized and systematic book piracy. Confronted with abundant and cheap pirated foreign books, local authors resorted to freelancing in magazines and lecture tours in a vain effort to make ends meet.

Pirates and unlicensed - and, therefore, subversive - publishers were prosecuted under a variety of monopoly and libel laws and, later, under national security and obscenity laws. Both royal and "democratic" governments acted ruthlessly to preserve their control of publishing.

John Milton wrote his passionate plea against censorship, Areopagitica, in response to the 1643 licensing ordinance passed by the British Parliament. The revolutionary Copyright Act of 1709 in England decreed that authors and publishers are entitled to exclusively reap the commercial benefits of their endeavors, though only for a prescribed period of time.

The never-abating battle between industrial-commercial publishers with their ever more potent technological and legal arsenal and the free-spirited arts and craftsmanship crowd now rages as fiercely as ever in numerous discussion lists, fora, tomes, and conferences.

William Morris started the "private press" movement in England in the 19th century to counter what he regarded as the callous commercialization of book publishing. When the printing press was invented, it was put to commercial use by private entrepreneurs (traders) of the day. Established "publishers" (monasteries), with a few exceptions (e.g., in Augsburg, Germany and in Subiaco, Italy) shunned it as a major threat to culture and civilization. Their attacks on printing read like the litanies against self-publishing or corporate-controlled publishing today.

But, as readership expanded - women and the poor became increasingly literate - the number of publishers multiplied. At the beginning of the 19th century, innovative lithographic and offset processes allowed publishers in the West to add illustrations (at first, black and white and then in color), tables, detailed maps and anatomical charts, and other graphics to their books.

Publishers and librarians scuffled over formats (book sizes) and fonts (Gothic versus Roman) but consumer preferences prevailed. The multimedia book was born. E-books will, probably, undergo a similar transition from static digital renditions of a print edition - to lively, colorful, interactive and commercially enabled objects.

The commercial lending library and, later, the free library were two additional reactions to increasing demand. As early as the 18th century, publishers and booksellers expressed the - groundless - fear that libraries will cannibalize their trade. Yet, libraries have actually enhanced book sales and have become a major market in their own right. They are likely to do the same for e-books.

Publishing has always been a social pursuit, heavily dependent on social developments, such as the spread of literacy and the liberation of minorities (especially, of women). As every new format matures, it is subjected to regulation from within and from without. E-books and other digital content are no exception. Hence the recurrent and current attempts at restrictive regulation and the legal skirmishes that follow them.

At its inception, every new variant of content packaging was deemed "dangerous". The Church, formerly the largest publisher of bibles and other religious and "earthly" texts and the upholder and protector of reading in the Dark Ages, castigated and censored the printing of "heretical" books, especially the vernacular bibles of the Reformation.

It even restored the Inquisition for the specific purpose of controlling book publishing. In 1559, it issued the Index Librorum Prohibitorum ("Index of Prohibited Books"). A few, mainly Dutch, publishers ended up on the stake. European rulers issued proclamations against "naughty printed books" of heresy and sedition.

The printing of books was subject to licensing by the Privy Council in England. The very concept of copyright arose out of the forced recording of titles in the register of the English Stationer's Company, a royal instrument of influence and intrigue. Such obligatory registration granted the publisher the right to exclusively copy the registered book - or, more frequently, a class of books - for a number of years, but politically constrained printable content, often by force.

Freedom of the press and free speech are still distant dreams in most parts of the earth. Even in the USA, the Digital Millennium Copyright Act (DMCA), the V-chip and other privacy-invading, dissemination-inhibiting, and censorship-imposing measures perpetuate a veteran though not so venerable tradition.

The more it changes, the more it stays the same. If the history of the book teaches us anything it is that there are no limits to the ingenuity with which publishers, authors, and booksellers, re-invent old practices. Technological and marketing innovations are invariably perceived as threats - only to be upheld later as articles of faith. Publishing faces the same issues and challenges it faced five hundred years ago and responds to them in much the same way.

Dan Poynter and Danny Snow - the acknowledged gurus of the e-book revolution - did it again. The fourth edition of their U-Publish.com tome is a "living book". The public release is slated for December 2006-January 2007. But no two volumes will be alike. An appendix in the POD paperback edition will be updated monthly with breaking news from the couple's widely-circulated newsletters and, thus, differ in size and content. The standard trade edition will reference Web locations for monthly updates.

This is only the latest in a series of experiments that, put together, constitute a novel re-definition through experimentation of the classical format of the book.

Consider the now defunct BookTailor. It used to sell its book customization software mainly to travel agents - but this technology is likely to conquer other niches (such as the legal and medical professions). It allows users to select bits and pieces from a library of e-books, combine them into a totally new tome and print and bind the latter on demand. The client can also choose to buy the end-product as an e-book.

Consider what this simple business model does to entrenched and age old notions such as "original" and "copies", copyright, and book identifiers. What is the "original" in this case? Is it the final, user-customized book - or its sources? And if no customized book is identical to any other - what happens to the intuitive notion of "copies"? Should BookTailor-generated books considered to be unique exemplars of one-copy print runs? If so, should each one receive a unique identifier (for instance, a unique ISBN)? Does the user possess any rights in the final product, composed and selected by him? What about the copyrights of the original authors?

Or take BookCrossing.com. On the face of it, it presents no profound challenge to established publishing practices and to the modern concept of intellectual property. Members register their books, obtain a BCID (BookCrossing ID Number) and then give the book to someone, or simply leave it lying around for a total stranger to find. Henceforth, fate determines the chain of events. Eventual successive owners of the volume are supposed to report to BookCrossing (by e-mail) about the book's and their whereabouts, thereby generating moving plots and mapping the territory of literacy and bibliomania.

This innocuous model subversively undermines the concept - legal and moral - of ownership. It also expropriates the book from the realm of passive, inert objects and transforms it into a catalyst of human interactions across time and space. In other words, it returns the book to its origins: a time capsule, a time machine and the embodiment of a historical narrative.

E-books, hitherto, have largely been nothing but an ephemeral rendition of their print predecessors. But e-books are another medium altogether. They can and will provide a different reading experience. Consider "hyperlinks within the e-book and without it - to web content, reference works, etc., embedded instant shopping and ordering links, divergent, user-interactive, decision driven plotlines, interaction with other e-books (using Bluetooth or another wireless standard), collaborative authoring, gaming and community activities, automatically or periodically updated content, ,multimedia capabilities, database, Favourites and History Maintenance (records of reading habits, shopping habits, interaction with other readers, plot related decisions and much more), automatic and embedded audio conversion and translation capabilities, full wireless piconetworking and scatternetworking capabilities and more".

EBRD (European Bank for Reconstruction and Development)

In typical bureaucratese, the pensive EBRD analyst ventures with the appearance of compunction: "A number of projects have fallen short of acceptable standards (notice the passive, exculpating voice - SV) and have put the reputation of the bank at risk". If so, very little was risked. The outlandish lavishness of its City headquarters, the apotheosis of the inevitable narcissism of its first French Chairman (sliding marble slabs, motion sensitive lighting and designer furniture) - is, at this stage, its only tangible achievement. In the territories of its constituencies and shareholders it is known equally for its logy pomposity, the irrelevance of its projects, its lack of perspicacity and its Kafkaesque procedures. And where the IMF sometimes indulges in oblique malice and corrupt opaqueness, the EBRD wallows merely in avuncular inefficacy. Both are havens of insouciant third rate economists and bankers beyond rating.

Established in 1991, "it exists to foster the transition towards open market oriented economies and to promote private and entrepreneurial initiative in the countries of central and eastern Europe and the Commonwealth of Independent States (CIS) committed to and applying the principles of multiparty democracy, pluralism and market economics. The EBRD seeks to help its 26 countries of operations to implement structural and sectoral economic reforms, promoting competition, privatization and entrepreneurship, taking into account the particular needs of countries at different stages of transition. Through its investments it promotes private sector activity, the strengthening of financial institutions and legal systems, and the development of the infrastructure needed to support the private sector. The Bank applies sound banking and investment principles in all of its operations. In fulfilling its role as a catalyst of change, the Bank encourages co-financing and foreign direct investment from the private and public sectors, helps to mobilize domestic capital, and provides technical co-operation in relevant areas. It works in close co-operation with international financial institutions and other international and national organizations. In all of its activities, the Bank promotes environmentally sound and sustainable development."

Grandiloquence aside, the EBRD was supposed to foster the formation of the private sector in the revenant wreckage of Central and Eastern Europe, the Balkan, Russia and the New Independent States. This it was mandated to do by providing finance where there was none ("bridging the gaps in the post communist financial system" to quote "The Economist"). Put more intelligibly, it was NOT supposed to transform itself into a long-term investment portfolio with equity holdings in most blue-chips in the region. Yet, this is precisely what it ended up becoming. It avoided project financing like the plague and met the burgeoning capital needs of small and medium size enterprises (SMEs) grudgingly. And it refuses to divest itself of stakes in the best run and most efficiently managed firms from Russia to the Czech Republic. In a way, it competes head on with other investors and commercial banks - often crowding them out with its subsidized financing.

One of its main mistakes, in a depressingly impressive salmagundi, is that it channelled precious resources to this budding sector (SMEs), the dynamo of every economy, through the domestic, decrepit, venal and politically manhandled banking system. The inevitable result was a colossal waste of resources. The money was allocated to sycophantic cronies and sinecured relatives (often one and the same) and to gigantic, state-owned or state-favoured loss makers. Most of it lay idle and yielded to its hosts a hefty income in arbitrage and speculation. As banks went bankrupt, they wiped whole portfolios of EBRD SME funds, theoretically guaranteed by even more bankrupt states.

Thus, the only segments of the private sector to benefit handsomely from the EBRD were lawyers and accountants involved in the umpteen lawsuits the EBRD is mired in. It is a growth industry in "countries" such as Russia. This is the melancholy outcome of indiscriminate, politically-motivated lending and of a lackadaisical performance as both lenders and shareholders. In the spirit of its first chairman, the suave and titivated Attali, the bank is in a constant road show, mortified by the possibility of its dissolution by reason of irrelevance. It aims to impress the West with its grandiose projects, mega investments, fast returns and acquiescence. In thus behaving, it is engaged in a perditionable perfidy of its fiduciary obligations. It lends to criminal managers, winking at their off-shore shenanigans and turning a blind eye to the scapegrace slaughter of minority shareholders. It throws good money after bad, cosies up to oligarchs near and far and engages in creative accounting. Instead of Westernizing the Easterners - it has been Easternized by them. Its sedentary though peregrinating employees are more adept at wining and at dining the high and mighty and at haughtily maundering in the odd, tangential, seminar - than at managing a banking institution or looking after the interests of their nominal shareholders with the tutelary solicitude expected of a bank.

Consider two examples:

Macedonia

The nascent private sector is nowhere to be found in the list of projects the EBRD so sagely chose to falter into here. The Electricity and Telecoms monopolies are prime beneficiaries as is the airport. The EBRD is also a passive shareholder in both big universal banks - until recently, conduits of state mismanagement. The SME and Trade Facilitation credit lines were conveniently divvied up among five domestic banks (one went belly up, the managers of two are under criminal investigation and one was sold to a Greek state bank). Despite vigorous protestations to the contrary, none of this money reached its proclaimed entrepreneurial targets. Two loans were made to giant local firms - the natural preserve of commercial lenders and equity investors the world over. The EBRD contributed nothing to the emergence of a management culture, to the development of proper corporate governance, to the safeguarding of property rights and the protection of minority shareholders here. Instead, it colluded in the perpetuation of monopolies, shoddy and shady banking practices, the pertinacious robbery titled "privatization" and the pretence of funding languishing private sector enterprises.

Russia

Its 2 billion US dollars portfolio all but wiped out in the August 1998 financial crisis, the EBRD has now returned with 700 million new Euros to be - conservatively but not more safely - lent in major energy and telecom behemoths.

The historic, pre-1998, portfolio appears impressive. Almost 11 billion US dollars were generated by the EBRD's less than 4. The bottom line reads 94 projects. Yet, when one neutralizes the infrastructural ones (including the gas and energy sector) - one is left with less than 50% of the amount. Add "infrastructure-like" projects (water transportation and the like) - and less than 30% of the portfolio went to what can be called proper "private sector". Moreover, even these investments and credits were geared towards traditional and smokestack industries: mining, food processing, pipelines, rubber and such. Not an entrepreneur in sight. And the EBRD's meagre loan-loss provisions and reserves cast serious doubts regarding the mental state of both its directors and its auditors.

To varying degrees, these two countries are typical. Development banks, like industrial policy, import substitution and poverty reduction, have gone in and out of multilateral fashion several times in the last few decades. But there is a consensus regarding some minimum aims of such bureaucracy-laden establishments - and the EBRD achieves none. It does not encourage entrepreneurship. It does not improve corporate governance. It does not enhance property rights. It does not allocate economic resources efficiently. It competes directly with other - more desirable - financing alternatives. It is not equipped to monitor its vast and inert portfolio. By implication it collaborates in graft, tax evasion and worse. It is a waste of scarce resources badly needed elsewhere. It should be administered a coup de grace. And its marbled abode - so out of touch with the realities of its clients and its balance sheet - should be sold to someone more up to the task. A bank, for instance.

POST SCRIPTUM - Comments Made to "The Banker" - February 2002

I would not have written the same article today. The EBRD used to be pretty monolithic in its four orientations: pro-state companies, pro-big business (or mega projects), pro-governmental projects, and pro-commodities (mostly energy products).

It is now more open to SME financing - and not only as lip service.

Instead of colluding with venal, inefficient, crony-ridden, and decrepit local banking systems - it has taken over them in partnership with foreign investors. It has a more tangible in-field operating presence.

Its assets are more balanced (in maturity structures, single lender exposures, collateral portfolios, etc.). It is more innovative and creative in its collaboration with the private sector, offering a varied range of vehicles. In short: it is becoming more community orientated and less "commercially" conservative. It begins to fulfill its original charter of filling the gap between IFI's and micro-lending. It is still hobbled by overweening political interventionism - but that is to be expected in a regional development bank (see the ADB, IADB, and so on).

E-Commerce

The recent bloodbath among online content peddlers and digital media proselytisers can be traced to two deadly sins. The first was to assume that traffic equals sales. In other words, that a miraculous conversion will spontaneously occur among the hordes of visitors to a web site. It was taken as an article of faith that a certain percentage of this mass will inevitably and nigh hypnotically reach for their bulging pocketbooks and purchase content, however packaged. Moreover, ad revenues (more reasonably) were assumed to be closely correlated with "eyeballs". This myth led to an obsession with counters, page hits, impressions, unique visitors, statistics and demographics.

It failed, however, to take into account the dwindling efficacy of what Seth Godin, in his brilliant essay ("Unleashing the IdeaVirus"), calls "Interruption Marketing" - ads, banners, spam and fliers. It also ignored, at its peril, the ethos of free content and open source prevalent among the Internet opinion leaders, movers and shapers. These two neglected aspects of Internet hype and culture led to the trouncing of erstwhile promising web media companies while their business models were exposed as wishful thinking.

The second mistake was to exclusively cater to the needs of a highly idiosyncratic group of people (Silicone Valley geeks and nerds). The assumption that the USA (let alone the rest of the world) is Silicone Valley writ large proved to be calamitous to the industry.

In the 1970s and 1980s, evolutionary biologists like Richard Dawkins and Rupert Sheldrake developed models of cultural evolution. Dawkins' "meme" is a cultural element (like a behaviour or an idea) passed from one individual to another and from one generation to another not through biological -genetic means - but by imitation.

Sheldrake added the notion of contagion - "morphic resonance" - which causes behaviour patterns to suddenly emerged in whole populations. Physicists talked about sudden "phase transitions", the emergent results of a critical mass reached. A latter day thinker, Michael Gladwell, called it the "tipping point".

Seth Godin invented the concept of an "ideavirus" and an attendant marketing terminology. In a nutshell, he says, to use his own summation:

"Marketing by interrupting people isn't cost-effective anymore. You can't afford to seek out people and send them unwanted marketing, in large groups and hope that some will send you money. Instead the future belongs to marketers who establish a foundation and process where interested people can market to each other. Ignite consumer networks and then get out of the way and let them talk."

This is sound advice with a shaky conclusion. The conversion from exposure to a marketing message (even from peers within a consumer network) - to an actual sale is a convoluted, multi-layered, highly complex process. It is not a "black box", better left unattended to. It is the same deadly sin all over again - the belief in a miraculous conversion. And it is highly US-centric. People in other parts of the world interact entirely differently.

You can get them to visit and you get them to talk and you can get them to excite others. But to get them to buy - is a whole different ballgame. Dot.coms had better begin to study its rules.

Economics, Behavioral Aspects of

"It is impossible to describe any human action if one does not refer to the meaning the actor sees in the stimulus as well as in the end his response is aiming at."
Ludwig von Mises

Economics - to the great dismay of economists - is merely a branch of psychology. It deals with individual behaviour and with mass behaviour. Many of its practitioners sought to disguise its nature as a social science by applying complex mathematics where common sense and direct experimentation would have yielded far better results.

The outcome has been an embarrassing divorce between economic theory and its subjects.

The economic actor is assumed to be constantly engaged in the rational pursuit of self interest. This is not a realistic model - merely a useful approximation. According to this latter day - rational - version of the dismal science, people refrain from repeating their mistakes systematically. They seek to optimize their preferences. Altruism can be such a preference, as well.

Still, many people are non-rational or only nearly rational in certain situations. And the definition of "self-interest" as the pursuit of the fulfillment of preferences is a tautology.

The theory fails to predict important phenomena such as "strong reciprocity" - the propensity to "irrationally" sacrifice resources to reward forthcoming collaborators and punish free-riders. It even fails to account for simpler forms of apparent selflessness, such as reciprocal altruism (motivated by hopes of reciprocal benevolent treatment in the future).

Even the authoritative and mainstream 1995 "Handbook of Experimental Economics", by John Hagel and Alvin Roth (eds.) admits that people do not behave in accordance with the predictions of basic economic theories, such as the standard theory of utility and the theory of general equilibrium. Irritatingly for economists, people change their preferences mysteriously and irrationally. This is called "preference reversals".

Moreover, people's preferences, as evidenced by their choices and decisions in carefully controlled experiments, are inconsistent. They tend to lose control of their actions or procrastinate because they place greater importance (i.e., greater "weight") on the present and the near future than on the far future. This makes most people both irrational and unpredictable.

Either one cannot design an experiment to rigorously and validly test theorems and conjectures in economics - or something is very flawed with the intellectual pillars and models of this field.

Neo-classical economics has failed on several fronts simultaneously. This multiple failure led to despair and the re-examination of basic precepts and tenets.

Consider this sample of outstanding issues:

Unlike other economic actors and agents, governments are accorded a special status and receive special treatment in economic theory. Government is alternately cast as a saint, seeking to selflessly maximize social welfare - or as the villain, seeking to perpetuate and increase its power ruthlessly, as per public choice theories.

Both views are caricatures of reality. Governments indeed seek to perpetuate their clout and increase it - but they do so mostly in order to redistribute income and rarely for self-enrichment.

Economics also failed until recently to account for the role of innovation in growth and development. The discipline often ignored the specific nature of knowledge industries (where returns increase rather than diminish and network effects prevail). Thus, current economic thinking is woefully inadequate to deal with information monopolies (such as Microsoft), path dependence, and pervasive externalities.

Classic cost/benefit analyses fail to tackle very long term investment horizons (i.e., periods). Their underlying assumption - the opportunity cost of delayed consumption - fails when applied beyond the investor's useful economic life expectancy. People care less about their grandchildren's future than about their own. This is because predictions concerned with the far future are highly uncertain and investors refuse to base current decisions on fuzzy "what ifs".

This is a problem because many current investments, such as the fight against global warming, are likely to yield results only decades hence. There is no effective method of cost/benefit analysis applicable to such time horizons.

How are consumer choices influenced by advertising and by pricing? No one seems to have a clear answer.

Advertising is concerned with the dissemination of information. Yet it is also a signal sent to consumers that a certain product is useful and qualitative and that the advertiser's stability, longevity, and profitability are secure. Advertising communicates a long term commitment to a winning product by a firm with deep pockets. This is why patrons react to the level of visual exposure to advertising - regardless of its content.

Humans may be too multi-dimensional and hyper-complex to be usefully captured by econometric models. These either lack predictive powers or lapse into logical fallacies, such as the "omitted variable bias" or "reverse causality". The former is concerned with important variables unaccounted for - the latter with reciprocal causation, when every cause is also caused by its own effect.

These are symptoms of an all-pervasive malaise. Economists are simply not sure what precisely constitutes their subject matter. Is economics about the construction and testing of models in accordance with certain basic assumptions? Or should it revolve around the mining of data for emerging patterns, rules, and "laws"?

On the one hand, patterns based on limited - or, worse, non-recurrent - sets of data form a questionable foundation for any kind of "science". On the other hand, models based on assumptions are also in doubt because they are bound to be replaced by new models with new, hopefully improved, assumptions.

One way around this apparent quagmire is to put human cognition (i.e., psychology) at the heart of economics. Assuming that being human is an immutable and knowable constant - it should be amenable to scientific treatment. "Prospect theory", "bounded rationality theories", and the study of "hindsight bias" as well as other cognitive deficiencies are the outcomes of this approach.

To qualify as science, economic theory must satisfy the following cumulative conditions:

a. ***All-inclusiveness (anamnetic)*** – It must encompass, integrate, and incorporate all the facts known about economic behaviour.

b. ***Coherence*** – It must be chronological, structured and causal. It must explain, for instance, why a certain economic policy leads to specific economic outcomes - and why.

c. ***Consistency*** – It must be self-consistent. Its sub-"units" cannot contradict one another or go against the grain of the main "theory". It must also be consistent with the observed phenomena, both those related to economics and those pertaining to non-economic human behaviour. It must adequately cope with irrationality and cognitive deficits.

d. ***Logical compatibility*** – It must not violate the laws of its internal logic and the rules of logic "out there", in the real world.

e. ***Insightfulness*** – It must cast the familiar in a new light, mine patterns and rules from big bodies of data ("data mining"). Its insights must be the inevitable conclusion of the logic, the language, and the evolution of the theory.

f. ***Aesthetic*** – Economic theory must be both plausible and "right", beautiful (aesthetic), not cumbersome, not awkward, not discontinuous, smooth, and so on.

g. ***Parsimony*** – The theory must employ a minimum number of assumptions and entities to explain the maximum number of observed economic behaviours.

h. ***Explanatory Powers*** – It must explain the behaviour of economic actors, their decisions, and why economic events develop the way they do.

i. ***Predictive (prognostic) Powers*** – Economic theory must be able to predict future economic events and trends as well as the future behaviour of economic actors.

j. ***Prescriptive Powers*** – The theory must yield policy prescriptions, much like physics yields technology. Economists must develop "economic technology" - a set of tools, blueprints, rules of thumb, and mechanisms with the power to change the " economic world".

k. ***Imposing*** – It must be regarded by society as the preferable and guiding organizing principle in the economic sphere of human behaviour.

l. ***Elasticity*** – Economic theory must possess the intrinsic abilities to self organize, reorganize, give room to emerging order, accommodate new data comfortably, and avoid rigid reactions to attacks from within and from without.

Many current economic theories do not meet these cumulative criteria and are, thus, merely glorified narratives.

But meeting the above conditions is not enough. Scientific theories must also pass the crucial hurdles of testability, verifiability, refutability, falsifiability, and repeatability. Yet, many economists go as far as to argue that no experiments can be designed to test the statements of economic theories.

It is difficult - perhaps impossible - to test hypotheses in economics for four reasons.

a. ***Ethical*** – Experiments would have to involve human subjects, ignorant of the reasons for the experiments and their aims. Sometimes even the very existence of an experiment will have to remain a secret (as with double blind experiments). Some experiments may involve unpleasant experiences. This is ethically unacceptable.

b. ***Design Problems*** - The design of experiments in economics is awkward and difficult. Mistakes are often inevitable, however careful and meticulous the designer of the experiment is.

c. ***The Psychological Uncertainty Principle*** – The current mental state of a human subject can be (theoretically) fully known. But the passage of time and, sometimes, the experiment itself, influence the subject and alter his or her mental state - a problem known in economic literature as "time inconsistencies". The very processes of measurement and observation influence the subject and change it.

d. ***Uniqueness*** – Experiments in economics, therefore, tend to be unique. They cannot be repeated even when the SAME subjects are involved, simply because no human subject remains the same for long. Repeating the experiments with other subjects casts in doubt the scientific value of the results.

e. ***The undergeneration of testable hypotheses*** – Economic theories do not generate a sufficient number of hypotheses, which can be subjected to scientific testing. This has to do with the fabulous (i.e., storytelling) nature of the discipline.

In a way, economics has an affinity with some private languages. It is a form of art and, as such, it is self-sufficient and self-contained. If certain structural, internal constraints and requirements are met – a statement in economics is deemed to be true even if it does not satisfy external (scientific) requirements. Thus, the standard theory of utility is considered valid in economics despite overwhelming empirical evidence to the contrary - simply because it is aesthetic and mathematically convenient.

So, what are economic "theories" good for?

Economic "theories" and narratives offer an organizing principle, a sense of order, predictability, and justice.

They postulate an inexorable drive toward greater welfare and utility (i.e., the idea of progress). They render our chaotic world meaningful and make us feel part of a larger whole. Economics strives to answer the "why's" and "how's" of our daily life. It is dialogic and prescriptive (i.e., provides behavioural prescriptions). In certain ways, it is akin to religion.

In its catechism, the believer (let's say, a politician) asks: "Why... (and here follows an economic problem or behaviour)".

The economist answers:

"The situation is like this not because the world is whimsically cruel, irrational, and arbitrary - but because ... (and here follows a causal explanation based on an economic model). If you were to do this or that the situation is bound to improve".

The believer feels reassured by this explanation and by the explicit affirmation that there is hope providing he follows the prescriptions. His belief in the existence of linear order and justice administered by some supreme, transcendental principle is restored.

This sense of "law and order" is further enhanced when the theory yields predictions which come true, either because they are self-fulfilling or because some real "law", or pattern, has emerged. Alas, this happens rarely. As "The Economist" notes gloomily, economists have the most disheartening record of failed predictions - and prescriptions.

Economies, Classification of

The national economies of the world can be divided to the scavenger and the predator types. The former are parasitic economies which feed off the latter. The relationship is often not that of symbiosis, where two parties maintain a mutually beneficial co-existence. Here, one economy feeds off others in a way, which is harmful, even detrimental to the hosts. But this interaction - however undesirable - is the region's only hope.

The typology of scavenger economies reveals their sources of sustenance:

Conjunctural - These economies feed off historical or economic conjunctures or crises. They position themselves as a bridge between warring or conflicting parties. Switzerland rendered this service to Nazi Germany (1933-1945), Macedonia and Greece to Serbia (1992 to the present), Cyprus aided and abetted Russia (1987 to the present), Jordan for Iraq (1991 to the present), and now, Montenegro acts the part for both Serbia and Kosovo. These economies consist of smuggling, siege breaking, contraband, arms trade and illegal immigration. They benefit economically by violating both international and domestic laws and by providing international outcasts and rogues with alternative routes of supply, and with goods and services.

Criminal - These economies are infiltrated by criminal gangs or suffused with criminal behaviour. Such infiltration is two phased: the properly criminal phase and the money laundering one. In the first phase, criminal activities yield income and result in wealth accumulation. In the second one, the money thus generated is laundered and legitimized. It is invested in legal, above-board activities. The economy of the USA during the 19th century and in the years of prohibition was partly criminal. It is reminiscent of the Russian economy in the 1990s, permeated by criminal conduct as it is. Russians often compare their stage of capitalist evolution to the American "Wild West".

Piggyback Service Economies - These are economies, which provide predator economies with services. These services are aimed at re-establishing economic equilibrium in the host (predator) economies. Tax shelters are a fine example of this variety. In many countries taxes are way too high and result in the misallocation of economic resources. Tax shelters offer a way of re-establishing the economic balance and re-instating a regime of efficient allocation of resources. These economies could be regarded as external appendages, shock absorbers and regulators of their host economies. They feed off market failures, market imbalances, arbitrage opportunities, shortages and inefficiencies. Many post-Communist countries have either made the provision of such services a part of their economic life or are about to do so. Free zones, off shore havens, off shore banking and transhipment ports proliferate, from Macedonia to Archangelsk.

Aid Economies - Economies that derive most of their vitality from aid granted them by donor countries, multilateral aid agencies and NGOs. Many of the economies in transition belong to this class. Up to 15% of their GDP is in the form of handouts, soft loans and technical assistance. Rescheduling is another species of financial subsidy and virtually all CEE countries have benefited from it. The dependence thus formed can easily deteriorate into addiction. The economic players in such economies engage mostly in lobbying and in political manoeuvring - rather than in production.

Derivative or Satellite Economies - These are economies, which are absolutely dependent upon or very closely correlated with other economies. This is either because they conduct most of their trade with these economies, or because they are a (marginal) member of a powerful regional club (or aspire to become one), or because they are under the economic (or geopolitical or military) umbrella of a regional power or a superpower. Another variant is the single-commodity or single-goods or single-service economies. Many countries in Africa and many members of the OPEC oil cartel rely on a single product for their livelihood. Russia, for instance, is heavily dependent on proceeds from the sale of its energy products. Most Montenegrins derive their livelihood, directly or indirectly, from smuggling, bootlegging and illegal immigration. Drugs are a major "export" earner in Macedonia and Albania.

Copycat Economies - These are economies that are based on legal or (more often) illegal copying and emulation of intellectual property: patents, brandnames, designs, industrial processes, other forms of innovation, copyrighted material, etc. The prime example is Japan, which constructed its whole mega-economy on these bases. Both Bulgaria and Russia are Meccas of piracy. Though prosperous for a time, these economies are dependent on and subject to the vicissitudes of business cycles. They are capital sensitive, inherently unstable and with no real long term prospects if they fail to generate their own intellectual property. They reflect the volatility of the markets for their goods and are overly exposed to trade risks, international legislation and imports. Usually, they specialize in narrow segments of manufacturing which only increases the precariousness of their situation.

The Predator Economies can also be classified:

Generators of Intellectual Property - These are economies that encourage and emphasize innovation and progress. They reward innovators, entrepreneurs, non-conformism and conflict. They spew out patents, designs, brands, copyrighted material and other forms of packaged human creativity. They derive most of their income from licensing and royalties and constitute one of the engines driving globalization. Still, these economies are too poor to support the complementary manufacturing and marketing activities. Their natural counterparts are the "Industrial Bases". Within the former Eastern Bloc, Russia, Poland, Hungary and Slovenia are, to a limited extent, such generators. Israel is such an economy in the Middle East.

Industrial Bases - These are economies that make use of the intellectual property generated by the former type within industrial processes. They do not copy the intellectual property as it is. Rather, they add to it important elements of adaptation to niche markets, image creation, market positioning, packaging, technical literature, combining it with other products or services, designing and implementing the whole production process, market (demand) creation, improvement upon the originals and value added services. These contributions are so extensive that the end products, or services can no longer to be identified with the originals, which serve as mere triggers. Again, Poland, Hungary, Slovenia (and to a lesser extent, Croatia) come to mind.

Consumer Oriented Economies - These are Third Wave (Alvin Toffler's term), services, information and knowledge driven economies. The over-riding set of values is consumer oriented. Wealth formation and accumulation are secondary. The primary activities are concerned with fostering markets and maintaining them. These "weightless" economies concentrate on intangibles: advertising, packaging, marketing, sales promotion, education, entertainment, servicing, dissemination of information, knowledge formation, trading, trading in symbolic assets (mainly financial), spiritual pursuits, and other economic activities which enhance the consumer's welfare (pharmaceuticals, for instance). These economies are also likely to sport a largish public sector, most of it service oriented. No national economy in CEE qualifies as "Consumer Oriented", though there are pockets of consumer-oriented entrepreneurship within each one.

The Trader Economies - These economies are equivalent to the cardiovascular system. They provide the channels through which goods and services are exchanged. They do this by trading or assuming risks, by providing physical transportation and telecommunications, and by maintaining an appropriately educated manpower to support all these activities. These economies are highly dependent on the general health of international trade. Many of the CEE economies are Trader economies. The openness ratio (trade divided by GDP) of most CEE countries is higher than the G7 countries'. Macedonia, for instance, has a GDP of 3.6 Billion US dollars and exports and imports of c. 2 billion US dollars. These are the official figures. Probably, another 0.5 billion Us dollars in trade go unreported. additionally, it has one of the lowest weighted customs rate in the world. Openness to trade is an official policy, actively pursued.

These economies are predatory in the sense that they engage in zero-sum games. A contract gained by a Slovenian company - is a contract lost by a Croatian one. Luckily, in this last decade, the economic cake tended to grow and the sum of zero sum games was more welfare to all involved. These vibrant economies - the hope of benighted and blighted regions - are justly described as "engines" because they pull all other (scavenger) economies with them. They are not likely to do so forever. But their governments have assimilated the lessons of the 1930s. Protectionism is bad for everyone involved - especially for economic engines. Openness to trade, protection of property rights and functioning institutions increase both the number and the scope of markets.

Education (in Countries in Transition)

October 2002 has been a busy month in central and eastern Europe, at least as far as education goes. "Kliment and Metodius" university in Skopje, Macedonia went on investigating forged diplomas issued to its students - and staff - in the economics faculty by Bulgarian diploma mills.

Similar allegations - of forged or hawked academic credentials - surface periodically against politicians and scholars in all the countries in transition - from Russia to Yugoslavia. Underpaid professors throughout the region have been accused in the local media of demanding - and receiving - bribes, including sexual favors, to tinker with exam marks.

The denizens of central and east Europe are schizophrenic about their education system. On the one hand, they are proud of its achievements. According to the 1996 Third

International Maths and Science Study, The Czech Republic and Slovakia fared better than Switzerland and Netherlands in mathematics.

Hungary and Russia beat Australia, Ireland, Canada, Belgium, Israel, Sweden, Germany, England, Norway, Denmark, the United States and a host of other Western heavyweights. The situation with science skills was even better with the Czech Republic in the second place out of 41 countries, Bulgaria ranked fifth, Slovenia seventh, Hungary ninth and Russia in the fourteenth rung. This stellar showing defied low spending per pupil and high number of students per class in these mostly poor countries.

But corruption is endemic, libraries and laboratories are poorly stocked, state institutions are cash-strapped and certain subjects - such as computer science, foreign languages, international law, business administration, and even economics - are poorly taught by Soviet-era educators. Hence the clamor for private and foreign alternatives. Brain drain is rampant. According to government figures, 82,000 youths - 4 percent of its total population - left Macedonia since 1991 to study abroad. Most of them never bother to return.

Foreign information technology firms are forced to open their facilities to cater to their growing needs for skills. In July, the first Cisco Certified Network Associate Academy on the Balkans was opened in the building of the Bulgarian Industrial Association (BIA).

Neighboring countries, such as Italy and Greece, aware of Bulgaria's cheap but well-educated cadre, have set up bilateral cooperation schemes to tap it. Italy now allows

Bulgarians to spend six months on work and study in Italian institutions. Both Uni Credito Italiano and Bulbank are offering interest-free loans to the would-be students.

Bulgaria signed with Greece a 2 year cooperation agreement including a student exchange program. The Serbian government submitted last week 11 projects worth $164 million to be funded the Greek Plan for Economic Reconstruction of the Balkan. Part of the money will be spent on educational schemes. Turkey is eyeing Macedonia. In a visit in august, the Turkish minister of education pledged to invest in eastern Macedonia home to a sizable Turkish minority.

Foreign establishments are sometimes regarded by xenophobic locals as cultural, social, and political beachheads. The excellent university of Blagoevgrad in Bulgaria is only half-jokingly known as "CIA University" due to the massive amounts of American funding and the number of American lecturers. It happens to straddle the border with Serbia, a one-time foe of the United States. The Central European University in Budapest, Hungary, funded with hundreds of millions of dollars from George Soros' fortune, has been subject to head-spinning conspiracy theories ever since it was founded in 1991.

But the most encouraging trend by far is the privatization of education, hitherto the patronage fief of politicians, trade unions, and state bureaucrats. According to The Economist Armenia had last year 69 private institutions of higher education with 20,000 students. Bulgaria had 9 with 28,000 students and Hungary had 32 with 28,000 undergraduates. The record belongs to Poland - 195 private institutions with 378,000 learners, one quarter of the total. Much smaller Romania had 54 establishments with 131,000 pupils - one third of all students in higher education.

Some of these private schools are joint ventures with enterprising municipalities. According to Mediapoolbg.com, the newly opened program of business administration offered by the City University in Pravets, Bulgaria and the International Higher Business School plans to teach management, e-commerce and information technologies.

The curriculum is subsidized by the US Congress and the Ministry of Education and Science. For an annual fee of $2500, students will attend classes taught by both Bulgarian and American lecturers and receive a dual Bulgarian and American diploma. City University offers both distance learning and classroom instruction in Poland, Romania, Bulgaria and Greece.

There is an intra-regional demand for successful managers of private educational facilities. The Regional Vice President of the aforementioned branch of City University in Bulgaria is Jan Rebro, a Slovak, who previously served as Chairman of College of Management, the first private college in Slovakia.

Education in these parts is not a luxury. According to a 1999 government report about unemployment, less than 2 percent of university graduates are unemployed in Macedonia - compared to more than 40 percent of the unskilled. In July, the Bulgarian National Statistics Institute published a survey of micro-enterprises, about 92 percent of all businesses in the country. The vast majority of all the owners-entrepreneurs turned out to be highly educated.

Governments are aware of the correlation between education and prosperity. The Serb authorities are offering 6-months interest-free loans to buy school books and supplies. HINA, the Croat news agency, published last month a government blueprint for countering the declining numbers of high school and college students over the past ten years and a drop in the quality of education. Only seven per cent of the population ever attend college and just over one third of these actually graduate.

But the countries of central and eastern Europe would do well not to fall into the sequential traps of Western education. As Alison Wolf recounts in her recently published tome "Does Education Matter? Myths about Education and Economic Growth" (Penguin Books, 2002), an obsession with quantitative targets in education reduces its quality and adversely affects economic growth.

Moreover, educational issues often serve as proxy for national agendas. Years of bloody clashes between Macedonians and Albanians in western Macedonia led, last year, following intense arm-twisting by the international community, to the opening of the Southeast Europe University in Albanian-dominated Tetovo. In a country still torn by inter-ethnic strife and daily violent clashes in mixed schools, the university is "committed to the Albanian culture, language, and population".

About half its board is comprised of nationalistic political activists. Bilingual education was always one of the chief demands of the Albanian minority. Yet, the opening of the university in February last year did nothing to forestall an armed uprising of Albanian rebels.

Similarly, equal educational opportunities tops the agenda of the 4-5 million Romas (gypsies) in central Europe and the Balkan. Last November, Save the Children, a charity, reported that two thirds of Roma children never attend school. Most of the rest are shunted off by hostile governments to special schools for the mentally challenged and drop out by age 15.

One in thousand ever makes it past the bullying and the bureaucratic hurdles to a university. Pressured by international public opinion and the European Union, governments reluctantly allowed private groups in the Czech Republic, Hungary and Slovakia to acquaint Roma toddlers with the indigenous languages so as to qualify them for a regular primary school.

Finally, caveat emptor. Some "private institutions" - especially distance learning diploma mills - front for scam artists. The quality of instructors and lecturers - most of them moonlighting between jobs in state institutions - is often questionable. Curricula are rarely effectively scrutinized and controlled and there is no proper process of accreditation. Annual fees are high and equal a few years to a few decades of average pay. Links and joint ventures with foreign universities help but cannot substitute for structured and continued oversight.

Can Socialist Professors of Economics Teach Capitalism?

Capitalism cannot be "learned" or "imported" or "emulated" or "simulated". Capitalism (or, rather, liberalism) is not only a theoretical construct. It is not only a body of knowledge. It is a philosophy, an ideology, a way of life, a mentality and a personality.

This is why professors of economics who studied under Socialism can never teach Capitalism in the truest sense of the word. No matter how intelligent and knowledgeable (and a minority of them are) - they can never convey the experience, the practice, the instincts and reflexes, the emotional hues and intellectual pugilistics that real, full scale, full blooded Capitalism entails. They are intellectually and emotionally castrated by their socialist past of close complicity with inefficiency, corruption and pathological economic thinking.

This is why workers and managers inherited from the socialist-communist period can never function properly in a Capitalist ambience. Both were trained at civil disobedience through looting their own state and factories. Both grew accustomed to state handouts and bribes disguised as entitlements, were suspicious and envious at their own elites (especially their politicians and crony professors), victims to suppressed rage and open, helpless, degrading dependence. Such workers and managers - no matter how well intentioned and well qualified or skilled - are likely to sabotage the very efforts whose livelihood depends on.

When the transition period of post-communist economies started, academics, journalists and politicians in the West talked about the "pent up energies" of the masses, now to be released through the twin processes of privatization and democratization. This metaphor of humans as capitalistically charged batteries waiting to unleash their stored energy upon their lands - was realistic enough. People were, indeed, charged: with pathological envy, with rage, with sadism, with pusillanimity, with urges to sabotage, to steal, to pilfer. A tsunami of destruction, a tidal wave of misappropriation, an orgy of crime and corruption and nepotism and cronyism swept across the unfortunate territories of Central and Eastern Europe (CEE). Transition was perceived by the many either as a new venue for avenging the past and for visiting the wrath of the masses upon the heads of the elites - or as another, accelerated, mode of stripping the state naked of all its assets. Finally, the latter propensity prevailed. The old elites used the cover of transition to enrich themselves and their cronies, this time "transparently" and "legally". The result was a repulsive malignant metastasis of capitalism, devoid of the liberal ideals or practices, denuded of ethics, floating in a space free of functioning, trusted institutions.

While the masses and their elites in CEE were busy scavenging, the West engaged in impotent debate between a school of "shock therapists" and a school of "institution builders". The former believed that appearances will create reality and that reality will alter consciousness (sounds like Marxism to me). Rapid privatization will generate a class of instant capitalists who, in turn, will usher in an era of real, multi-dimensional liberalism. The latter believed that the good wine of Capitalism can be poured only to the functioning receptacles of liberalism. They advocated much longer transition periods in which privatization will come only after the proper institutions were erected. Both indulged in a form of central planning. IMF-ism replaced Communism. The international financial institutions and their hordes of well-paid, well-accommodated experts - replaced the Central Committee of the party. Washington replaced Moscow. It was all very familiar and cosy.

Ever the adapters, the former communist elites converted to ardent capitalism. With the fervour with which they had recited Marxist slogans in their past - they chanted capitalist sobriquets in the present. It was catechism, uttered soullessly, in an alien language, in the marble cathedrals of capitalism in London and Washington. There was commitment or conviction behind it and it was tainted by organized crime and all-pervasive corruption. The West was the new regime to be suckered and looted and pillaged and drained. The deal was simple: mumble the mantras of the West, establish Potemkin institutions, keep peace and order in your corner of the world, give the West strategic access to your territory. In return the West will turn a blind eye to the worst excesses and to worse than excesses. This was the deal struck in Russia with the "reformists", in Yugoslavia with Milosevic, the "peacemaker", in the Czech Republic with Klaus the "economic magician" of Central Europe. It was communism all over: a superpower buying influence and colluding with corrupt elites to rob their own nations blind.

It could have been different.

Post-war Japan and Germany are two examples of the right kind of reconstruction and reforms. Democracy took real root in these two former military regimes. Economic prosperity was long lived because democracy took hold. And the ever tenuous, ever important trust between the citizens and their rulers and among themselves was thus enhanced.

Trust is really the crux of the matter.

Economy is called the dismal science because it pretends to be one, disguising its uncertainties and shifting fashions with mathematical formulae. Economy describes the aggregate behaviour of humans and, in this restricted sense, it is a branch of psychology.

People operate within a marketplace and attach values to their goods and services and to their inputs (work, capital, natural endowments) through the price mechanism. This elaborate construct, however, depends greatly on trust. If people were not to trust each other and / or the economic framework (within which they interact) - economic activities would have gradually ground to a halt. A clear inverse relationship exists between the general trust level and the level of economic activity.

There are four major types of trust:

1. Trust related to Intent - the market players assume that other players are (generally) rational, that they have intentions, that these intentions conform with the maximization of benefits and that people are likely to act on their intentions.

2. Trust related to Liquidity - the market players assume that other players possess or have access, or will possess, or will have access to the liquid means needed in order to materialize their intentions and that - barring force majeure - this liquidity is the driving force behind the formation of these intentions. People in possession of liquidity wish to maximize the returns on their money and are driven to economically transact.

3. Trust related to knowledge and ability - the market players assume that other players possess or have access to, or will possess, or will have access to the know-how, technology and intellectual

property and wherewithal necessary to materialize their intention (and, by implication, the transactions that they enter into). Another assumption is that all the players are "enabled": physically, mentally, legally and financially available and capable to perform their parts as agreed between the players in each and every particular transaction. A hidden assumption is that the players evaluate themselves properly: that they know their strengths and weaknesses, that they have a balanced picture of themselves and realistic set of expectations, self esteem and self confidence to support that worldview (including a matching track record). Some allowance is made for "game theory" tactics: exaggeration, disinformation, even outright deception - but this allowance should not overshadow the merits of the transaction and its inherent sincerity.

4. Trust related to the Economic horizon and context - the market players assume that the market will continue to exist as an inert system, unhindered by external factors (governments, geopolitics, global crises, changes in accounting policies, hyperinflation, new taxation - anything that could deflect the trajectory of the market). They, therefore, have an "investment or economic horizon" to look forward to and upon which they can base their decisions. They also have cultural, legal, technological and political contexts within which to operate. The underlying assumptions of stability are very much akin to the idealized models that scientists study in the accurate sciences (indeed, in economy as well).

When one or more of these basic building blocks of trust is fractured that the whole edifice of the market crumbles. Fragmentation ensues, more social and psychological than economic in nature. This is very typical of poor countries with great social and economic polarization. It is also very typical of countries "in transition" (a polite way to describe a state of total shock and confusion). People adopt several reaction patterns to the breakdown in trust:

a. Avoidance and isolation - they avoid contact with other people and adopt reclusive behaviour. The number of voluntary interactions decreases sharply.

b. Corruption - People prefer shortcuts to economic benefits because of the collapse of the horizon trust (=they see no long term future and even doubt the very continued existence of the system).

c. Crime - Criminal activity increases.

d. Fantastic and Grandiose delusions to compensate for a growing sense of uncertainty and fear and for a complex of inferiority. This nagging feeling of inferiority is the result of the internalization of the image of the people in their own eyes and in the eyes of others. This is a self-reinforcing mechanism (vicious circle). The results are under-confidence and a handicapped sense of self esteem. The latter undulates and fluctuates from overvaluation of one's self and others to devaluation of both.

e. Hypermobility - People are not loyal to the economic cells within which they function. They switch a lot of jobs, for instance, or ignore contracts that they made. The concepts of exclusivity, the sanctity of promises, loyalty, future, a career path - all get eroded. As a result, there is no investment in the future (in the acquisition of skills or in long term investments, to give but two examples).

f. Cognitive Dissonance - The collapse of the social and economic systems adversely affects the individual. One of the classic defence mechanisms is the cognitive dissonance. The person involved tells himself that he really chose and wanted his way of life, his decrepit environment, his low standard of living, etc. ("We are poor because we chose not to be like the inhuman West").

g. The Pathological Envy - The Cognitive Dissonance is often coupled with a pathological envy (as opposed to benign jealousy). This is a destructive type of envy which seeks to deprive others of their successes and possessions. It is very typical of societies with a grossly unequal distribution of wealth.

h. The Mentality (or the Historical) Defences - these are defence mechanisms which make use of an imagined mentality problem ("we are like that, we have been like this for ages now, nothing to do, we are deformed") - or build upon some historical pattern, or invented pattern ("we have been enslaved and submissive for five centuries - what can you expect").

i. The Passive-Aggressive reaction: occurs mainly when the market players have no access to more legitimate and aggressive venues of reacting to their predicament or when they are predisposed to suppressing of aggression (or when they elect to not express it). The passive-aggressive reactions are "sabotage"-type reactions: slowing down of the work, "working by the book", absenteeism, stealing from the workplace, fostering and maintaining bureaucratic procedures and so on.

j. The inability to postpone satisfaction - The players regress to a child-like state, demanding immediate satisfaction, unable to postpone it and getting frustrated, aggressive and deceiving if they are required to do so by circumstances. They engage in short term activities, some criminal, some dubious, some legitimate: trading and speculation, gambling, short termism.

The results are, usually, catastrophic:

- A reduction in economic activity, in the number of interactions and in the field of economic potentials (the product of all possible economic transactions).
- An erosion of the human capital, its skills and availability.
- Brain drain - skilled people desert, en masse, the fragmented economic system and move to more sustainable ones.
- Resort to illegal and to extra-legal activities.

- Social and economic polarization. Interethnic tensions and tensions between the very rich and the very poor tend to erupt and to explode.

And this is where most countries in transition are at right now. To a large extent, it is the fault of their elites. Providing orientation and guidance is supposed to be their function and why society invests in them. But the elites in all countries in transition - tainted by long years of complicity in the unseemly and the criminal - never exerted moral or intellectual authority over their people. At the risk of sounding narcissistic, allow me to quote myself (from "The Poets and the Eclipse"). Replace "intellectuals of the Balkan" with "intellectuals of the countries in transition":

"The intellectuals of the Balkans - a curse, not in disguise. a nefarious presence, ominous, erratic and corrupt. Sometimes, at the nucleus of all conflict and mayhem - at other times (of ethnic cleansing or suppression of the media) conspicuously absent. Zeligs of umpteen disguises and ever-changing, shimmering loyalties.

They exert no moderating, countervailing influence - on the contrary, they radicalize, dramatize, poison and incite. Intellectuals are prominent among all the nationalist parties in the Balkans - and rare among the scant centre parties that have recently sprung out of the ashes of communism.

They do not disseminate the little, outdated knowledge that they do possess. Rather they keep it as a guild would, unto themselves, jealously. In the vanity typical of the insecure, they abnegate all foreign knowledge. They rarely know a second language sufficiently to read it. They promote their brand of degreed ignorance with religious zeal and punish all transgressors with fierceness and ruthlessness. They are the main barriers to technology transfers and knowledge enhancement in this wretched region. Their instincts of self preservation go against the best interests of their people. Unable to educate and teach - they prostitute their services, selling degrees or corrupting themselves in politics. They make up a big part of the post communist nomenclature as they have a big part of the communist one. The result is economics students who never heard of Milton Friedman or Kenneth Arrow and students of medicine who offer sex or money or both to their professors in order to graduate.

Thus, instead of advocating and promoting freedom and liberalization - they concentrate on the mechanisms of control, on manipulating the worn levers of power. They are the dishonest brokers of corrupted politicians and their businessmen cronies. They are heavily involved - oft times the initiators - of suppression and repression, especially of the mind and of the spirit. The black crows of nationalism perched upon their beleaguered ivory towers.

The intellectuals of the Balkans failed miserably. Terrified by the sights and sounds of their threatened territory - they succumbed to obscurantism, resorted to the nostalgic, the abstract and the fantastic, rather than to the pragmatic. This choice is evident even in their speech. Marred by centuries of cruel outside domination - it is all but meaningless. No one can understand what a Balkanian has to say. Both syntax and grammar are tortured into incomprehensibility. Evasion dominates, a profusion of obscuring verbal veils, twists and turns hiding a vacuous deposition.

The Balkan intellectuals chose narcissistic self absorption and navel gazing over 'other-orientation'. Instead of seeking integration (as distinct from assimilation) - they preach and practice isolation. They aim to differentiate themselves not in a pluralistic, benign manner - but in vicious, raging defiance of 'mondialism' (a Serbian propaganda term). To define themselves AGAINST all others - rather than to compare and learn from the comparison. Their love affair with a (mostly concocted) past, their future-phobia, the ensuing culture shock - all follow naturally from the premises of their disconsolate uniqueness. Balkan intellectuals are all paranoids. Scratch the surface, the thin, bow tied, veneer of 'kultur' - and you will find an atavistic poet, fighting against the very evil wrought by him and by his actions. This is the Greek tragedy of this breathtaking region. Nature here is cleverer than humans. It is exactly their conspiracies that bring about the very things they have to conspire against in the first place.

All over the world, intellectuals are the vanguard, the fifth column of new ideas, the resistance movement against the occupation of the old and the banal. Here intellectuals preach conformity, doing things the old, proven way, protectionism against the trade of liberal minds. All intellectuals here - fed by the long arm of the state - are collaborators. True, all hideous regimes had their figleaf intellectuals and with a few exceptions, the regimes in the Balkans are not hideous. But the principle is the same, only the price varies. Prostituting their unique position in semi-literate, village-tribal societies - intellectuals in the Balkans sold out en masse. They are the inertial power -

rather than the counterfist of reform. They are involved in politics of the wrong and doomed kind. The Balkan would have been better off had they decided to remain aloof, detached in their archipelago of universities.

There is no real fire in Balkan intellectuals. Oh, they get excited and they shout and blush and wave their hands ever so vigorously. But they are empty. It is full gas in neutral. They get nowhere because they are going nowhere. They are rational and conservative and some are emotional and "leftist". But it is all listless and lifeless, like the paces of a very old mechanism, set in motion 80 years ago and never unwound.

All that day of the eclipse of the last millennium, even the intellectuals stayed in their cellars and in their offices and did not dare venture out. They emerged when night fell, accustomed to the darkness, unable to confront their own eclipse, hiding from the evil influence of a re-emerging sun."

A Note on Resistance to Learning

"It is impossible for a man to learn what he thinks he already knows."
Epictetus

The denizens of the Balkans resist learning. They reject newfangled knowledge not because they are traditionalists - but because they are craven and because they are pragmatic.

Craven first:

In the paranoid and surrealistic landscape of the former Soviet Bloc, to admit to ignorance is to publicly acknowledge a deficiency, a personal defeat, and a shortcoming. It is to hand your foes a weapon. It is not only a narcissistic injury (and that it is), but also a guaranteed professional suicide.

Thus, in the interest of self-preservation, it is more advisable to invent "facts" than to search for them; to claim education than to seek it; and to feign erudition than to acquire it. Ill-informed professors pass on their half-baked notions and inane "theories" from one molested generation to another in a vast conspiracy aided by the lack of access to foreign texts and outside experts.

Insecurity bred by nescience yields conformity and rigid "conservatism". Toeing the line is a survival strategy, not rocking the boat a religious principle, the boorish quid pro quo of Luddites, quacks, and conspiracy theorists the only form of "higher education".

Inevitably, as a purely defensive posture, a monopoly of "learning" has emerged in all these geographical domains. Real knowledge, propounded by genuine (typically, Western) experts threatens to unravel this unholy cartel, counteract the vested interests it reifies, and shatter the ersatz "scholarship" it is founded upon. Hence the fierce objection to any outside "interference" and "intrusion". Provincialism and obscurantism are elevated to the level of an ideology.

Nor is there a grassroots movement of minds eager for intellectual edification and cross-fertilization. Education is a loss-making proposition. Formal training goes unrewarded in these nether regions. Nepotism and cronyism reign supreme. One's advancement, future prospects, and career depend on one's connections or family of origin. One's peers are perforce disqualified to judge one's progress and accomplishments, having been educated by the same inapts and oil snake salesmen that here pass for "professors". Indeed, why bother with textbooks and exams when social networking gets you places faster and far more securely?

Electricity (Markets in Central and Eastern Europe)

Russia's lower house, the Duma, debated, in November 29, 2002 a far reaching reform in the bloated and inefficient electricity generation sector. Worried by resurging inflation, the Russian government scrapped its plan to allow the Federal Energy Commission to fix tariffs for gas, power, and railways. A Commission spokesman complained to Moscow Times that government officials have overridden its authority to regulate the prices of natural monopolies. It threatened to take the matter to court.

Electricity throughout the former Soviet bloc is heavily subsidized. Governments are reluctant to raise prices to realistic levels lest they incur the wrath of their impoverished subjects and reignite dormant inflation. Fuel prices, government taxes, and variable costs, such as labor, have been rising steeply in the last decade but the electricity behemoths' ability to amend their tariffs to reflect these is politically curbed.

The Russian Unified Energy Systems electricity monopoly was allowed to up its prices in 2002 by a mere

14 percent - barely the rate of Russian inflation. Its chances to attract the $50 billion in investments it says it needs in the forthcoming 10 years are slim as long as it continues to charge its customers - both wholesale and retail - a fraction of the cost of electricity its West European counterparts charge theirs. A restructuring plan, approved by the government in May 2001, is going nowhere. The sale of loss making generating plants - even at bargain basement prices and to insiders - is impossible without a massive - and massively unpopular - boost to electricity prices.

Vociferous protests in Croatia in October 2002 forced the government to shelf a scheduled 9 percent hike in the price of electricity for domestic consumption. The IMF is displeased with the government's stranglehold over the energy sector and is pushing for liberalization. Slovakia's news agency, TASR, reported in November 2002 that thousands of members of the Trade Unions Confederation demonstrated in Bratislava against proposed budget cuts and increases in regulated prices, including electricity's.

Still, consumers will not be able to buck the trend forever. Even the rich countries of the region are facing already unsustainable electricity subsidy bills. The Slovenian news agency, STA, reported on November 14, 2002 that Slovenian producers of electricity and natural gas warned that - once the domestic market opens to foreign competition in January 2003 - they will be at a disadvantage due to the unrealistic electricity "price model". In hindsight, this proved to be wrong.

Yet, liberalization and privatization have acquired a bad name after the debacles in California and elsewhere in the world. Moreover, electricity generation depends on a free market in fuels - a rarity in central and eastern Europe. Prices cannot rise above the increase in net disposable income.

As infrastructure crumbles, replacement costs soar. The Albanian Daily News reported that in the 12 months to September 2002, Albania's electricity self-sufficiency decreased from 66 percent to 46 percent. Power cuts of up to 18 hours a day are not rare. The same applies to Kosovo, where an electric storm demolished the local generation plant in July 2002, and to Montenegro.

The dependence of many countries in transition on decrepit and antiquated nuclear power plants causes friction with the European Union. Austria and the Czech Republic have clashed over the much-disputed Temelin facility. Croatia and Slovenia are locked in a bitter dispute over their shared ownership of the Krsko nuclear plant.

Lithuania derives 78 percent of its power the atomic way. Slovakia gets 53 percent of its electricity from its reactors, Ukraine - 46 percent, Bulgaria, in the throes of a controversial plan to modernize its nuclear works in Kozloduy, 42 percent, Hungary and Slovenia - 39 percent.

Nor can pure market mechanisms solve the problem. Late in 2001, hundreds of Romas, having been cut off the grid for unpaid bills, demonstrated in Plovdiv and in Lom, Bulgaria. Remote and rural areas are poorly catered to even by state-owned utilities, let alone by privatized ones.In December 2001, the Romanian government restructured Electrica, an electricity utility, but wisely retained ownership of the long-distance distribution network.

Bulgaria is emerging as an energy hub. The cabinet is drafting a bill which calls for far-reaching liberalization. Subsidies for both electricity and heating would be phased out by 2006. The country is refurbishing its thermal power generation plants with an aim to reduce its dependence on oil, gas and coal imports from Russia and Ukraine.

Bulgaria is slated to establish a regional energy distribution coordination centre under the auspices of the Stability Pact. Bulgaria covers 40-50 percent of southeast Europe's entire electricity deficit every winter. It also exports electricity to Turkey and even to Romania. Italy and Greece are negotiating a transit agreement which will permit the former to import Bulgarian electricity through the latter's territory.

Bulgaria is not the only exporter. Romania, Croatia and even Bosnia sell power. In local terms, the market is sizable. Serbia's annual electricity import bill amounts to $100 million. In 2001, Bulgaria's exports to Turkey, Greece and Yugoslavia reached $150 million. The annual figure is much higher since 2002. Romania doubled its electricity exports - mostly to Yugoslavia and Greece - during the first half of 2002 to $48 million.

Aware of this, the World Bank has recently increased the amount of money allocated to energy projects. In Albania alone, it has earmarked $16m to reconstruct three hydropower plants and another $1 million to install electricity meters in Shkoder, in the north. Even the pariah Republika Srpska, the Serb part of Bosnia-Herzegovina, stands to get $90 million to construct an electricity grid.

Multilateral funds will not be enough, though. Private capital is essential. In mid-2002, Macedonia has retained

Austria's Meinl Bank to act as consultant and prepare within 11 months a sales strategy for the its national electricity company ESM. That won't be easy. The utility is in horrendous shape having served as the outgoing coalition's agency of patronage and cash cow. The country was reduced to importing more than one ninth of its consumption from Bulgaria. Indeed, real no progress was made by July 2005.

The more venal and xenophobic the political class, the less welcome are foreign investors. The Moldovan government seeks to annul the sale, in 2000, of three electricity distribution companies to Union Fenosa, a Spanish energy group. The World Bank is furious. Moldovan announcements of massive exports of electricity to Romania were greeted with derision by the alleged client.

Private investors, though, seem to have lost their appetite for bloated state monopolies. According to Albania's Ministry of Industry and Energy, even a giant like General Electric prefers to build 10 small thermal power plants in the country's larger cities. Other investors are interested in 23 hydropower plants about to be privatized.

Some utilities choose to tap the capital markets. Romania's Hidroelectrica launched a Eurobond issue of more than 120 million euros to improve hydropower equipment. Parex Bank and the Baltic investment company, Suprema, organized a consortium to lend $25 million to reconstruct one of Riga's thermoelectric power stations.

Electricity is no longer merely a national affair, but, rather, a regional one. A memorandum regarding the establishment of a southeast European energy market and its ultimate integration with the European Union's was signed In mid-November 2002 in Athens by ministers from Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Greece, Macedonia, Romania and Yugoslavia. These represent a market with more than 55 million consumers who will be able to buy power directly from generating utilities by 2005, pledged the document. As it turned out, another pipe dream.

But this touches upon a second conundrum. Households and firms don't pay their bills. The threat of widespread social unrest prevents the utilities from cutting them off. Better metering is one solution. The InvestRomania business daily reports that the national electricity company, Transelectrica, backed by the European Bank for Reconstruction and Development, signed a $20 million contract with the Swiss firm Landis&Gyr to install remote counters of wholesale electricity. The hope is that with resumed growth and rising incomes this problem will vanish together with the currently common blackouts and brownouts.

Interview with Aleksandar Dimishkovski of BID Consulting, Macedonia

Conducted: September 2007

Until recently and for four years, Aleksandar Dimishkovski worked as a business and finance correspondent in Macedonia's best-selling daily newspaper, "Dnevnik". In the past year, he also served as a personal advisor to the general manager of a foreign-owned company that has established its network in Macedonia. He is known as a market analyst and a business consultant and has recently founded "BID Consulting".

Q: Has the electricity grid throughout the Balkans and in Macedonia in particular improved or deteriorated in the last ten years? How did privatization and restructuring influence each of the components in the chain from electricity generation to the end consumer?

AD: The electricity grid throughout the Balkans at this point doesn't differ a lot from the time when socialistic regimes ruled this part of the world. Considering the time frame, surely it is not correct to say that the investments done to increase the quality of the electricity grids and especially in the cross-country transmission grids were satisfactory. There was some increase of inter-transmission capacity, but not enough to ensure the transmission of the demanded quantities of electricity. The quality of the national electric grids varies from country to country but is commonly low. Macedonia for instance, has network losses of more than 30 percent annually, which is around five times the average in the European Union (EU) countries.

On the other hand, the investments in electricity generation pretty much changed the picture in the Balkans regarding which country now has enough quantities of electricity from domestic production, which country is able to export and which country is an electricity importer.

What is common to the majority of the countries in the Balkans now is the fact that they all are importers of electricity, with the exceptions of Romania and Bulgaria. These two countries have done a lot to ensure their position in the Balkans energy market, even through a privatization process, although at this point it may not seem so evident, especially in the case of Bulgaria, because of the shut down of two reactors in the nuclear power plant Kozloduy. Nevertheless, both countries - now EU members - are still investing billions in new electricity generation facilities and they will likely secure the lead on the electricity export side.

However, this is not the case with the countries of the former Yugoslavia. Most of them managed to finish the necessary privatization and reforms, but they all seem to have forgotten about the importance of investments in production. That contributed to the current state of things where the majority of the countries in the Balkans are importers.

Albania and Greece followed the same tendency not to invest, and after 15 years they are still lacking investments in electricity generation, which is demonstrated by the increase in the imported quantities of electricity.

The biggest paradox is that in most countries there are still incredibly low prices of electricity, which are a by-product of omnipresent subsidies. These prices can't be supported by any economic or commercial reason, the social aspect notwithstanding.

3. You are predicting a crisis in electricity generation and provision in Macedonia this coming winter 2007. Can you explain what is this gloomy scenario based on?

AD: It is based mainly on the dearth of electricity in the whole region. At this point, Macedonia imports around 30 percent of the quantities needed to satisfy consumption. And with the present level of expected domestic production, there surely will be a gap between demand and supply. This is especially so because of the fact that in Macedonia, during the winter months, the level of consumption is almost twice as big as in the summer months.

In fact, because of draught and other summer-related problems, the water potential for generation of electricity via hydro power plants at the moment is at very low level, lower than 20 percent.

Another problem is the steady growth in consumption. Macedonia has one of the highest rates of growth of electricity consumption in the whole region. And the predictions are that in the medium term, growth will constantly and drastically accelerate.

What adds fuel to the fire is the present situation in the entire region. Albania faced and faces a major energy crisis. Greece is constantly increasing the its imported quantities of electricity. In the wake of the closure of two reactors Kozloduy in January 2006, there simply isn't enough electricity to go round. The whole region is facing an energy crisis. Bulgaria, which was one of the biggest exporters of electricity in Europe, has recently started to import it!

The Balkans lacks electricity generation facilities. In such a constellation it is normal for electricity prices to increase. Bearing in mind the fact that in many countries electricity prices are still heavily subsidized, it is normal to expect problems, even from the macroeconomic point of view.

Macedonia is maybe in the worst position at the moment. Its market is too small to be interesting for the big European energy "players" and it is not financially powerful, compared to the other countries in the region. So, Macedonia is unable either to invest in the expansion of its electricity generation or to buy and import electricity.

4. Is hydroelectric power the solution? What about alternative sources (wind, solar, nuclear)? Will the construction of additional plants solve the problem in the short term? Is microgeneration a viable option?

AD: Hydroelectric power is a definite possibility but only in the long term. It takes a while for a hydro power plant to be built and become operational, at least three to five years, depending on its size. In fact it may be the best solution, because Macedonia now uses around 30 percent of its hydro potential for electricity generation.

Unfortunately, it can't be used as core energy. It is too dependant on external influences and factors, such as the weather. If a dry season occurs, than the whole system is at risk. But it can and it must be used more than the present level of usage. Wind and the solar energy are good options as well. Nevertheless, they are also merely supplements to the basic energy market.

Nuclear energy on the other hand, is out of the question for many reasons, even from a legal point of view. The Macedonian parliament has passed a declaration that forbids the use of a nuclear energy for electricity generation on Macedonian territory. Besides that, the geographic conditions are very inappropriate for building a nuclear power plant. Even the cooling of a nuclear reactor could be a problem, because it requires a lot of water.

The best solution is to have combined production. As a base or core energy, we could use thermal power plants as the situation is now. They run on coal extracted from Macedonian territory. This, in conjunction with the use of natural gas for electricity production could secure Macedonia's energy needs in the next 50 years. Understandably, this has to be combined with the deployment of renewable sources of energy on both the micro and on macro level.

In any case, the construction of additional plants can't be a short term solution, because it takes time for a power plant to be built. For instance: LNG (natural gas) power plants require the shortest construction time, yet even this process usually takes at least two years.

5. Electricity in Macedonia and throughout the region is heavily subsidized. Do you foresee a reduction in this state support?

AD: Unfortunately, subsidies are one of the biggest reasons for the upcoming energy crisis. Because of the low price, there simply wasn't any money for investments in electricity generation, although in the price structure there is a part that supposedly should be spent on investments. Even now, the price that households pay for electricity and even the price for industry are lower than they should be.

Nevertheless, with the signing of the Athens Memorandum, and the creation of the Energy

Community, Macedonia is obliged to liberalize the energy market, with a view towards achieving the market conditions present in the EU zone. So, subsidies will very soon be out. The qualified consumers – industrial facilities - will be forced to secure their own deals for electricity supply in the open market, starting from January 2008.

It is predicted that the total liberalization of the electricity market will be in place at the beginning of 2015, at which time even households will choose from whom to buy their electricity.

At this point, the organizational structure of the electricity market in the country is not well prepared for these processes, and this could contribute towards some delay in the liberalization process. But it is inescapable and with the aspirations of Macedonia to become a member of the EU, the sooner they are implemented, the better it is for the integration process as well.

6. Can you describe the structure of the electricity export market in the region? Who is exporting, who is importing, and who are likely to become net exporters and net importers in the foreseeable future?

AD: That's an easy one. Almost all the countries of the Balkans are net importers, except Romania and Bulgaria. Recently, even Bulgaria started to import small quantities. But, these two countries had invested enough to secure their future as exporters of electricity. For instance, Bulgaria is rushing to build a second nuclear power plant in Belene, near the border with Romania, which should be finished in around five years. Romania too, started the construction of another nuclear power plant.

As to the rest of the Balkan countries, there are some signs of positive change, but it is still unclear, who, when and if some of the countries would be able to become net exporters of electricity. If we exclude Albania whose system is pretty much based on hydroelectric power, the other countries are quite similar. The majority have coal-fuelled electricity production as core energy. This is made possible by their sizes- most of these countries have small territories - and by the unused potential in many of them.

Still, at this point, it seems like in the near future, we shouldn't expect any drastic changes in the electricity production field in the Balkans. And even if something does change, it is likely to be negligible, both from the energetic point of view, as well as the financial one.

Employee and Management Owned Firms

Margaret Thatcher started a world trend during her tenure as Prime Minister is Downing Street. It is called: Privatization. It consisted of the transfer of control of a state-owned enterprise to the Private Sector. This was done by selling the shares of the company. At times, the control itself was maintained by the state - but the economic benefits emanating from the ownership of shares was partly sold to privates. Such economic benefits are comprised of the dividend yield of the shares plus the appreciation in their value (due to the involvement of the private sector) known as capital gains.

But the privatization process was not entirely homogeneous, uniform, transparent, or, for that matter, fair.

The stock of some of the enterprises was sold to an individual, or group of individuals, by a direct, negotiated sale. A "controlling stake" (nucleus) was thus sold, ostensibly yielding to the state a premium paid by the private investors for the control of the sold firm.

This method of privatization was criticized as "crony capitalism". For some reason, a select group of businessmen, all cronies of the ruling political elite, seemed to benefit the most. They bought the controlling stakes at unrealistically low prices, said the critics. To support their thesis, they pointed to the huge disparity between the price at which the "cronies" bought the shares - and the price at which they, later, sold it to the public through the stock exchange. The "cronies" cried foul: the difference in the prices was precisely because of privatization, better management and financial control. Maybe. But the recurrence of the same names in every major privatization deal still looked suspiciously odd.

Then there was the second version: selling the shares of the privatized firms directly to the public. This was done using either of two methods:

1. An offering of the shares in the stock exchange (a cash method), or

2. The distribution of vouchers universally, to all the adult citizens of the country, so that they could all share the wealth accumulated by the state in an equitable manner. The vouchers are convertible to baskets of shares in a prescribed list of state enterprises (a nonchash method).

But a smaller group of (smaller) countries selected a whole different way of privatizing. They chose to TRANSFORM the state-owned firm instead of subjecting them to outright privatization.

Transformation - the venue adopted by Macedonia - is the transfer of the control of a firm and / or the economic benefits accruing to its shareholders to groups which were previously - or still are - connected to the firm.

In this single respect, transformation constitutes a major departure - not to say deviation - from classical privatization.

Ownership of the transformed firm can revert to either of the following groups, or to a combination thereof:

1. The employees of the firm, through a process called Employee BuyOut (EBO).

2. The management of the firm, in the form of a Management BuyOut or Buy In (MBO / MBI).

3. A select group from within the firm. Such a group uses the assets - current and future - of the firm as collaterals, thus enabling them to get the credits necessary to purchase the shares of the firm. This is called a Leveraged BuyOut, because the assets of the firm itself are leveraged in order to purchase it (LBO).

4. Finally, the creditors of the firm can team up and agree to convert the firm's debts to them into equity in the firm, in a Debt to Equity Swap (DES).

Sometimes, the state continues to maintain an interest in privatized - as well as in transformed - firms. This is especially true for natural monopolies, utilities, infrastructure and defence industries. All the above are considered to be strategic matters of national interest. Some countries - Russia and Israel, for ones - continue to own a "Golden Share". This highly specific type of security allows the state to exercise decision making powers, veto powers, or, at least, control over business matters that it considers vital to its security, financial viability, or even to its traditions. Israel's golden share in the national air carrier, EI AI, allows it to prevent flights in and out during the religiously holy day of Sabbath!

Until very recently the common (economic) wisdom in the West had it that Transformation was - in the best case - a sterile, make - believe exercise. The worst case included cronyism and corruption. One thing was to privatize and another was to privateer. But there were some grounds for some solid criticisms as well:

(1) The main ideological thrust behind privatization was the revitalization of stale and degenerated state firm. Badly managed, wrongly financially controlled, applying an incoherent admixture of business and non business (political, social, geopolitical) considerations to their decision making process - state firm were considered as anachronistic as dinosaurs. Many preferred to see them as extinct as those ancient reptiles. An injection of private initiative acquired the status of ideological panacea to the corporate malaise of the public sector.

But this is precisely what was missing in the Transformation version. It offered nothing new: no new management, no new ideas (were likely to come from the same old team) and, above all and as a direct result of this preference of old over new - no new capital.

To this, the supporters of Transformation answer that the one thing which is new - personal capitalistic incentives - far outweighs all the old elements. Incentive driven initiative is likely to bring in its wake and to herald the transformation - in the most complete and realistic sense - of the state firm.

Change, renovation and innovation - say the latter - are immediate by products of personal profit motivation, the most powerful known to Mankind.

(2) The process of Transformation blurred the distinction between labour, management and ownership. Employees acted as potential managers and as co-owners in the newly transformed companies. The very concept of hierarchy, clear chains of authority (going down) and of responsibility (going up) - was violated. A ship must have one captain lest it sinks. It is not in vain that the management function was separated from the ownership function. Employees, managers and owners, all have differing views and differences of opinion concerning every possible aspect of corporate governance and the proper conduct of business.

Employees want to maximize employment and the economic benefits attached to it - managers and shareholders wish to minimize this parameter and its effects on the corporation. Managers wish to maximize their compensation - employees and owners wish to minimize or moderate it, each group for its own, disparate reasons.

This break in the "chain of command", this diffusive, fog like property of the newly transformed entity lead to dysfunction, financial mismanagement, lack of clarity of vision and of day to day operations, labour unrest (when the unrealistic expectations of the workforce are not met).

So, at the beginning, during the 1980s, the West preferred to privatize state owned firms - rather than to transform them. A fast accumulating body of economic research demonstrated unambiguously that privatization did miracles to the privatized firms. In certain cases, productivity shot up 6 times. Between 60 to 80 percent of GNPs in the West are private now and a vigorous trend to privatize what remains of the public sector still persists.

But the same studies revealed a less pleasant phenomenon: only a select group of businessmen benefited from privatization. The paranoid allusions of the critics of this process were completely substantiated. Something was very corrupted in implementation of the seemingly wholesome idea of privatization. The public - as a whole - economically suffered.

This led to the emergence of a new social consciousness. It was provoked by the unacceptable social costs of capitalism: more people under the poverty line, homelessness, a radicalization in the inequity of the distribution of income among different strata of society. But this trend was enhanced by the apparent corruption of the privatization process.

This new social consciousness converged with yet another all important and all pervasive trend: the formation of small businesses by small time entrepreneurs. The latter functioned both as owners and as employees in their firms. There were 16 million such owners-workers in the USA alone (1995 figures). About 99% of the 22 million registered businesses in the USA were small businesses. No economic planner or politician could ignore these figures. Employee owned firms became the majority in the service and advanced technology sectors of the economy - the fastest growing, most lucrative sectors.

In its own way, as a result of these two trends, the West was moving back to transformation and away from privatization, away from separation of ownership and labour, away from differentiation between capital and workforce. This is a major revolution.

The OECD (the organization of the richer countries in the world) established an institute which follows trends in the poorer parts of the world, politely called "Economies in Transition". This is the CCET.

According to the CCET's latest report, privatization continues in an uneven pace throughout the former Eastern Bloc. Some countries nearly completed it. Others have claimed to have completed it - but haven't even started it in reality. Some countries - Macedonia amongst them - have sold the shares of state owned firms (=businesses with social capital) to managers and workers - but the managers and workers have largely not paid for these shares yet. It is by no means certain that they will. If the managers and workers default on their obligations to pay the state - the ownership of the company will revert back to the state. This is paper privatization, a transformation of expectations. No one can seriously claim that the transformation is completed before the new owners of the firms respect their financial obligations to the state.

In all, privatization the world over, proceeded more rapidly with small firms. Selling the bigger firms was much more difficult. Most of this behemoths were composed of numerous profit centres and loss making business activities. A solidarity of accounts and guarantees existed between the various operations. The more profitable parts of a company supported and subsidized the less competent, the losing parts. This was not very attractive to investors.

The official figures are heart warming. In parentheses - the percentage of firms privatized:

Albania , Czech Republic , Estonia , Hungary , Lithuania, Poland and Slovakia all privatized 90% of their small firms. In Russia and Latvia, the figure is 70%.

The picture is more clouded with the larger firms:

Czech Republic (81%), Hungary, Estonia (75%), Lithuania (57%), Russia (55%), Latvia and Slovakia (46%), Mongolia (41%), Poland (32%), Moldavia (27%), Romania (13%), Belarus and Bulgaria (11%), Georgia (2%).

But what hides behind the figures?

The Czech Republic is infamous for its cronyism and for the massive transfer of wealth to the hands of a few people close to government circles.

On the face of it, the situation in Poland looks a bit better: a universal voucher system was instituted. People were allowed to deposit their shares with 14 management funds. These funds also bought some of the shares, making them part owners. They control now 500 enterprises, which make up 5% of the country's GNP.

Some of these funds are 50% foreign owned, so their management and moral standards are Western. But, even there, rumours abound and not only rumours.

So, what is better - privatization or transformation?

Maybe the lesson is that we are all human. There is no method immune to human fallacies and desires, to corruption or to allegations of it. Transformation tends to benefit more people - so, maybe it looks more just. But long term it is inefficient and leads to the ruining of the firms involved and to permanent damage both to the economy and to the workers-owners. Is it better to be the owner of a bankrupt firm - or to work in a functioning firm, where you have no ownership stake? This is not an ideological or a philosophical question. Ask the employees of the Pelagonija Construction Group.

Privatization, on the other hand, is much more open to manipulation - but at least it secures the continued existence of the firms and the continuous employment of the workers.

Sometimes, in economic reality, we have to give up justice (or the appearance of it) - in order to secure the very survival of the workers involved.

Energy Security

The pursuit of "energy security" has brought us to the brink. It is directly responsible for numerous wars, big and small; for unprecedented environmental degradation; for global financial imbalances and meltdowns; for growing income disparities; and for ubiquitous unsustainable development.

It is energy ***insecurity*** that we should seek.

The uncertainty incumbent in phenomena such "peak oil", or in the preponderance of hydrocarbon fuels in failed states fosters innovation. The more insecure we get, the more we invest in the recycling of energy-rich products; the more substitutes we find for energy-intensive foods; the more we conserve energy; the more we switch to alternatives energy; the more we encourage international collaboration; and the more we optimize energy outputs per unit of fuel input.

A world in which energy (of whatever source) will be abundant and predictably available would suffer from entropy, both physical and mental. The vast majority of human efforts revolve around the need to deploy our meager resources wisely. Energy also serves as a geopolitical "organizing principle" and disciplinary rod. Countries which waste energy (and the money it takes to buy it), pollute, and conflict with energy suppliers end up facing diverse crises, both domestic and foreign. Profligacy is punished precisely because energy in insecure. Energy scarcity and precariousness thus serves a global regulatory mechanism.

But the obsession with "energy security" is only one example of the almost religious belief in "scarcity".

Enlargement (of European Union)

European Union (EU) leaders, meeting in Copenhagen, are poised to sign an agreement to admit ten new members to their hitherto exclusive club. Eight of the fortunate acceders are former communist countries: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia. Bulgaria and Romania are tentatively slated to join in 2007. The exercise will cost in excess of $40 billion over the next three years. The EU's population will grow by 75 million souls.

In the wake of the implosion of the USSR in 1989-91, the newly independent countries of the Baltic and central Europe, traumatized by decades of brutal Soviet imperialism, sought to fend off future Russian encroachment. Entering NATO and the EU was perceived by them as the equivalent of obtaining geopolitical insurance policies against a repeat performance of their tortured histories.

This existential emphasis shifted gradually to economic aspects as an enfeebled, pro-Western and contained Russia ceased to represent a threat. But the ambivalence towards the West is still there. Mild strands of paranoid xenophobia permeate public discourse in central Europe and, even more so, in east Europe.

The Czechs bitterly remember how, in 1938, they were sacrificed to the Nazis by a complacent and contemptuous West. The Poles and Slovenes fear massive land purchases by well heeled foreigners (read: Germans). Everyone decries the "new Moscow" - the faceless, central planning, remote controlling bureaucracy in Brussels. It is tough to give up hard gained sovereignty and to immerse oneself in what suspiciously resembles a loose superstate.

But surely comparing the EU or NATO to the erstwhile "Evil Empire" (i.e., the Soviet Union) is stretching it too far? The USSR, after all, did not hesitate to exercise overwhelming military might against ostensible allies such as Hungary (1956) and the Czechoslovaks (1968)? Try telling this to the Serbs who were demonized by west European media and then bombarded to smithereens by NATO aircraft in 1999.

Though keen on rejoining the mainstream of European history, civilization and economy, the peoples of the acceding swathe are highly suspicious of Western motives and wary of becoming second-class citizens in an enlarged entity. They know next to nothing about how the EU functions.

They are chary of another period of "shock therapy" and of creeping cultural imperialism. Rendered cynical by decades of repression, they resent what they regard as discriminatory accession deals imposed on them in a "take it or leave it" fashion by the EU.

Anti-EU sentiment and Euroscepticism are vocal - though abating - even in countries like Poland, an erstwhile bastion of Europhilia. Almost two thirds of respondents in surveys conducted by the EU in Estonia, Latvia, Slovenia and Lithuania are undecided about EU membership or opposed to it altogether. The situation in the Czech Republic is not much different. Even in countries with a devout following of EU accession, such as Romania, backing for integration has declined this year.

These lurking uncertainties are reciprocated in the west. The mostly Slav candidates are stereotyped and disparaged by resurgent rightwing, anti-immigration parties, by neo-nationalists, trade protectionists and vested interests. Countries like Spain, France, Ireland, Greece and Portugal stand to receive less regional aid and agricultural subsidies from the common EU till as the money flows east.

Core constituencies in the west - such as farmers and low-skilled industrial workers - resent the enlargement project. Anti-Slav prejudices run rampant in Italy, Austria and Germany. The incompatibilities are deepest. For instance, according to research recently published by the Pew Center, the new members are staunchly pro-American, though less so than ten years ago. In stark contrast, the veteran core of the EU is anti-American.

Many of the denizens of the candidate countries regard the EU as merely an extended Germany. It is the focus of numerous conspiracy theories, especially in the Balkan. The losers of the second world war - Japan and Germany - are out to conquer the world, this time substituting money for bullets. Germany, insist the Serbs and the Macedonians - instigated the breakdown of the Yugoslav Federation to establish a subservient Croatia. Wasn't Slobodan Milosevic, the Serb dictator, ousted in favor of the German-educated Zoran Djindjic? - they exclaim triumphantly.

Germany is reasserting itself. United, it is the largest country in Europe and one of the richest. Its forces are keeping the fragile peace in Balkan hot spots, like Macedonia. It will contribute to the EU's long-heralded rapid reaction force. It owns the bulk of the, frequently overdue, sovereign debts of Russia, Ukraine and other east European countries.

One tenth of Germany's trade is with the candidate countries, a turnover comparable to its exchange with the United States. German goods constitute two fifths of all EU trade with the new members. Germans are the largest foreign direct investors throughout the region - from Hungary to Croatia. German banks compete with German-owned Austrian banks over control of the region's fledgling financial sector. The study of German as a second or third language has surged.

Last year alone, German corporations plunged $3.6 billion into the economies of the acceding countries. German multinationals like Volkswagen and Siemens employ almost 400,000 people in central Europe - for one tenth to one eighth their cost in the fatherland.

Quoted by the World Socialist, the German Chamber of Industry and Commerce (IHK) estimates that the production costs in mechanical engineering and plant construction are 20 percent lower in Poland than in Germany, while quality is more or less the same.

Germany runs the EU rather single-handedly, though with concessions to a megalomaniacally delusional France. In September, the German and French leaders, meeting tête-à-tête in a hotel, dictated to other members the fate, for the next 11 years, of half the EU's budget - the portion wasted on the Common Agricultural Policy (CAP).

Germany's hegemonic role is likely to be enhanced by enlargement. Many of the new members - e.g., the Czech Republic - depend on it economically. Others - like

Hungary - share with it a common history. German is spoken in the majority of the candidates. They trade with Germany and German businessmen and multinational are heavily invested in their economies. A "German Bloc" within the EU is conceivable - unless Poland defects to the increasingly marginalized French or to the British.

Germany's federalist instincts - its express plan to create a "United States of Europe", central government and all - are, therefore, understandable, though spurned by the candidate countries. Germany is likely to press for even further enlargement to the east. The EU's commissioner for enlargement is a German, Gunter Verheugen.

The dilapidated expanses of the former Soviet satellites are Germany's natural economic hinterland - on the way to the way more lucrative Asian markets. Hence Germany's reluctance to admit Turkey, a massive, pro-American, potential competitor for Asian favors. Integrating Russia would be next on Germany's re-emerging Ostpolitik.

This firmly places Germany on an economic and military collision course with the United States. As Stratfor, the strategic forecasting consultancy, put it recently: "In Washington's opinion, America's obsessions should be NATO's obsessions." Germany, the regional superpower, has other, more pressing priorities: "maintaining stability in its region, making sure that Russian evolution is benign and avoiding costly conflicts in which it has only marginal interest".

Moreover, there is an entirely different - and much less benign - interpretation of EU enlargement. It is based on the incontrovertible evidence that the German ends in

Europe have remained the same - only the means have changed. The German "September Plan" to impose an economic union on the vanquished nations of Europe following a military victory, called, in 1914, for "(the establishment of) an economic organization ... through mutual customs agreements ... including France, Belgium, Holland, Denmark, Austria, Poland, and perhaps Italy, Sweden, and Norway".

Europe spent the first half of the 19th century (following the 1815 Congress of Vienna) containing a post-Napoleonic France. The Concert of Europe was specifically designed to reflect the interests of the Big Powers, establish the limits to their expansion in Europe, and create a continental "balance of deterrence". For a few decades it proved to be a success.

The rise of a unified, industrially mighty and narcissistic Germany led to two ineffably ruinous world wars. In an effort to prevent a repeat of Hitler, the Big Powers of the West, led by the USA, the United Kingdom and France, attempted to contain Germany from both east and west. The western plank consisted of an "ever closer" European Union and a divided Germany.

The collapse of the eastern flank of anti-German containment - the USSR - led to the re-emergence of a united Germany. As the traumatic memories of the two world conflagrations receded, Germany resorted to applying its political weight - now commensurate with its economic and demographic might - to securing EU hegemony. Germany is also a natural and historical leader of central Europe - the future lebensraum of both the EU and NATO and the target of their expansionary predilections, euphemistically termed "enlargement".

Thus, virtually overnight, Germany came to dominate the Western component of anti-German containment - even as the Eastern component has chaotically disintegrated.

The EU - notably France - is reacting by trying to assume the role formerly played by the USSR. EU integration is an attempt to assimilate former Soviet satellites and dilute Germany's power by re-jigging rules of voting and representation. If successful, this strategy will prevent Germany from bidding yet again for a position of dominance in Europe by establishing a "German Union" separate from the EU.

If this gambit fails, however, Germany will emerge triumphant, at the head of the world's second largest common market and most prominent trading bloc. Its second-among-equal neighbors will be reduced to mere markets for its products and recruitment stages for its factories.

In this exegesis, EU enlargement has already degenerated into the same tiresome and antiquated mercantilist game among 19th century continental Big Powers. Even Britain has hitherto maintained its Victorian position of "splendid isolation". There is nothing wrong with that. The Concert of Europe ushered in a century of globalization, economic growth and peace. Yet, alas, this time around, it has thus far been quite a cacophony.

The countries of central and east Europe - especially those slated to join the European Union (EU) in May next year - are between the American rock and the European hard place. The Czech republic, Hungary and Poland, already NATO members, have joined Spain, Britain and other EU veterans in signing the "letter of eight" in support of US policy in the Gulf. NATO and EU aspirants - including most of the nations of the Balkans - followed suit in a joint statement of the Vilnius Group.

The denizens of the region wonder what is meant by "democracy" when their own governments so blithely ignore public opinion, resolutely set against the looming conflict. The heads of these newly independent polities counter by saying that leaders are meant to mold common perceptions, not merely follow them expediently. The mob opposed the war against Hitler, they remind us, somewhat non-germanely.

But the political elite of Europe is, indeed, divided.

France is trying to reassert its waning authority over an increasingly unruly and unmanageably expanding European Union. Yet, the new members do not share its distaste for American hegemony. On the contrary, they regard it as a guarantee of their own security. They still fear the Russians, France's and Germany's new found allies in the "Axis of Peace" (also known as the Axis of Weasels).

The Czechs, for instance, recall how France (and Britain) sacrificed them to Nazi Germany in 1938 in the name of realpolitik and the preservation of peace. They think that America is a far more reliable sponsor of their long-term safety and prosperity than the fractured European "Union".

Their dislike of what they regard as America's lightweight leadership and overt - and suspect - belligerence notwithstanding, the central and east Europeans are grateful to the United States for its unflinching - and spectacularly successful - confrontation with communism.

France and Germany - entangled in entente and Ostpolitik, respectively - cozied up to the Kremlin, partly driven by their Euro-communist parties. So did Italy. While the Europeans were busy kowtowing to a repressive USSR and castigating the USA for its warmongering, America has liberated the Soviet satellites and bankrolled their painful and protracted transition.

Historical debts aside, America is a suzerain and, as such, it is irresistible. Succumbing to the will of a Big Power is the rule in east and central Europe. The nations of the region have mentally substituted the United States for the Soviet Union as far as geopolitics are concerned. Brussels took the place of Moscow with regards to economic issues. The Czechs, Poles, Hungarians, assorted Balkanians, even the Balts - have merely switched empires.

There are other reasons for these countries' pro-Americanism. The nations of central, east and southeast (Balkans) Europe have sizable and economically crucial diasporas in the united States. They admire and consume American technology and pop culture. Trade with the USA and foreign direct investment are still small but both are growing fast.

Though the EU is the new and aspiring members' biggest trading partner and foreign investor - it has, to borrow from Henry Kissinger, no "single phone number". While France is enmeshed in its Byzantine machinations, Spain and Britain are trying to obstruct the ominous re-emergence of French-German dominance.

By catering to popular aversion of America's policies, Germany's beleaguered Chancellor, Gerhard Schroeder, is attempting to score points domestically even as the German economy is imploding.

The euro-Atlantic structures never looked worse. The European Union is both disunited and losing its European character. NATO has long been a dysfunctional alliance in search of a purpose. For a while, Balkan skirmishes provided it with a new lease on life. But now the Euro-Atlantic alliance has become the Euro-Atlantic divide.

The only clear, consistent and cohesive voice is America's. The new members of NATO are trying to demonstrate their allegiance - nay, obsequiousness - to the sole identifiable leader of the free world.

France's bid at European helmsmanship failed because both it and Russia are biased in favor of the current regime in Iraq. French and Russian firms have signed more than 1700 commercial contracts with Saddam's murderous clique while their British and American competitors were excluded by the policies of their governments.

When sanctions against Iraq are lifted - and providing Saddam or his hand-picked successor are still in place - Russian energy behemoths are poised to explore and extract billions of barrels of oil worth dozens of billions of dollars. Iraq owes Russia $9 billion which Russia wants repaid.

But the United States would be mistaken to indulge in Schadenfreude or to gleefully assume that it has finally succeeded in isolating the insolent French and the somnolent Germans. Public opinion - even where it carries little weight, like in Britain, or in the Balkans - cannot be ignored forever.

Furthermore, all the countries of Europe share real concerns about the stability of the Middle East. A divided Iraq stands to unsettle neighbours near and far. Turkey has a large Kurdish minority as does Iran. Conservative regimes in the Gulf fear Iraq's newfound and American-administered democracy. In the wake of an American attack on Iraq, Islamic fundamentalism and militancy will surely surge and lead to a wave of terror. Europe has vested historical, economic and geopolitical interests in the region, unlike America.

Persistent, unmitigated support for the USA in spite of French-German exhortations will jeopardize the new and aspiring members' position in an enlarged EU. Accession is irreversible but they can find themselves isolated and marginalized in decision making processes and dynamics long after the Iraqi dust has settled. EU officials already gave public warnings to this effect.

It is grave error to assume that France and Germany have lost their pivotal role in the EU. Britain and Spain are second rank members - Britain by Europhobic choice and Spain because it is too small to really matter. Russia - a smooth operator - chose to side with France and Germany, at least temporarily. The new and aspiring members would have done well to follow suit.

Instead, they have misconstrued the signs of the gathering storm: the emerging European rapid deployment force and common foreign policy; the rapprochement between France and Germany at the expense of the pro-American but far less influential Britain, Italy and Spain; the constitutional crisis setting European federalists against traditional nationalists; the growing rupture between "Old Europe" and the American "hyperpower".

The new and aspiring members of NATO and the EU now face a moment of truth and are being forced to reveal their hand. Are they pro-American, or pro-German (read: pro federalist Europe)? Where and with whom do they see a common, prosperous future? What is the extent of their commitment to the European Union, its values and its agenda?

The proclamations of the European eight (including the three central European candidates) and the Vilnius Ten must have greatly disappointed Germany - the unwavering sponsor of EU enlargement. Any further flagrant siding with the United States against the inner core of the EU would merely compound those errors of judgment. The EU can punish the revenant nations of the communist bloc with the same dedication and effectiveness with which it has hitherto rewarded them.

Pomp and circumstance often disguise a sore lack of substance. The three days summit of the Central European Initiative is no exception. Held in Macedonia's drab capital, Skopje, the delegates including the odd chief of state, discussed their economies in what was presumptuously dubbed by them the "small Davos", after the larger and far more important annual get together in Switzerland.

Yet the whole exercise rests on a series of politically correct confabulations. To start with, Macedonia, the host, as well as Albania, Bulgaria, Romania, Ukraine and other east European backwaters hardly qualify for the title "central European". Mitteleuropa is not merely a geographical designation which excludes all but two or three of the participants. It is also a historical, cultural, and social entity which comprises the territories of the erstwhile German and, especially, Austro-Hungarian (Habsburg) empires.

Moreover, the disparity between the countries assembled in the august conference precludes a common label. Slovenia's GDP per capita is 7 times Macedonia's. The economies of the Czech Republic, Poland, and Hungary are light years removed from those of Yugoslavia or even Bulgaria.

Nor do these countries attempt real integration. While regional talk shops, such as ASEAN and the African Union, embarked on serious efforts to establish customs and currency zones - the countries of central and eastern Europe have drifted apart and intentionally so. Intra-regional trade has declined every single year since 1989. Intra-regional foreign direct investment is almost non-existent.

Macedonia's exports to Yugoslavia, its next door neighbor, amount to merely half its exports to the unwelcoming European Union - and are declining. Countries from Bulgaria to Russia have shifted 50-75 percent of their trade from their traditional COMECON partners to the European Union and, to a lesser degree, the Middle East, the Far East and the United States.

Nor do the advanced members of the club fancy a common label. Slovenia abhors its Balkan pedigree. Croatia megalomaniacally considers itself German. The

Czechs and the Slovaks regard their communist elopement a sad aberration as do the Hungarians. The Macedonians are not sure whether they are Serbs, Bulgarians, or Macedonians. The Moldovans wish they were Romanians. The Romanians secretly wish they were Hungarians. The Austrians are sometimes Germans and sometimes Balkanians. Many Ukrainians and all Belarusians would like to resurrect the evil empire, the USSR.

This identity crisis affects the European Union. Never has Europe been more fractured. It is now a continent of four speeds. The rich core of the European Union, notably Germany and France, constitutes its engine. The mendicant members - from Greece to Portugal - enjoy inane dollops of cash from Brussels but have next to no say in Union matters.

The shoo-in candidates - Poland, Hungary, the Czech Republic and, maybe, Slovakia, if it keeps ignoring the outcomes of its elections - are frantically distancing themselves from the queue of beggars, migrants and criminals that awaits at the pearly gates of Brussels. The Belgian Curtain -between central European candidates and east European aspirants - is falling fast and may prove to be far more divisive and effective than anything dreamt up by Stalin.

The fourth group comprises real candidates - such as Bulgaria - and would be applicants, such as Romania, Macedonia, Albania, Yugoslavia, Bosnia-Herzegovina and even Croatia. Some of them are tainted by war crimes. Others are addicted to donor conferences. Yet others are travesties of the modern nation state having been hijacked and subverted by tribal crime gangs. Most of them combine all these unpalatable features.

Many of these countries possess the dubious distinction of having once been misruled by the sick man of Europe, the Ottoman Empire. In a moment of faux-pas honesty, Valerie Giscard D'Estaing, the chairman of the European Union's much-touted constitutional convention, admitted last week that a European Union with Turkey will no longer be either European or United. Imagine how they perceive the likes of Macedonia, or Albania.

As the Union enlarges to the east and south, its character will be transformed. It will become poorer and darker, more prone to crime and corruption, to sudden or seasonal surges of immigration, to fractiousness and conflict. It is a process of conversion to a truly multi-ethnic and multi-cultural grouping with a weighty Slav and Christian Orthodox presence. Not necessarily an appetizing prospect, say many.

The former communist countries in transition are supposed to be miraculously transformed by the accession process. Alas, the indelible pathologies of communism mesh well with Brussels's unmanageable, self-perpetuating and opaque bureaucracy. These mutually-enhancing propensities are likely to yield a giant and venal welfare state with a class of aged citizens in the core countries of the European Union living off the toil of young, mostly Slav, laborers in its eastern territories. This is the irony: the European Union is doomed without enlargement. It needs these countries far more than they need it.

The strategic importance of western Europe has waned together with the threat posed by a dilapidated Russia. Both south Europe and its northern regions are emerging as pivotal. Enlargement would serve to enhance the dwindling geopolitical relevance of the EU and heal some of the multiple rifts with the USA.

But the main benefits are economic.

Faced with an inexorably ageing populace and an unsustainable system of social welfare and retirement benefits, the EU is in dire need of young immigrants. According to the United Nations Population Division, the EU would need to import 1.6 million migrant workers annually to maintain its current level of working age population. But it would need to absorb almost 14 million new, working age, immigrants per year just to preserve a stable ratio of workers to pensioners.

Eastern Europe - and especially central Europe - is the EU's natural reservoir of migrant labor. It is ironic that xenophobic and anti-immigration parties hold the balance of power in a continent so dependent on immigration for the survival of its way of life and institutions.

The internal, common, market of the EU has matured. Its growth rate has leveled off and it has developed a mild case of deflation. In previous centuries, Europe exported its excess labor and surplus capacity to its colonies - an economic system known as "mercantilism".

The markets of central, southern, and eastern Europe - West Europe's hinterland - are replete with abundant raw materials and dirt-cheap, though well-educated, labor. As indigenous purchasing power increases, the demand for consumer goods and services will expand. Thus, the enlargement candidates can act both as a sink for Europe's production and the root of its competitive advantage.

Moreover, the sheer weight of their agricultural sectors and the backwardness of their infrastructure can force a reluctant EU to reform its inanely bloated farm and regional aid subsidies, notably the Common Agricultural Policy. That the EU cannot afford to treat the candidates to dollops of subventioary largesse as it does the likes of France, Spain, Portugal, and Greece is indisputable. But even a much-debated phase-in period of 10 years would burden the EU's budget - and the patience of its member states and denizens - to an acrimonious breaking point.

The countries of central and eastern Europe are new consumption and investment markets. With a total of 300 million people (Russia counted), they equal the EU's population - though not its much larger purchasing clout. They are likely to while the next few decades on a steep growth curve, catching up with the West. Their proximity to the EU makes them ideal customers for its goods and services. They could provide the impetus for a renewed golden age of European economic expansion.

Central and eastern Europe also provide a natural land nexus between west Europe and Asia and the Middle East. As China and India grow in economic and geopolitical importance, an enlarged Europe will find itself in the profitable role of an intermediary between east and west.

The wide-ranging benefits to the EU of enlargement are clear, therefore. What do the candidate states stand to gain from their accession? The answer is: surprisingly little. All of them already enjoy, to varying degrees, unfettered, largely duty-free, access to the EU. To belong, a few - like Estonia - would have to dismantle a much admired edifice of economic liberalism.

Most of them would have to erect barriers to trade and the free movement of labor and capital where none existed. All of them would be forced to encumber their fragile economies with tens of thousands of pages of prohibitively costly labor, intellectual property rights, financial, and environmental regulation. None stands to enjoy the same benefits as do the more veteran members - notably in agricultural and regional development funds.

Joining the EU would deliver rude economic and political shocks to the candidate countries. A brutal and rather sudden introduction of competition in hitherto much-sheltered sectors of the economy, giving up recently hard-won sovereignty, shouldering the debilitating cost of the implementation of reams of guideline, statutes, laws, decrees, and directives, and being largely powerless to influence policy outcomes. Faced with such a predicament, some countries may even reconsider.

The vote in Ireland two years ago (2002) was the second time in 36 months that its increasingly disillusioned citizenry had to decide the fate of the European Union by endorsing or rejecting the crucial Treaty of Nice. The treaty seeks to revamp the union's administration and the hitherto sacred balance between small and big states prior to the accession of 10 central and east European countries. Enlargement has been the centerpiece of European thinking ever since the meltdown of the eastern bloc.

Shifting geopolitical and geo-strategic realities in the wake of the September 11 atrocities have rendered this project all the more urgent. NATO - an erstwhile anti-Soviet military alliance is search of purpose - is gradually acquiring more political hues. Its remit has swelled to take in peacekeeping, regime change, and nation-building.

Led by the USA, it has expanded aggressively into central and northern Europe. It has institutionalized its relationships with the countries of the Balkan through the "Partnership for Peace" and with Russia through a recently established joint council. The Czech Republic, Poland, and Hungary - the eternal EU candidates - have full scale members of NATO for 3 years now.

The EU responded by feebly attempting to counter this worrisome imbalance of influence with a Common Foreign and Security Policy and a rapid deployment force. Still, NATO's chances of replacing the EU as the main continental political alliance are much higher than the EU's chances of substituting for NATO as the pre-eminent European military pact. the EU is hobbled by minuscule and decreasing defence spending by its mostly pacifistic members and by the backwardness of their armed forces.

That NATO, under America's thumb, and the vaguely anti-American EU are at cross-purposes emerged during the recent spat over the International Criminal Court. Countries, such as Romania, were asked to choose between NATO's position - immunity for American soldiers on international peacekeeping missions - and the EU's (no such thing). Finally - and typically - the EU backed down. But it was a close call and it cast in sharp relief the tensions inside the Atlantic partnership.

As far as the sole superpower is concerned, the strategic importance of western Europe has waned together with the threat posed by a dilapidated Russia. Both south Europe and its northern regions are emerging as pivotal. Airbases in Bulgaria are more useful in the fight against Iraq than airbases in Germany.

The affairs of Bosnia - with its al-Qaida's presence - are more pressing than those of France. Turkey and its borders with central Asia and the middle east is of far more concern to the USA than disintegrating Belgium. Russia, a potentially newfound ally, is more mission-critical than grumpy Germany.

Thus, enlargement would serve to enhance the dwindling strategic relevance of the EU and heal some of the multiple rifts with the USA - on trade, international affairs (e.g., Israel), defence policy, and international law. But this is not the only benefit the EU would derive from its embrace of the former lands of communism.

Faced with an inexorably ageing populace and an unsustainable system of social welfare and retirement benefits, the EU is in dire need of young immigrants. According to the United Nations Population Division, the EU would need to import 1.6 million migrant workers annually to maintain its current level of working age population. But it would need to absorb almost 14 million new, working age, immigrants per year just to preserve a stable ratio of workers to pensioners.

Eastern Europe - and especially central Europe - is the EU's natural reservoir of migrant labor. It is ironic that xenophobic and anti-immigration parties hold the balance of power in a continent so dependent on immigration for the survival of its way of life and institutions.

The internal, common, market of the EU has matured. Its growth rate has leveled off and it has developed a mild case of deflation. In previous centuries, Europe exported its excess labor and surplus capacity to its colonies - an economic system known as "mercantilism".

The markets of central, southern, and eastern Europe - West Europe's hinterland - are replete with abundant raw materials and dirt-cheap, though well-educated, labor. As indigenous purchasing power increases, the demand for consumer goods and services will expand. Thus, the enlargement candidates can act both as a sink for Europe's production and the root of its competitive advantage.

Moreover, the sheer weight of their agricultural sectors and the backwardness of their infrastructure can force a reluctant EU to reform its inanely bloated farm and regional aid subsidies, notably the Common Agricultural Policy. That the EU cannot afford to treat the candidates to dollops of subventioary largesse as it does the likes of France, Spain, Portugal, and Greece is indisputable. But even a much-debated phase-in period of 10 years would burden the EU's budget - and the patience of its member states and denizens - to an acrimonious breaking point.

The countries of central and eastern Europe are new consumption and investment markets. With a total of 300 million people (Russia counted), they equal the EU's population - though not its much larger purchasing clout. They are likely to while the next few decades on a steep growth curve, catching up with the West. Their proximity to the EU makes them ideal customers for its goods and services. They could provide the impetus for a renewed golden age of European economic expansion.

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Entrepreneurship

The Dutch proudly point to their current rate of unemployment at less than 2%. Labour force participation is at a historically high 74% (although in potential man-hour terms it stands at 62%). France is as hubristic with its labour policies - the 35 hours week and the earlier reduction in employers' participation in social contributions. Employment is sharply up in a host of countries with liberalized labour markets - Britain, Spain, Ireland, Finland. The ECB brags that employment in the euro zone has been rising faster than in the USA since 1997.

This is a bit misleading. Euro zone unemployment is far higher and labour force participation far lower than America's. The young are especially disadvantaged. Only Britain is up to American standards. The European labour market is highly inefficient in matching demand and supply. Labour mobility among regions and countries is glacial and generous unemployment benefits are a disincentive to find a job.

Reforms are creeping into the legislative agendas of countries as diverse as Italy and Germany. Labour laws are re-written to simplify hiring and firing practices and to expand the role of private employment agencies. But militant unions - such as Germany's IG Metal - threaten to undo all the recent gains in productivity and wage restraint.

The European Commission - a bastion of "social Europe" - has just equalized the rights and benefits of temporary workers (with more than 6 weeks of tenure) and full-time ones. Yet another reformist adviser to the Italian Minister of Labour was assassinated. This was followed by a million-workers strong demonstration in Rome's Circo Massimo against minor reforms in firing practices.

But the most successful and efficient labour market in the world, in the States, is associated with a different ethos and an idiosyncratic sociology of work. The frame of mind of the American employee and his employer is fundamentally at odds with European mentality. In Europe, one is entitled to be employed, it is a basic human right and a public good. Employers - firms and businessmen - are parties to a social treaty within a community of stakeholders with equipotent rights. Decisions are reached by consensus and consultation. Peer pressure and social oversight are strong.

Contrast this with the two engines of American economic growth: entrepreneurship and workaholism.

The USA, according to the "Global Entrepreneurship Monitor", is behind South Korea and Brazil in entrepreneurial activity prevalence index. But 7 percent of its population invested an average of $4000 per person in start-ups in 2000.

A 10-country study conducted in 1997-9 by Babson College, the London School of Business, and the Kauffman Center for Entrepreneurial Leadership found gaping disparities between countries. More than 8 percent of all Americans started a new business - compared to less than 1.5 percent in Finland. Entrepreneurship accounted for one third of the difference in economic growth rates among the surveyed countries.

Entrepreneurship is a national state of mind, a vestige of the dominant culture, an ethos. While in Europe bankruptcy is a suicide-inducing disgrace bordering on the criminal - in the USA it is an integral and important part of the learning curve. In the USA, entrepreneurs are social role models, widely admired and imitated. In Europe they are regarded with suspicion as receptacles of avarice and non-conformity. It is common in the States to choose entrepreneurship as a long-term career path. In Europe it is considered professional suicide.

In the USA, entrepreneurs are supported by an evolved network of financial institutions and venues: venture capital (VC), Initial Public Offerings (IPO's) in a multitude of stock exchanges, angel investors, incubators, technological parks, favourable taxation of stock options, and so on. Venture capitalists invested $18 billion in start-ups in 1998, $48 in 1999, almost $100 billion in 2000.

The dot.com crash deflated this tsunami - but only temporarily. US venture capitalists still invest four times the average of their brethren elsewhere - c. 0.5 percent of GDP. This translates to an average investment per start up ten times larger than the average investment outside America.

American investors also power the VC industry in the UK, Israel, and Japan. A Deloitte Touche survey conducted last month (and reported in the Financial Times) shows that a whopping 89 percent of all venture capitalists predict an increase in the value of their investments and in their exit valuations in the next 6 months.

Entrepreneurs in the USA still face many obstacles - from insufficient infrastructure to severe shortages in skilled manpower. The July 2001 report of the National Commission on Entrepreneurship (NCOE) said that less than 5 percent of American firms that existed in 1991 grew their employment by 15 percent annually since, or doubled their employment in the feverish markets of 1992-7. But the report found high growth companies virtually everywhere - and most of them were not "hi-tech" either. Start-ups capitalized on the economic strengths of each of the 394 regions of the USA.

As opposed to the stodgy countries of the EU, many post-communist countries in transition (e.g., Russia, Estonia) have chosen to emulate the American model of job creation and economic growth through the formation of new businesses. International financial institutions - such as the EBRD and the World Bank - provided credit lines dedicated to small and medium enterprises in these countries. As opposed to the USA, entrepreneurship has spread among all segments of the population in Central and Eastern Europe.

In a paper, prepared for USAID by the IRIS Centre in the University of Maryland, the authors note the surprising participation of women - they own more than 40% of all businesses established between 1990-7 in Hungary and 38% of all businesses in Poland.

Virtually all governments, east and west, support their "small business" or "small and medium enterprises" sector.

The USA's Small Business Administration had its loan guarantee authority cut by half - yet to a still enviable $5 billion in FY 2003. But other departments have picked up the slack.

The US Department of Agriculture (USDA) beefed up its Rural Business-Cooperative Service. The Economic Development Administration (EDA) supports "economically-distressed areas, regions, and communities". The International Trade Administration (ITA) helps exporters - as do OPIC (Overseas Private

Investment Corporation), the US Commercial Service, the Department of Commerce (mainly through its Technology Administration), the Minority Business Development Agency, the US Department of Treasury, and a myriad other organizations - governmental, non-governmental, and private sector.

Another key player is academe. New proposed bipartisan legislation will earmark $20 million to encourage universities to set up business incubators. Research institutes all over the world - from Israel to the UK - work closely with start-ups and entrepreneurs to develop new products and license them. They often spawn joint ventures with commercial enterprises or spin-off their own firms to exploit technologies developed by their scientists.

MIT's Technology Licensing Office processes two inventions a day and files 3-5 patent applications a week. Since 1988, it started 100 new companies. It works closely with the Cambridge Entrepreneurship Center (UK), the Asian Entrepreneurship Development Center (Taiwan), the Turkish Venture Capital Association, and other institutions in Japan, Israel, Canada, and Latin America.

This is part of a much larger wave of in-house corporate innovation dubbed "intrapreneurship". The most famous example is "Post-It" which was developed, in-house, by a 3M employee and funded by the company. But all major and medium American firms encourage institutionalized intrapreneurship.

Entrepreneurship and intrapreneurship are often associated with another American phenomenon - the workaholic. Bryan Robinson in his 1998 tome, "Chained to the Desk", identifies four types of workaholism (or "work addiction"):

1. The Bulimic Workaholic Style - "Either I do it perfectly or not at all";
2. The Relentless Workaholic Style - "It has to be finished yesterday";
3. Attention-Deficit Workaholic Style - adrenaline junkies who use work as a focusing device;
4. Savouring Workaholic Style - slow, methodical, and overly scrupulous workers.

Workaholism is confused by most Americans with "hard work", a pillar of the Protestant work ethic, by now an American ethos. Employers demand long work hours from their employees. Dedication to one's work results in higher financial rewards and faster promotion. Technology fosters a "work everywhere, work anytime" environment.

Even before the introduction of the 35 hours week in France, Americans worked 5 weekly hours more than the French, according to a 1998 study by the Families and Work Institute. Americans also out-worked the industrious Germans by 4 hours and the British by 1 hour. The average American work week has increased by 10% (to 44 weekly hours) between 1977-98.

One third of all American bring work home, yet another increase of 10% over the same period. According to the Economic Policy Institute, Germans (and Italians) took 42 days of vacation a year in 1998 - compared to 19 days taken by Americans. This figure may have since deteriorated to 13 annual vacation days. Even the Japanese take 25 days a year.

In a survey conducted by Oxford Health Plans, 34 percent of all respondents described their jobs as "pressing and with no downtime". Thirty two percent never left the building during the working day and had lunch at their desk. Management promotes only people who work late, believed a full one seventh.

Most Europeans - with the notable exception of the British - regard their leisure and vacation times as well as time dedicated to family and friends as important components in a balanced life - no less important than the time they spend at work. They keep these realms strictly demarcated.

Work addiction is gradually encroaching on the European work scene as well. But many Europeans still find American - and, increasingly British - obsession with work to be a distasteful part of the much derided "Anglo-Saxon" model of capitalism. They point at the severe health problems suffered by workaholics - three times as many heart failures as their non-addicted peers.

More than 10,000 workers died in 1997 in Japan from work-stress related problems ("Karoshi") . The Japanese are even more workaholic than the Americans - a relatively new phenomenon there, according to Testsuro Kato, a professor of political science in Hitotsubashi University.

But what is the impact of all this on employment and the shape of labour?

The NCOE identifies five common myths pertaining to entrepreneurial growth companies:

1. The risk taking myth - "Most successful entrepreneurs take wild, uncalculated risks in starting their companies".
2. The hi-tech invention myth - "Most successful entrepreneurs start their companies with a breakthrough invention - usually technological in nature".
3. The expert myth - "Most successful entrepreneurs have strong track records and years of experience in their industries".
4. The strategic vision myth - "Most successful entrepreneurs have a well-considered business plan and have researched and developed their ideas before taking action".
5. The venture capital myth - "Most successful entrepreneurs start their companies with millions in venture capital to develop their idea, buy supplies, and hire employees".

Entrepreneurship overlaps with two other workplace revolutions: self-employment and flexitime. The number of new businesses started each year in the USA tripled from the 1960's to almost 800,000 in the 1990's. Taking into account home-based and part-time ventures - the number soars to an incredible 5 million new businesses a year. Most entrepreneurs are self-employed and work flexible hours from home on ever-changing assignments. This kaleidoscopic pattern has already "infected" Europe and is spreading to Asia.

Small businesses absorbed many of the workers made redundant in the corporate downsizing fad of the 1980's.

They are the backbone of the services and knowledge economy. Traditional corporations often outsource many of their hitherto in-house functions to such nascent, mom-and-pop, companies (the "virtual corporation"). Small and medium businesses network extensively, thus reducing their overhead and increasing their flexibility and mobility. The future belongs to these proliferating small businesses and to those ever-fewer giant multinationals which will master the art of harnessing them.

Environmentalism

"It wasn't just predictable curmudgeons like Dr. Johnson who thought the Scottish hills ugly; if anybody had something to say
about mountains at all, it was sure to be an insult. (The Alps: "monstrous excrescences of nature," in the words of one wholly
typical 18th-century observer.)"

Stephen Budiansky, "Nature? A bit overdone", U.S. News & World Report, December 2, 1996

The concept of "nature" is a romantic invention. It was spun by the likes of Jean-Jacques Rousseau in the 18th century as a confabulated utopian contrast to the dystopia of urbanization and materialism. The traces of this dewy-eyed conception of the "savage" and his unmolested, unadulterated surroundings can be found in the more malignant forms of fundamentalist environmentalism.

At the other extreme are religious literalists who regard Man as the crown of creation with complete dominion over nature and the right to exploit its resources unreservedly. Similar, veiled, sentiments can be found among scientists. The Anthropic Principle, for instance, promoted by many outstanding physicists, claims that the nature of the Universe is preordained to accommodate sentient beings - namely, us humans.

Industrialists, politicians and economists have only recently begun paying lip service to sustainable development and to the environmental costs of their policies. Thus, in a way, they bridge the abyss - at least verbally - between these two diametrically opposed forms of fundamentalism. Similarly, the denizens of the West continue to indulge in rampant consumption, but now it is suffused with environmental guilt rather than driven by unadulterated hedonism.

Still, essential dissimilarities between the schools notwithstanding, the dualism of Man vs. Nature is universally acknowledged.

Modern physics - notably the Copenhagen interpretation of quantum mechanics - has abandoned the classic split between (typically human) observer and (usually inanimate) observed. Environmentalists, in contrast, have embraced this discarded worldview wholeheartedly. To them, Man is the active agent operating upon a distinct reactive or passive substrate - i.e., Nature. But, though intuitively compelling, it is a false dichotomy.

Man is, by definition, a part of Nature. His tools are natural. He interacts with the other elements of Nature and modifies it - but so do all other species. Arguably, bacteria and insects exert on Nature far more influence with farther reaching consequences than Man has ever done.

Still, the "Law of the Minimum" - that there is a limit to human population growth and that this barrier is related to the biotic and abiotic variables of the environment - is undisputed. Whatever debate there is veers between two strands of this Malthusian Weltanschauung: the utilitarian (a.k.a. anthropocentric, shallow, or technocentric) and the ethical (alternatively termed biocentric, deep, or ecocentric).

First, the Utilitarians.

Economists, for instance, tend to discuss the costs and benefits of environmental policies. Activists, on the other hand, demand that Mankind consider the "rights" of other beings and of nature as a whole in determining a least harmful course of action.

Utilitarians regard nature as a set of exhaustible and scarce resources and deal with their optimal allocation from a human point of view. Yet, they usually fail to incorporate intangibles such as the beauty of a sunset or the liberating sensation of open spaces.

"Green" accounting - adjusting the national accounts to reflect environmental data - is still in its unpromising infancy. It is complicated by the fact that ecosystems do not respect man-made borders and by the stubborn refusal of many ecological variables to succumb to numbers. To complicate things further, different nations weigh environmental problems disparately.

Despite recent attempts, such as the Environmental Sustainability Index (ESI) produced by the World Economic Forum (WEF), no one knows how to define and quantify elusive concepts such as "sustainable development". Even the costs of replacing or repairing depleted resources and natural assets are difficult to determine.

Efforts to capture "quality of life" considerations in the straitjacket of the formalism of distributive justice - known as human-welfare ecology or emancipatory environmentalism - backfired. These led to derisory attempts to reverse the inexorable processes of urbanization and industrialization by introducing localized, small-scale production.

Social ecologists proffer the same prescriptions but with an anarchistic twist. The hierarchical view of nature - with Man at the pinnacle - is a reflection of social relations, they suggest. Dismantle the latter - and you get rid of the former.

The Ethicists appear to be as confounded and ludicrous as their "feet on the ground" opponents.

Biocentrists view nature as possessed of an intrinsic value, regardless of its actual or potential utility. They fail to specify, however, how this, even if true, gives rise to rights and commensurate obligations. Nor was their case aided by their association with the apocalyptic or survivalist school of environmentalism which has developed proto-fascist tendencies and is gradually being scientifically debunked.

The proponents of deep ecology radicalize the ideas of social ecology ad absurdum and postulate a transcendentalist spiritual connection with the inanimate (whatever that may be). In consequence, they refuse to intervene to counter or contain natural processes, including diseases and famine.

The politicization of environmental concerns runs the gamut from political activism to eco-terrorism. The environmental movement - whether in academe, in the media, in non-governmental organizations, or in legislature - is now comprised of a web of bureaucratic interest groups.

Like all bureaucracies, environmental organizations are out to perpetuate themselves, fight heresy and accumulate political clout and the money and perks that come with it. They are no longer a disinterested and objective party. They have a stake in apocalypse. That makes them automatically suspect.

Bjorn Lomborg, author of "The Skeptical Environmentalist", was at the receiving end of such self-serving sanctimony. A statistician, he demonstrated that the doom and gloom tendered by environmental campaigners, scholars and militants are, at best, dubious and, at worst, the outcomes of deliberate manipulation.

The situation is actually improving on many fronts, showed Lomborg: known reserves of fossil fuels and most metals are rising, agricultural production per head is surging, the number of the famished is declining, biodiversity loss is slowing as do pollution and tropical deforestation. In the long run, even in pockets of environmental degradation, in the poor and developing countries, rising incomes and the attendant drop in birth rates will likely ameliorate the situation in the long run.

Yet, both camps, the optimists and the pessimists, rely on partial, irrelevant, or, worse, manipulated data. The multiple authors of "People and Ecosystems", published by the World Resources Institute, the World Bank and the United Nations conclude: "Our knowledge of ecosystems has increased dramatically, but it simply has not kept pace with our ability to alter them."

Quoted by The Economist, Daniel Esty of Yale, the leader of an environmental project sponsored by World Economic Forum, exclaimed:

"Why hasn't anyone done careful environmental measurement before? Businessmen always say, 'what matters gets measured'. Social scientists started quantitative measurement 30 years ago, and even political science turned to hard numbers 15 years ago. Yet look at environmental policy, and the data are lousy."

Nor is this dearth of reliable and unequivocal information likely to end soon. Even the Millennium Ecosystem Assessment, supported by numerous development agencies and environmental groups, is seriously under-financed. The conspiracy-minded attribute this curious void to the self-serving designs of the apocalyptic school of environmentalism. Ignorance and fear, they point out, are among the fanatic's most useful allies. They also make for good copy.

Envy

Conservative sociologists self-servingly marvel at the peaceful proximity of abject poverty and ostentatious affluence in American - or, for that matter, Western -

cities. Devastating riots do erupt, but these are reactions either to perceived social injustice (Los Angeles 1965) or to political oppression (Paris 1968). The French Revolution may have been the last time the urban sans-culotte raised a fuss against the economically enfranchised.

This pacific co-existence conceals a maelstrom of envy. Behold the rampant Schadenfreude which accompanied the antitrust case against the predatory but loaded Microsoft. Observe the glee which engulfed many destitute countries in the wake of the September 11 atrocities against America, the epitome of triumphant prosperity. Witness the post-World.com orgiastic castigation of avaricious CEO's.

Envy - a pathological manifestation of destructive aggressiveness - is distinct from jealousy.

The New Oxford Dictionary of English defines envy as:

"A feeling of discontented or resentful longing aroused by someone else's possessions, qualities, or luck ... Mortification and ill-will occasioned by the contemplation of another's superior advantages."

Pathological envy - the fourth deadly sin - is engendered by the realization of some lack, deficiency, or inadequacy in oneself. The envious begrudge others their success, brilliance, happiness, beauty, good fortune, or wealth. Envy provokes misery, humiliation, and impotent rage.

The envious copes with his pernicious emotions in five ways:

1. They attack the perceived source of frustration in an attempt to destroy it, or "reduce it" to their "size". Such destructive impulses often assume the disguise of championing social causes, fighting injustice, touting reform, or promoting an ideology.

2. They seek to subsume the object of envy by imitating it. In extreme cases, they strive to get rich quick through criminal scams, or corruption. They endeavor to out-smart the system and shortcut their way to fortune and celebrity.

3. They resort to self-deprecation. They idealize the successful, the rich, the mighty, and the lucky and attribute to them super-human, almost divine, qualities. At the same time, they humble themselves. Indeed, most of this strain of the envious end up disenchanted and bitter, driving the objects of their own erstwhile devotion and adulation to destruction and decrepitude.

4. They experience cognitive dissonance. These people devalue the source of their frustration and envy by finding faults in everything they most desire and in everyone they envy.

5. They avoid the envied person and thus the agonizing pangs of envy.

Envy is not a new phenomenon. Belisarius, the general who conquered the world for Emperor Justinian, was blinded and stripped of his assets by his envious peers. I - and many others - have written extensively about envy in command economies. Nor is envy likely to diminish.

In his book, "Facial Justice", Hartley describes a post-apocalyptic dystopia, New State, in which envy is forbidden and equality extolled and everything enviable is obliterated. Women are modified to look like men and given identical "beta faces". Tall buildings are razed.

Joseph Schumpeter, the prophetic Austrian-American economist, believed that socialism will disinherit capitalism. In "Capitalism, Socialism, and Democracy" he foresaw a conflict between a class of refined but dirt-poor intellectuals and the vulgar but filthy rich businessmen and managers they virulently envy and resent. Samuel Johnson wrote: "He was dull in a new way, and that made many people think him great." The literati seek to tear down the market economy which they feel has so disenfranchised and undervalued them.

Hitler, who fancied himself an artist, labeled the British a "nation of shopkeepers" in one of his bouts of raging envy. Ralph Reiland, the Kenneth Simon professor of free enterprise at Robert Morris University, quotes David Brooks of the "weekly Standard", who christened this phenomenon "bourgeoisophobia":

"The hatred of the bourgeoisie is the beginning of all virtue' - wrote Gustav Flaubert. He signed his letters 'Bourgeoisophobus' to show how much he despised 'stupid grocers and their ilk ... Through some screw-up in the great scheme of the universe, their narrow-minded greed had brought them vast wealth, unstoppable power and growing social prestige."

Reiland also quotes from Ludwig van Mises's "The Anti-Capitalist Mentality":

"Many people, and especially intellectuals, passionately loathe capitalism. In a society based on caste and status, the individual can ascribe adverse fate to conditions beyond his control. In ... capitalism ... everybody's station in life depends on his doing ... (what makes a man rich is) not the evaluation of his contribution from any 'absolute' principle of justice but the evaluation on the part of his fellow men who exclusively apply the yardstick of their personal wants, desires and ends ... Everybody knows very well that there are people like himself who succeeded where he himself failed. Everybody knows that many of those he envies are self-made men who started from the same point from which he himself started. Everybody is aware of his own defeat. In order to console himself and to restore his self- assertion, such a man is in search of a scapegoat. He tries to persuade himself that he failed through no fault of his own. He was too decent to resort to the base tricks to which his successful rivals owe their ascendancy. The nefarious social order does not accord the prizes to the most meritorious men; it crowns the dishonest, unscrupulous scoundrel, the swindler, the exploiter, the 'rugged individualist'."

In "The Virtue of Prosperity", Dinesh D'Souza accuses prosperity and capitalism of inspiring vice and temptation. Inevitably, it provokes envy in the poor and depravity in the rich.

With only a modicum of overstatement, capitalism can be depicted as the sublimation of jealousy. As opposed to destructive envy - jealousy induces emulation. Consumers - responsible for two thirds of America's GDP - ape role models and vie with neighbors, colleagues, and family members for possessions and the social status they endow. Productive and constructive competition - among scientists, innovators, managers, actors, lawyers, politicians, and the members of just about every other profession - is driven by jealousy.

The eminent Nobel prize winning British economist and philosopher of Austrian descent, Friedrich Hayek, suggested in "The Constitution of Liberty" that innovation and progress in living standards are the outcomes of class envy. The wealthy are early adopters of expensive and unproven technologies. The rich finance with their conspicuous consumption the research and development phase of new products. The poor, driven by jealousy, imitate them and thus create a mass market which allows manufacturers to lower prices.

But jealousy is premised on the twin beliefs of equality and a level playing field. "I am as good, as skilled, and as talented as the object of my jealousy." - goes the subtext - "Given equal opportunities, equitable treatment, and a bit of luck, I can accomplish the same or more."

Jealousy is easily transformed to outrage when its presumptions - equality, honesty, and fairness - prove wrong. In a paper recently published by Harvard University's John M. Olin Center for Law and titled "Executive Compensation in America: Optimal Contracting or Extraction of Rents?", the authors argue that executive malfeasance is most effectively regulated by this "outrage constraint":

"Directors (and non-executive directors) would be reluctant to approve, and executives would be hesitant to seek, compensation arrangements that might be viewed by observers as outrageous."

Espionage

On November 11, 2002, Sweden expelled two Russian diplomats for spying on radar and missile guidance technologies for the JAS 39 British-Swedish Gripen fighter jet developed by Telefon AB LM Ericsson, the telecommunications multinational. The Russians threatened to reciprocate. Five current and former employees of the corporate giant are being investigated. Ironically, the first foreign buyer of the aircraft may well be Poland, a former Soviet satellite state and a current European Union candidate.

Sweden arrested in February 2001 a worker of the Swiss-Swedish engineering group, ABB, on suspicion of spying for Russia. The man was released after two days for lack of evidence and reinstated. But the weighty Swedish daily, Dagens Nyheter, speculated that the recent Russian indiscretion was in deliberate retaliation for Swedish espionage in Russia. Sweden is rumored to have been in the market for Russian air radar designs and the JAS radar system is said by some observers to uncannily resemble its eastern counterparts.

The same day, a Russian military intelligence (GRU) colonel, Aleksander Sipachev, was sentenced in Moscow to eight years in prison and stripped of his rank. According to Russian news agencies, he was convicted of attempting to sell secret documents to the CIA. Russian secret service personnel, idled by the withering of Russia's global presence, resort to private business or are re-deployed by the state to spy on industrial and economic secrets in order to aid budding Russian multinationals.

According to the FBI and the National White-collar Crime Center, Russian former secret agents have teamed with computer hackers to break into corporate networks to steal vital information about product development and marketing strategies. Microsoft has admitted to such a compromising intrusion.

In a December 1999 interview to Segodnya, a Russia paper, Eyer Winkler, a former high-ranking staffer with the National Security Agency (NSA) confirmed that "corruption in the Russian Government, the Foreign Intelligence Service, and the Main Intelligence Department allows Russian organized criminal groups to use these departments in their own interests. Criminals receive the major part of information collected by the Russian special services by means of breaking into American computer networks."

When the KGB was dismantled and replaced by a host of new acronyms, Russian industrial espionage was still in diapers. as a result, it is a bureaucratic no-man's land roamed by agents of the GRU, the Foreign Intelligence Service (SVR), and smaller outfits, such as the Federal Agency on Government Communications and Information (FAPSI).

According to Stratfor, the strategic forecasting consultancy, "the SVR and GRU both handle manned intelligence on U.S. territory, with the Russian Federal Security Service (FSB) doing counterintelligence in America. Also, both the SVR and GRU have internal counterintelligence units created for finding foreign intelligence moles." This, to some extent, is the division of labor in Europe as well.

Germany's Federal Prosecutor has consistently warned against $5 billion worth of secrets pilfered annually from German industrial firms by foreign intelligence services, especially from east Europe and Russia. The Counterintelligence News and Developments newsletter pegs the damage at $13 billion in 1996 alone:

"Modus operandi included placing agents in international organizations, setting up joint-ventures with German companies, and setting up bogus companies. The (Federal Prosecutor's) report also warned business leaders to be particularly wary of former diplomats or people who used to work for foreign secret services because they often had the language skills and knowledge of Germany that made them excellent agents."

Russian spy rings now operate from Canada to Japan. Many of the spies have been dormant for decades and recalled to service following the implosion of the USSR. According to Asian media, Russians have become increasingly active in the Far East, mainly in Japan, South Korea, Taiwan, and mainland China.

Russia is worried about losing its edge in avionics, electronics, information technology and some emerging defense industries such as laser shields, positronics, unmanned vehicles, wearable computing, and real time triple C (communication, command and control) computerized battlefield management. The main targets are, surprisingly, Israel and France. According to media reports, the substantive clients of Russia's defense industry - such as India - insist on hollowing out Russian craft and installing Israeli and west European systems instead.

Russia's paranoid state of mind extends to its interior. Uralinformbureau reported earlier in 2002 that the Yamal-Nenets autonomous okrug (district) restricted access to foreigners citing concerns about industrial espionage and potential sabotage of oil and gas companies. The Kremlin maintains an ever-expanding list of regions and territories with limited - or outright - forbidden - access to foreigners.

The FSB, the KGB's main successor, is busy arresting spies all over the vast country. To select a random events of the dozens reported every year - and many are not - the Russian daily Kommersant recounted in February 2002 how when the Trunov works at the Novolipetsk metallurgical combine concluded an agreement with a Chinese company to supply it with slabs, its chief negotiator was nabbed as a spy working for "circles in China". His crime? He was in possession of certain documents which contained "intellectual property" of the crumbling and antiquated mill pertaining to a slab quality enhancement process.

Foreigners are also being arrested, though rarely. An American businessman, Edmund Pope, was detained in April 2000 for attempting to purchase the blueprints of an advanced torpedo from a Russian scientist. There have been a few other isolated apprehensions, mainly for "proper", military, espionage. But Russians bear the brunt of the campaign against foreign economic intelligence gathering.

Strana.ru reported in December 2001 that, speaking on the occasion of Security Services Day, Putin - himself a KGB alumnus - warned veterans that the most crucial task facing the services today is "protecting the country's economy against industrial espionage".

This is nothing new. According to History of Espionage Web site, long before they established diplomatic relations with the USA in 1933, the Soviets had Amtorg Trading Company. Ostensibly its purpose was to encourage joint ventures between Russian and American firms. Really it was a hub of industrial undercover activities. Dozens of Soviet intelligence officers supervised, at its peak during the Depression, 800 American communists. The Soviet Union's European operations in Berlin (Handelsvertretung) and in London (Arcos, Ltd.) were even more successful.

Espionage, Industrial

The Web site of GURPS (Generic Universal Role Playing System) lists 18 "state of the art equipments (sic) used for advanced spying". These include binoculars to read lips, voice activated bugs, electronic imaging devices, computer taps, electromagnetic induction detectors, acoustic stethoscopes, fiber optic scopes, detectors of acoustic emissions (e.g., of printers), laser mikes that can decipher and amplify voice-activated vibrations of windows, and other James Bond gear.

Such contraptions are an integral part of industrial espionage. The American Society for Industrial Security (ASIC) estimated a few years ago that the damage caused by economic or commercial espionage to American industry between 1993-5 alone was c. $63 billion.

The average net loss per incident reported was $19 million in high technology, $29 million in services, and $36 million in manufacturing. ASIC than upped its estimate to $300 billion in 1997 alone - compared to $100 billion assessed by the 1995 report of the White House Office of Science and Technology.

This figures are mere extrapolations based on anecdotal tales of failed espionage. Many incidents go unreported. In his address to the 1998 World Economic Forum, Frank Ciluffo, Deputy Director of the CSIS Global Organized Crime Project, made clear why:

"The perpetrators keep quiet for obvious reasons. The victims do so out of fear. It may jeopardize shareholder and consumer confidence. Employees may lose their jobs. It may invite copycats by inadvertently revealing vulnerabilities. And competitors may take advantage of the negative publicity. In fact, they keep quiet for all the same reasons corporations do not report computer intrusions."

Interactive Television Technologies complained - in a press release dated August 16, 1996 - that someone broke into its Amherst, NY, offices and stole "three computers containing the plans, schematics, diagrams and specifications for the BUTLER, plus a number of computer disks with access codes." BUTLER is a proprietary technology which helps connect television to computer networks, such as the Internet. It took four years to develop.

In a single case, described in the Jan/Feb 1996 issue of "Foreign Affairs", Ronald Hoffman, a software scientist, sold secret applications developed for the Strategic Defense Initiative to Japanese corporations, such as Nissan Motor Company, Mitsubishi Electric, Mitsubishi

Heavy Industries, and Ishikawajima-Harima Heavy Industries. He was caught in 1992, having received $750,000 from his "clients", who used the software in their civilian aerospace projects.

Canal Plus Technologies, a subsidiary of French media giant Vivendi, filed a lawsuit last March against NDS, a division of News Corp. Canal accused NDS of hacking into its pay TV smart cards and distributing the cracked codes freely on a piracy Web site. It sued NDS for $1.1 billion in lost revenues. This provided a rare glimpse into information age, hacker-based, corporate espionage tactics.

Executives of publicly traded design software developer Avant! went to jail for purchasing batches of computer code from former employees of Cadence in 1997.

Reuters Analytics, an American subsidiary of Reuters Holdings, was accused in 1998 of theft of proprietary information from Bloomberg by stealing source codes from its computers.

In December 2001, Say Lye Ow, a Malaysian subject and a former employee of Intel, was sentenced to 24 months in prison for illicitly copying computer files containing advanced designs of Intel's Merced (Itanium) microprocessor. It was the crowning achievement of a collaboration between the FBI's High-Tech squad and the US Attorney's Office CHIP - Computer Hacking and Intellectual Property - unit.

U.S. Attorney David W. Shapiro said: "People and companies who steal intellectual property are thieves just as bank robbers are thieves. In this case, the Itanium microprocessor is an extremely valuable product that took Intel and HP years to develop. These cases should send the message throughout Silicon Valley and the Northern District that the U.S. Attorney's Office takes seriously the theft of intellectual property and will prosecute these cases to the full extent of the law."

Yet, such cases are vastly more common than publicly acknowledged.

"People have struck up online friendships with employers and then lured them into conspiracy to commit espionage. People have put bounties on laptops of executives. People have disguised themselves as janitors to gain physical access," Richard Power, editorial director of the Computer Security Institute told MSNBC.

Marshall Phelps, IBM Vice President for Commercial and Industry Relations admitted to the Senate Judiciary Committee as early as April 1992:

"Among the most blatant actions are outright theft of corporate proprietary assets. Such theft has occurred from many quarters: competitors, governments seeking to bolster national industrial champions, even employees. Unfortunately, IBM has been the victim of such acts."

Raytheon, a once thriving defense contractor, released "SilentRunner", a $25,000-65,000 software package designed to counter the "insider threat". Its brochure, quoted by "Wired", says:

"We know that 84 percent of your network threats can be expected to come from inside your organization.... This least intrusive of all detection systems will guard the integrity of your network against abuses from unauthorized employees, former employees, hackers or terrorists and competitors."

This reminds many of the FBI's Carnivore massive network sniffer software. It also revives the old dilemma between privacy and security. An Omni Consulting survey of 3200 companies worldwide pegged damage caused by insecure networks at $12 billion.

There is no end to the twists and turns of espionage cases and to the creativity shown by the perpetrators.

On June 2001 an indictment was handed down against Nicholas Daddona. He stands accused of a unique variation on the old theme of industrial espionage: he was employed by two firms - transferring trade secrets from one (Fabricated Metal Products) to the other (Eyelet).

Jungsheng Wang was indicted last year for copying the architecture of the Sequoia ultrasound machine developed by Acuson Corporation. He sold it to Bell Imaging, a Californian company which, together with a Chinese firm, owns a mainland China corporation, also charged in the case. The web of collaboration between foreign - or foreign born - scientists with access to trade and technology secrets, domestic corporations and foreign firms, often a cover for government interests - is clearly exposed here.

Kenneth Cullen and Bruce Zak were indicted on April 2001 for trying to purchase a printed or text version of the source code of a computer application for the processing of health care benefit claim forms developed by ZirMed. The legal status of printed source code is unclear. It is undoubtedly intellectual property - but of which kind? Is it software or printed matter?

Peter Morch, a senior R&D team leader for CISCO was accused on March 2001 for simply burning onto compact discs all the intellectual property he could lay his hands on with the intent of using it in his new workplace, Calix Networks, a competitor of CISCO.

Perhaps the most bizarre case involves Fausto Estrada. He was employed by a catering company that served the private lunches to Mastercard's board of directors. He offered to sell Visa proprietary information that he claimed to have stolen from Mastercard. In a letter signed "Cagliostro", Fausto demanded $1 million. He was caught red-handed in an FBI sting operation on February 2001.

Multinationals are rarely persecuted even when known to have colluded with offenders. Steven Louis Davis pleaded guilty on January 1998 to stealing trade secrets and designs from Gillette and selling them to its competitors, such as Bic Corporation, American Safety Razor, and Warner Lambert. Yet, it seems that only he paid the price for his misdeeds - 27 months in prison. Bic claims to have immediately informed Gillette of the theft and to have collaborated with Gillette's Legal Department and the FBI.

Nor are industrial espionage or the theft of intellectual property limited to industry. Mayra Justine Trujillo-Cohen was sentenced on October 1998 to 48 months in prison for stealing proprietary software from Deloitte-Touche, where she worked as a consultant, and passing it for its own. Caroll Lee Campbell, the circulation manager of Gwinette Daily Post (GDP), offered to sell proprietary business and financial information of his employer to lawyers representing a rival paper locked in bitter dispute with GDP.

Nor does industrial espionage necessarily involve clandestine, cloak and dagger, operations. The Internet and information technology are playing an increasing role.

In a bizarre case, Caryn Camp developed in 1999 an Internet-relationship with a self-proclaimed entrepreneur, Stephen Martin. She stole he employer's trade secrets for Martin in the hope of attaining a senior position in Martin's outfit - or, at least, of being richly rewarded. Camp was exposed when she mis-addressed an e-mail expressing her fears - to a co-worker.

Steven Hallstead and Brian Pringle simply advertised their wares - designs of five advanced Intel chips - on the Web. They were, of course, caught and sentenced to more than 5 years in prison. David Kern copied the contents of a laptop inadvertently left behind by a serviceman of a competing firm. Kern trapped himself. He was forced to plead the Fifth Amendment during his deposition in a civil lawsuit he filed against his former employer. This, of course, provoked the curiosity of the FBI.

Stolen trade secrets can spell the difference between extinction and profitability. Jack Shearer admitted to building an $8 million business on trade secrets pilfered from Caterpillar and Solar Turbines.

United States Attorney Paul E. Coggins stated: "This is the first EEA case in which the defendants pled guilty to taking trade secret information and actually converting the stolen information into manufactured products that were placed in the stream of commerce. The sentences handed down today (June 15, 2000) are among the longest sentences ever imposed in an Economic Espionage case."

Economic intelligence gathering - usually based on open sources - is both legitimate and indispensable. Even reverse engineering - disassembling a competitor's products to learn its secrets - is a grey legal area. Spying is different. It involves the purchase or theft of proprietary information illicitly. It is mostly committed by firms. But governments also share with domestic corporations and multinationals the fruits of their intelligence networks.

Former - and current - intelligence operators (i.e., spooks), political and military information brokers, and assorted shady intermediaries - all switched from dwindling Cold War business to the lucrative market of "competitive intelligence".

US News and World Report described on May 6, 1996, how a certain Mr. Kota - an alleged purveyor of secret military technology to the KGB in the 1980's - conspired with a scientist, a decade later, to smuggle biotechnologically modified hamster ovaries to India.

This transition fosters international tensions even among allies. "Countries don't have friends - they have interests!" - screamed a DOE poster in the mid-nineties. France has vigorously protested US spying on French economic and technological developments - until it was revealed to be doing the same. French relentless and unscrupulous pursuit of purloined intellectual property in the USA is described in Peter Schweizer's "Friendly Spies: How America's Allies Are Using Economic Espionage to Steal Our Secrets."

"Le Mond" reported back in 1996 about intensified American efforts to purchase from French bureaucrats and legislators information regarding France's WTO, telecommunications, and audio-visual policies. Several CIA operators were expelled.

Similarly, according to Robert Dreyfuss in the January 1995 issue of "Mother Jones", Non Official Cover (NOC) CIA operators - usually posing as businessmen - are stationed in Japan. These agents conduct economic and technological espionage throughout Asia, including in South Korea and China.

Even the New York Times chimed in, accusing American intelligence agents of assisting US trade negotiators by eavesdropping on Japanese officials during the car imports row in 1995. And President Clinton admitted openly that intelligence gathered by the CIA regarding the illegal practices of French competitors allowed American aerospace firms to win multi-billion dollar contracts in Brazil and Saudi Arabia.

The respected German weekly, Der Spiegel, castigated the USA, in 1990, for arm-twisting the Indonesian government into splitting a $200 million satellite contract between the Japanese NEC and US manufacturers. The American, alleged the magazines, intercepted messages pertaining to the deal, using the infrastructure of the National Security Agency (NSA). Brian Gladwell, a former NATO computer expert, calls it "state-sponsored information piracy".

Robert Dreyfuss, writing in "Mother Jones", accused the CIA of actively gathering industrial intelligence (i.e., stealing trade secrets) and passing them on to America's

Big Three carmakers. He quoted Clinton administration officials as saying: "(the CIA) is a good source of information about the current state of technology in a foreign country ... We've always managed to get intelligence to the business community. There is contact between business people and the intelligence community, and information flows both ways, informally."

A February 1995 National Security Strategy statement cited by MSNBC declared:

"Collection and analysis can help level the economic playing field by identifying threats to U.S. companies from foreign intelligence services and unfair trading practices."

The Commerce Department's Advocacy Center solicits commercial information thus:

"Contracts pursued by foreign firms that receive assistance from their home governments to pressure a customer into a buying decision; unfair treatment by government decision-makers, preventing you from a chance to compete; tenders tied up in bureaucratic red tape, resulting in lost opportunities and unfair advantage to a competitor. If these or any similar export issues are affecting your company, it's time to call the Advocacy Center."

And then, of course, there is Echelon.

Exposed two years ago by the European Parliament in great fanfare, this telecommunications interception network, run by the US, UK, New Zealand, Australia, and

Canada has become the focus of bitter mutual recriminations and far flung conspiracy theories.

These have abated following the brutal terrorist attacks of September 11 when the need for Echelon-like system with even laxer legal control was made abundantly clear. France, Russia, and 28 other nations operate indigenous mini-Echelons, their hypocritical protestations to the contrary notwithstanding.

But, with well over $600 billion a year invested in easily pilfered R&D, the US is by far the prime target and main victim of such activities rather than their chief perpetrator. The harsh - and much industry lobbied - "Economic Espionage (and Protection of Proprietary Economic Information) Act of 1996" defines the criminal offender thus:

"Whoever, intending or knowing that the offense will benefit any foreign government, foreign instrumentality, or foreign agent, knowingly" and "whoever, with intent to convert a trade secret, that is related to or included in a product that is produced for or placed in interstate or foreign commerce, to the economic benefit of anyone other than the owner thereof, and intending or knowing that the offense will , injure any owner of that trade secret":

"(1) steals, or without authorization appropriates, takes, carries away, or conceals, or by fraud, artifice, or deception obtains a trade secret (2) without authorization copies, duplicates, sketches, draws, photographs, downloads, uploads, alters, destroys, photocopies, replicates, transmits, delivers, sends, mails, communicates, or conveys a trade secret (3) receives, buys, or possesses a trade secret, knowing the same to have been stolen or appropriated, obtained, or converted without authorization (4) attempts to commit any offense described in any of paragraphs (1) through (3); or (5) conspires with one or more other persons to commit any offense described in any of paragraphs (1) through (4), and one or more of such persons do any act to effect the object of conspiracy."

Other countries either have similar statutes (e.g., France) - or are considering to introduce them. Taiwan's National Security Council has been debating a local version of an economic espionage law lat month. There have been dozens of prosecutions under the law hitherto. Companies - such as "Four Pillars" which stole trade secrets from Avery Dennison - paid fines of millions of US dollars. Employees - such as PPG's Patrick Worthing - and their accomplices were jailed.

Foreign citizens - like the Taiwanese Kai-Lo Hsu and Prof. Charles Ho from National Chiao Tung university - were detained. Mark Halligan of Welsh and Katz in Chicago lists on his Web site more than 30 important economic espionage cases tried under the law by July last year.

The Economic Espionage law authorizes the FBI to act against foreign intelligence gathering agencies toiling on US soil with the aim of garnering proprietary economic information. During the Congressional hearings that preceded the law, the FBI estimated that no less that 23 governments, including the Israeli, French, Japanese, German, British, Swiss, Swedish, and Russian, were busy doing exactly that. Louis Freeh, the former director of the FBI, put it succinctly: "Economic Espionage is the greatest threat to our national security since the Cold War."

The French Ministry of Foreign Affairs runs a program which commutes military service to work at high tech US firms. Program-enrolled French computer engineers were arrested attempting to steal proprietary source codes from their American employers.

In an interview he granted to the German ZDF Television quoted by "Daily Yomiuri" and Netsafe, the former Director of the French foreign counterintelligence service, the DGSE, freely confessed:

"....All secret services of the big democracies undertake economic espionage ... Their role is to peer into hidden corners and in that context business plays an important part ... In France the state is not just responsible for the laws, it is also an entrepreneur. There are state-owned and semi-public companies. And that is why it is correct that for decades the French state regulated the market with its right hand in some ways and used its intelligence service with its left hand to furnish its commercial companies ... It is among the tasks of the secret services to shed light on and analyze the white, grey and black aspects of the granting of such major contracts, particularly in far-off countries."

The FBI investigated 400 economic espionage cases in 1995 - and 800 in 1996. It interfaces with American corporations and obtains investigative leads from them through its 26 years old Development of Espionage, Counterintelligence, and Counter terrorism Awareness (DECA) Program renamed ANSIR (Awareness of National Security Issues and Response). Every local FBI office has a White Collar Crime squad in charge of thwarting industrial espionage. The State Department runs a similar outfit called the Overseas Security Advisory Council (OSAC).

These are massive operations. In 1993-4 alone, the FBI briefed well over a quarter of a million corporate officers in more than 20,000 firms. By 1995, OSAC collaborated on overseas security problems with over 1400 private enterprises. "Country Councils", comprised of embassy official and private American business, operate in dozens of foreign cities. They facilitate the exchange of timely "unclassified" and threat-related security information.

More than 1600 US companies and organization are currently permanently affiliated wit OSAC. Its Advisory Council is made up of twenty-one private sector and four public sector member organizations that, according to OSAC, "represent specific industries or agencies that operate abroad. Private sector members serve for two to three years. More than fifty U.S. companies and organizations have already served on the Council. Member organizations designate representatives to work on the Council.

These representatives provide the direction and guidance to develop programs that most benefit the U.S. private sector overseas. Representatives meet quarterly and staff committees tasked with specific projects. Current committees include Transnational Crime, Country Council Support, Protection of Information and Technology, and Security Awareness and Education."

But the FBI is only one of many agencies that deal with the problem in the USA. The President's Annual Report to

Congress on "Foreign Economic Collection and Industrial Espionage" dated July 1995, describes the multiple competitive intelligence (CI) roles of the Customs Service, the Department of Defense, the Department of Energy, and the CIA.

The federal government alerts its contractors to CI threats and subjects them to "awareness programs" under the DOD's Defense Information Counter Espionage (DICE) program. The Defense Investigative Service (DIS) maintains a host of useful databases such as the Foreign Ownership, Control, or Influence (FOCI) register. It is active otherwise as well, conducting personal security interviews by industrial security representatives and keeping tabs on the foreign contacts of security cleared facilities. And the list goes on.

According to the aforementioned report to Congress:

"The industries that have been the targets in most cases of economic espionage and other collection activities include biotechnology; aerospace; telecommunications, including the technology to build the 'information superhighway'; computer software/ hardware; advanced transportation and engine technology; advanced materials and coatings, including 'stealth' technologies; energy research; defense and armaments technology; manufacturing processes; and semiconductors. Proprietary business information-that is, bid, contract, customer, and strategy in these sectors is aggressively targeted. Foreign collectors have also shown great interest in government and corporate financial and trade data."

The collection methods range from the traditional - agent recruitment and break ins - to the technologically fantastic. Mergers, acquisitions, joint ventures, research and development partnerships, licensing and franchise agreements, friendship societies, international exchange programs, import-export companies - often cover up for old fashioned reconnaissance. Foreign governments disseminate disinformation to scare off competitors - or lure then into well-set traps.

Foreign students, foreign employees, foreign tourist guides, tourists, immigrants, translators, affable employees of NGO's, eager consultants, lobbyists, spin doctors, and mock journalists are all part of national concerted efforts to prevail in the global commercial jungle. Recruitment of traitors and patriots is at its peak in international trade fairs, air shows, sabbaticals, scientific congresses, and conferences.

On May 2001, Takashi Okamoto and Hiroaki Serizwa were indicted of stealing DNA and cell line reagents from Lerner Research Institute and the Cleveland Clinic Foundation. This was done on behalf of the Institute of Physical and Chemical Research (RIKEN) in Japan - an outfit 94 funded by the Japanese government. The indictment called RIKEN "an instrumentality of the government of Japan".

The Chinese Ministry of Posts and Telecommunications was involved on May 2001 in an egregious case of theft of intellectual property. Two development scientists of Chinese origin transferred the PathStar Access Server technology to a Chinese corporation owned by the ministry. The joint venture it formed with the thieves promptly came out with its own product probably based on the stolen secrets.

The following ad appeared in the Asian Wall Street Journal in 1991 - followed by a contact phone number in western Europe:

"Do you have advanced/privileged information of any type of project/contract that is going to be carried out in your country? We hold commission/agency agreements with many large European companies and could introduce them to your project/contract. Any commission received would be shared with yourselves."

Ben Venzke, publisher of Intelligence Watch Report, describes how Mitsubishi filed c. 1500 FOIA (Freedom of Information Act) requests in 1987 alone, in an effort to enter the space industry. The US Patent office is another great source of freely available proprietary information.

Industrial espionage is not new. In his book, "War by Other Means: Economic Espionage in America", The Wall Street Journal's John Fialka, vividly describes how Frances Cabot Lowell absconded from Britain with the plans for the cutting edge Cartwright loom in 1813.

Still, the phenomenon has lately become more egregious and more controversial. As Cold War structures - from NATO to the KGB and the CIA - seek to redefine themselves and to assume new roles and new functions, economic espionage offers a tempting solution.

Moreover, decades of increasing state involvement in modern economies have blurred the traditional demarcation between the private and the public sectors. Many firms are either state-owned (in Europe) or state-financed (in Asia) or sustained by state largesse and patronage (the USA). Many businessmen double as politicians and numerous politicians serve on corporate boards.

Eisenhower's "military-industrial complex" though not as sinister as once imagined is, all the same, a reality. The deployment of state intelligence assets and resources to help the private sector gain a competitive edge is merely its manifestation.

As foreign corporate ownership becomes widespread, as multinationals expand, as nation-states dissolve into regions and coalesce into supranational states - the classic, exclusionary, and dichotomous view of the world ("we" versus "they") will fade. But the notion of "proprietary information" is here to stay. And theft will never cease as long as there is profit to be had.

Exchange Rates

We are used to reading financial statements denominated in US dollars or to pay our rent in euros. Economic indicators are normally converted to a common currency to allow for international comparisons. The exchange rates used are the official exchange rates (where foreign exchange persist) or market exchange rates (where the markets freely determine the exchange rates between the local currency and foreign currencies). The theory says that exchange rates are adjust through the mechanism of the market so that the prices in local currency of a group of identical goods and services represent equivalent value in other currencies. Put differently: 31 Denars should buy the same quantities of identical goods and services in Macedonia as 1 DM buys in Germany. Otherwise, one of the currencies is overvalued, the other one is undervalued and the exchange rate is "wrong" (sometimes, kept artificially wrong by the governments involved). This is the Law of One Price.

In reality, such adjustments do not reflect timely or accurately changing economic circumstances. The involvement of the state, for example, by imposing currency controls and by intervening in the markets (through the Central Bank and using its reserves), determining interest rates, slapping import tariffs, and introducing export subsidies distort the veracity of market- based exchange rates.

As long as goods are traded across borders, the possibility of arbitrage exists: the same goods can be bought cheaply in one place (call it territory A) - and sold for a profit in another (call it territory B), until the price equalizes. Prices tend to equalize, because there will always be someone who is willing to make less profit. He will sell (in B) at a reduced price which will be closer to the cheaper price that he paid in A. This way, the price mechanism will equate the purchasing power of the currencies of A and B: the same money will be needed to buy the same goods in A and B. Fiscal policy is considered to be of little consequence regarding exchange rates. The costs of transportation are ignored. In short, this ideal picture is very misleading. The reason is that many goods and services cannot be traded at all (non-tradables). Real estate, for instance. The relative value of such goods in A and B has nothing to do with the exchange rates. These goods are not part of the flows of currencies which determine exchange rates. They are bought and sold only in local currency. Their relative value is independent of the exchange rate mechanism and cannot be determined by studying it. To summarize: international comparisons based on market exchange rates usually greatly over- or understate the value of a nation's economic activity.

The Purchasing Power Parity (PPP) theories are the rivals of the Exchange Rate ones. The comparison is based on an evaluations of the purchasing powers of currencies - rather than on their exchange rates.

The procedure is fairly straight forward (and a little more convincing): the prices several hundred goods and services are regularly monitored (for instance, by the International Comparison Project (ICP) which operates in a large number of participating countries). The exchange rates are adjusted to reflect differences in purchasing power and thus to create purchasing power parity (PPP). PPP currency values are the number of units of a local currency required to buy the same quantity of comparable goods and services in the local market as one U.S. dollar would buy in an "average country" (in an average of all the countries). Sometimes, PPP comparisons are made against some base country. Could 55 Denars buy what 1 dollar buys in the USA? If so, the exchange rate is "right" because both currencies have the same purchasing power.

No article about PPP can ignore the "Economist Big Mac Index of Purchasing Power". The idea is ingenious: the Big Mac, the staple of the McDonald's restaurants, is almost completely identical the world over. In Beijing, Paris, Skopje and Tel-Aviv the same raw materials are put together in the same quantities to produce the same Big Mac. So, the Big Mac is really a "basket" of goods and services (the sales, cleaning, maintenance, accounting and so on) which is universal. In other words, it is a global index. By comparing the prices of Big Macs in various countries we can get a rough estimate whether the exchange rates properly reflect the relative purchasing power of the currencies involved. "The Economist" has been publishing the Index for a few years now and the results are amazing:

Exchange rates deviate wildly from real purchasing power. The Big Mac costs in the USA 2.58 USD (= 140 Denars). In Venezuela and Israel it costs 30% more. In Japan it costs 12% less, in Greece 20% less, in Russia 25% less, in Czech Republic 35% less, in Poland and Hungary almost 50% less. Translated to foreign exchange terms, the currencies of Hungary and Poland are 50% undervalued and the Israeli Shekel is 30% overvalued and should be devalued by the same amount.

In Macedonia a Big Mac costs 95 Denars - 40% less than in the USA! In other words: 95 Denars are the equivalent of 2.58 USD and the exchange rate should have been 37 Denars to the USD - and not 55.

This is a light hearted way of measuring PPP but all the international financial institutions agree today that the exchange rates used in their reports should be at least compared (if not actually adjusted) to reflect the purchasing power. The World Bank now uses both modes of presentation to present estimates of GDP. The IMF uses country weights based on PPP-based GDP for calculating growth rates and other economic indicators.

This has enormous implications. If this is true, the developing world's share of the economic activity in the world is larger than that adduced from the exchange rates. Granted, exchange rates provide us with a fair estimate of trade potential - but, after all, trade is only a part (and not the biggest) of the world economy.

As the new decade entered, the United Nations devised an index of Purchase Power Parity comparing the spending prowess of most of its members. The index included a basket of such items as average incomes, taxes, interest rates, insurance, utilities, gasoline, milk, newspapers and other typical expenses. As usual, the USA constituted the benchmark at 100. The first published index showed Greece at 35 (=three Greeks equal the purchasing power of one American consumer). A few more numbers:

GERMANY 89, JAPAN 86, FRANCE 82, SWEDEN 77, AUSTRALIA 77, SINGAPORE 77, UK 72, ISRAEL 62, SPAIN 56, SAUDI ARABIA 42, ARGENTINA 37, CHILE 35, MEXICO 31, RUSSIA 26, BRAZIL 22, TURKEY 22, POLAND 20, SOUTH AFRICA 16, EGYPT 15, INDONESIA 12, CHINA 8, KENYA 6, INDIA 5.

So, what should be the exchange rate of the Denar? Skopsko and everything is possible: 37 Denars to the USD in McDonald's. Reality, however, is more grim. The (formal) average salary in Macedonia is 170 USD per month. Taking into consideration a 50% black economy factor, the real monthly wage is closer to 350 USD. This is still 10% of the average salary in the USA. The PPP theories ignore this important consideration. How strong (or weak) the currency is - is one important consideration but to say that it incorporates all the available information would be to miss the point. I am sure that the prices that McDonald's can and does charge in Skopje were influenced by the very simple fact that people have 90% less money here than in St. Louis.

Judging by the money supply, the availability of money through earnings, the wealth accumulation (savings rate and interest payable on M1 type instruments) - Macedonia is both inordinately illiquid and insanely expensive. To rent an apartment here costs 50-100 DM per square meter which is 60% of the rent in the most luxurious neighbourhoods in Tel-Aviv. Israel's GDP, however is 35 times that of Macedonia and the minimum legal wage is 900 DM. To my mind, there is little question that the purchasing power of the Macedonians is miserable. The combination of law wages and expensive prices sustained by a small rich elite is a clear sign of erosion of the power to spend of the great majority.

Other measures of currency parity are also unfavourable to the Denar. An important measure is the Covered (and Uncovered) Interest Parity (C/UIP). Roughly, it says that the differences in interest rates should be equal but opposite in sign to the (forward) exchange rate premium or discount between currencies.

Consider an American investor. Investment in either America or in Macedonia should yield the same return if the exchange rate risk is to be removed. If this were not the case, currency arbitrageurs would have moved in and made a profit. If the interest rate paid on the MKD is 10% and to borrow in American USD costs 6% - if the exchange rate remains stable, the investor will borrow USD, invest in MKD and earn 4% just by converting one currency to another (assuming free convertibility).

The fact that this is not happening in Macedonia proves that people still believe that the Denar is overvalued and should be heavily devalued. In other words: they think that the exchange rate risks are higher than the potential arbitrage profit. In a country far more dangerous than Macedonia (Israel) the foreign exchange reserves shot up by 130% (to 19.3 billion USD) precisely because of this: speculators converted dollars to Shekels to earn the high real interest that it offers in terms of dollars.

But, ultimately, exchange rates are determined by the supply and demand for the local currency relative to foreign currencies. This is a fundamental issue. In a country with a big trade or payments deficit, the demand for foreign exchange will exert pressure on the exchange rate of the local currency. In Thailand, Indonesia, Malaysia, Mexico - the trade deficit was less than 10% of GDP. Still, their currencies collapsed and were devalued by tens of percents, many times violently and in the space of a few horrible days. Macedonia's trade deficit stands at 16% (double that of Thailand's and Mexico prior to the demolition of their currencies).In a country with a big trade deficit, the fact that a currency is stable for a long time only means that it will collapse more spectacularly. It is like a pressure cooker: the more the lid is on, the higher the pressure and the resulting vapour. The trade deficit is covered by unilateral transfers from international financial institutions and donors. This is not a way to build a healthy currency (or economy, for that matter). Moreover, the bleeding of foreign exchange goes towards an increase in consumption. Investments of foreign exchange in capital assets (example: machinery and plant) generates enough foreign exchange in exports to recoup the outflow. Foreign exchange spent on cars and on caviar is foreign exchange lost.

The high interest rates in Macedonia and the infusions of capital from abroad keep the currency overvalued. Its appreciation is the result of conjectures not of fundamentals.

The writing is on the wall: a country which is running a large trade or current account deficit must balance its balance of payments with capital inflows (capital account surplus). If investors lose confidence in the country, capital inflows will cease (maybe reverse direction) leading to a depreciation (e.g., Mexico in 1994). For "investors" read in the last sentence "the international financial community". The important monthly "Euromoney" downgraded the credit rating of Macedonia (to the 151st place!!!) largely on these grounds. Current account + Capital account = change in gov't reserves. Today's reserves are sufficient to cover 2-3 months of imports. This is ample - but this is also temporary. The danger is imminent and the results could be catastrophic.

Exclaves, Economies of

Cabinda is a member of the Hague based UNPO - the Unrepresented Nations and Peoples Organization. Among the dozens of other members are Abkhazia, the Albanians in Macedonia, Bashkortostan, Gaguzia, and Iraqi Kurdistan. Some erstwhile members became independent states - including Estonia, East Timor, Armenia, Georgia, and Latvia. The Cabindese Government in Exile (in charge of a little more than a poorly designed Web site and a few badly trained guerillas) thinks it is a good omen and a portent of things to come.

The history of the past five decades is littered with artificial polities, ethnically heterogeneous and internecine entities, unsustainable borders, divided loyalties, corrupt, self-serving regimes, civil wars, and looted natural endowments - all the tragic outcomes of the chaotic disintegration of colonial powers. Among the debris are a series of exclaves - "a portion of territory of one state completely surrounded by territory of another or others" (OED). Cabinda is an exclave, as are Ceuta, Melilla, Kaliningrad, and, of course, Gibraltar. But while the latter - a bone of contention between two EU members, Spain and the United Kingdom - is constantly in the limelight, not much is said (or done) about the former four.

CABINDA

Cabinda is 2,800 sq. m.. (7,300 sq. km.) of sweaty tropical forest and less than 200,000 inhabitants strong (counting more than 20,000 refugees in Congo). Nominally, it is an Angolan province separated from Angola by a Congolese corridor leading to the Congo river and thence to the sea. It is inordinately rich in natural resources: hardwood, cassava, bananas, coffee, cocoa (cacao), crude rubber, palm products, phosphate, manganese. quartz, gold, potassium, and, above all, oil (about 500,000 barrels per day). Huge rigs have been producing most of Angola's GDP off Cabinda's luscious shores since 1968. Cabinda has the second richest variety of forest trees after the Amazon. Unending strips of invaluable species such as black wood, ebony, and African sandal wood still harbor (protected) mountain gorillas. Wood of Cabinda origin is avidly sought by connoisseurs in Portugal, Germany, Italy, and the Netherlands.

Had Cabinda been an independent state and had all 400,000 Cabindese repatriated - GDP per capita would have still amounted to $7000, making it the richest territory in Africa. Small wonder that many of the bloodiest battles in Angola's protracted war of independence from the Portuguese (1961-1975) took place here.

Yet, even after the coveted independence was achieved, very little of the oil bonanza trickled back to the disgruntled Cabindese. They still depend on subsistence agriculture for a living. Infant mortality is among the highest in the world and only 3 in 10 people have access even to rudimentary health services. The average life expectancy is 47 years and the literacy rate is 42%.

Cabinda mostly has dust roads, deforestation, desertification, soil erosion, and oil spills to show for its gifts of nature. The Cabindese blame foreign oil firms (Chevron, Elf) for importing goods and services duty free - rather than purchase them locally or invest in local infrastructure and industry. Hence the Cabindese rebelliousness, constant strife, and low intensity warfare. The peace agreements in Congo mean that Angola may have a shot at taking over the Congolese strips that separate it from Cabinda and at attacking rebel UNITA camps on Congolese soil. In short, Cabinda is running out of friends and out of its insular geography.

"Today, the Angolese colonialiste (sic) and their agents are occupying the Cabindese territory and become the enemies of the Cabindese people. We are Cabindese in our heart and our soul and we are sadly witnessing the destruction and the ransacking our country." - says the "government". It is open to an economic federation with Angola but wishes to "develop agriculture by supporting and stimulating the creation of farmers' cooperatives in the free zones and refugees' camps". And what would be its economic philosophy after Cabinda's yearned for independence? "Promote an economic policy of free exchange and humanitarian vocation." More specifically, the government has plans to develop Cabinda's largely untapped diamond, cobalt, and uranium veins. But it all sounds desperate and self-delusional. Abandoned by the international community (Cabinda was once a member of the Organization of African Unity as an independent state), bereft of its strategic importance, economically raped by east and west alike - Cabinda is fast dwindling and literally dying.

This by no means is the universal fate of all exclaves.

KALININGRAD

Kaliningrad port is ice-free. It is so unusual in the Baltic Sea that this serendipity led to prosperity throughout the illustrious history (Kant lived and taught here) of this region and its eponymous capital (formerly known as Konigsburg). It attracted a navy base (home to the Russian Baltic fleet), fishermen, logging companies, and derivative industries (shipping, processed food, machinery). Kaliningrad has the makings of a "Hong Kong on the Baltic Sea" as Chernomyrdin predicted when Russia established it as a "pilot" Europe-orientated Special Economic Zone (really a hybrid customs and offshore investment zone) in 1996. Yet, in 1998 it attracted only $11 million (and a year later, only $18 million) in investments, both foreign and inward. This reluctance was a penalty for its political affiliation, being a part of Russian and its (until recently) impossible tax code, capricious and venal legal system, prying intelligence services (on the lookout for separatist tendencies), lack of funding from the centre, the regional administration's blatant protectionism and interventionism, and discrepancies between the legal systems (e.g. VAT rates).

Things, though, have improved recently.

To quell secessionist stirrings, the Pravoslav Church has come out unequivocally in favor of a Russian Kaliningrad, as have all the governments of the region. The investment climate in Russia itself has improved dramatically since 1998 with a new tax code and other pro-business bits of legislation enacted by a Putin-awed Duma. Both Poland and Lithuania - which sandwich Kaliningrad between them - are slated to join the EU. Kaliningrad's workforce is highly qualified and polyglot. The city is bristling with more than 50,000 small and medium enterprises (mostly trading companies). Its transport infrastructure (inherited partly from the military) and banks (some Polish and German) outshine most other provinces in Russia. It is rich in certain mineral resources: amber, (high grade) oil, peat, rock salt, brown coal (merely 50 million tons), timber, and construction materials. Of course, there is an impressive variety of high value fish (eel and salmon being the most lucrative).

Various Swiss, Polish, Lithuanian, and German firms have started to shift their production facilities to the exclave. More than 1200 joint ventures with foreign partners from more than 50 countries have been registered. BMW and KIA cars are already produced there - as well as pulp and paper (Cepruss). Even the EU has chipped in and provided grants and credits of almost 10 million euro. The Autosan bus enterprise (part of the Zasada Group in Poland) decided to assemble there buses for sale in the Russian market. Vicuinai, a Lithuanian food concern will launch a $5 million fish processing plant in Kaliningrad in July this year. German firms are all over the place - from oil production equipment ("Baltkran") to a sewing factory ("Grammer AG"). German banks extended tens of millions of dollars in credits to the regional government. German Lander (such as Hamburg and Schleswig-Holstein) have their own representation.

Still, its cosmopolitan aspirations as a bridge between Russia, the EU, and the Baltic notwithstanding, Kaliningrad is a part of decrepit and drab Russia. Baltiyisk, a 50,000 strong town in the Kaliningrad region, went without water on New Year's day due to a ruptured pipe. Production, since 1990, declined precipitously in the important food, machinery, and fishing industries. The fate of exclaves is oft determined by their political affiliation rather than by their geographical realities or geopolitical aspirations.

CEUTA AND MELILLA (C&M)

Indigenous Moroccan Jews call them "Morocco Spaniol". These are the Jews who were expelled from Spain in 1492 and who chose to settle in self-imposed ghettoes on the shores of Morocco, a few kilometers from their abandoned homes. Their return is imminent, so they believed. They preserved their Ladino dialect (a mixture of Hebrew words and Castilian Spanish), their social hierarchy, and their institutions for centuries of forlorn yearning.

Today there are very few Jews in Morocco but native Moroccans (and an assortment of other Africans and Asians) cross the straits to Spain clandestinely. They do so mostly from two Spanish exclaves, together 31 sq. km. big, on the Moroccan shore (it is the shortest distance) - Ceuta (73,000 people) and Melilla (65,000). The smuggling of immigrants may be the single biggest economic activity in these two heavily subsidized territories. Until recently, C&M were flanked by huge camps of would be migrants who survived on the charity of the locals and on drug trading. Ever since Spain, at the EU's panicky behest, cordoned off the beach with barbed wire and fortifications, the camps have dwindled (though the Red Cross still feeds 1000 people daily in and around Ceuta alone).

Yet, not only people make use of the age old smuggling routes through C&M. The Riff area, Morocco's Wild West and major drug growing zone, smuggles its $3-4 billion a year in produce to Western Europe using very much the same infrastructure (a fleet of tiny and capsizing boats). Child prostitution rings have sprung up. Remittances from those who made it into the heartland amount to at least another $1 billion (many say double that). Money laundering is a thriving activity among both bitter rivals: the Moslem and Christian Spanish residents of the exclaves.

Not everything is crime and corruption in C&M. Ceuta sports a thriving food processing and handmade textile industries. It is an important refueling and fishing port and a trendy tourist destination. It used to be duty free until 1995 (Melilla's similar status was revoked in 1992), but its port facilities are still active. The city fathers are trying to develop aquaculture. Still, official unemployment is near 30%. The situation in Melilla is even worse.

The irony is that C&M (where the euro is legal tender) receive dollops of cash from the EU in "regional aid" and preferential fishing quotas (both territories are excluded from NATO, though). Spain has just increased by 55% (to 200 million euros) the subsidy it pays Endesa, the power utility, to light up C&M (and other Spanish territories the world over). This means that c. 2% of the electricity bills of every Spaniard go towards subsidizing the energy needs of these strategically meaningless locations. Spain also doles out cash (c. $10 million a year) to its national ferry companies to provide maritime links with C&M and other overseas territories. In a recent tender not one foreign or domestic private shipping company presented a bid. Spain expressed astonishment.

Morocco hotly contests Spanish sovereignty in Ceuta and Melilla, but hitherto to no avail. Spain holds local elections there (recently won in Ceuta by the ex-convict mayor of the Andalusian city of Marbella and his people). The tacit understanding is that Morocco will accept back Moroccan illegal immigrants caught by Spanish authorities. In return, Spain invests in Morocco (in labour intensive industries, to keep the human tide at bay). Morocco depends on remittances from expatriates and so promotes with the EU the idea of an immigration quota.

C&M are at the heart of the tension between established, wealthy, sated societies and hungry, deprived and bitter immigrants from developing countries. To the former it is a threat - to the latter a promise. In this bottleneck of festering corruption and crime, the future of Europe unfolds in slow motion: barbed wire, drug dealing, violence, aid dependency, and the inevitable opening of its gates to the manpower it so direly needs and so long exploited in its colonies.

Expectations, Economic

Economies revolve around and are determined by "anchors": stores of value that assume pivotal roles and lend character to transactions and economic players alike. Well into the 19 century, tangible assets such as real estate and commodities constituted the bulk of the exchanges that occurred in marketplaces, both national and global. People bought and sold land, buildings, minerals, edibles, and capital goods. These were regarded not merely as means of production but also as forms of wealth.

Inevitably, human society organized itself to facilitate such exchanges. The legal and political systems sought to support, encourage, and catalyze transactions by enhancing and enforcing property rights, by providing public goods, and by rectifying market failures.

Later on and well into the 1980s, symbolic representations of ownership of real goods and property (e.g, shares, commercial paper, collateralized bonds, forward contracts) were all the rage. By the end of this period, these surpassed the size of markets in underlying assets. Thus, the daily turnover in stocks, bonds, and currencies dwarfed the annual value added in all industries combined.

Again, Mankind adapted to this new environment. Technology catered to the needs of traders and speculators, businessmen and middlemen. Advances in telecommunications and transportation followed inexorably. The concept of intellectual property rights was introduced. A financial infrastructure emerged, replete with highly specialized institutions (e.g., central banks) and businesses (for instance, investment banks, jobbers, and private equity funds).

We are in the throes of a third wave. Instead of buying and selling assets one way (as tangibles) or the other (as symbols) - we increasingly trade in expectations (in other words, we transfer risks). The markets in derivatives (options, futures, indices, swaps, collateralized instruments, and so on) are flourishing.

Society is never far behind. Even the most conservative economic structures and institutions now strive to manage expectations. Thus, for example, rather than tackle inflation directly, central banks currently seek to subdue it by issuing inflation targets (in other words, they aim to influence public expectations regarding future inflation).

The more abstract the item traded, the less cumbersome it is and the more frictionless the exchanges in which it is swapped. The smooth transmission of information gives rise to both positive and negative outcomes: more efficient markets, on the one hand - and contagion on the other hand; less volatility on the one hand - and swifter reactions to bad news on the other hand (hence the need for market breakers); the immediate incorporation of new data in prices on the one hand - and asset bubbles on the other hand.

Hitherto, even the most arcane and abstract contract traded was somehow attached to and derived from an underlying tangible asset, no matter how remotely. But this linkage may soon be dispensed with. The future may witness the bartering of agreements that have nothing to do with real world objects or values.

In days to come, traders and speculators will be able to generate on the fly their own, custom-made, one-time, investment vehicles for each and every specific transaction. They will do so by combining "off-the-shelf", publicly traded components. Gains and losses will be determined by arbitrary rules or by reference to extraneous events. Real estate, commodities, and capital goods will revert to their original forms and functions: bare necessities to be utilized and consumed, not speculated on.

Experts, Foreign

"There is nothing so good for the human soul as the discovery that there are ancient and flourishing civilized societies which have somehow managed to exist for many centuries and are still in being though they have had no help from the traveler in solving their problems."

Walter Lippmann

In "Alice's Adventures in Wonderland", Lewis Carroll wrote: ***"Curtsy while you're thinking of something to say. It saves time."***

What a missed career. He should have been an expat expert. To paraphrase a sentence originally written about women (no misogynism implied): "What else is a foreign consultant but a foe to friendship, an inescapable punishment, a necessary evil, a natural temptation, a desirable calamity, a domestic danger, a delectable detriment, an evil nature, painted with fair colours?" (Anne Baring and Jules Cashford, They Myth of the Goddess: Evolution of an Image (London: Penguin Books Inc., 1993).

Not unlike poor Mr. Prufrock in T.S. Eliot's "The Love Song of J. Alfred Prufrock," foreign advisors in the exotic countries of CEE, especially once moderately inebriated, are prone to dramatic monologues and musings, "measuring out their lives in coffee spoons" as they contemplate "the yellow smoke that slides along the street, rubbing its back upon the window-panes."

All foreign advisors belong to either of three categories: the hustlers, the bureaucrats and the corporates.

The first sub-species peddle their specious wares aggressively, flamboyantly and relentlessly. They present a picturesque assortment of quaint British eccentricities and pronounced professional idiosyncrasies. They often are under a cloud - but never in the shade. Sometimes they even flaunt their chequered past and colourful adventures. It is the only form of entertainment in the drab cemetery that Eastern and Southeastern Europe is. In the hope of landing a fat consultancy contract with a confused minister or with a terror-stricken central banker, with a quadriplegic stock exchange or with a dying industry lobby, with sansculotte trade unions or with gullible Western NGOs - they gypsy around, living off tattered suitcases in shabby hotels, yearning to strike gold in the next station of their mendicant's journey. Necessarily abstemious - they are otherwise and when serendipity strikes, containers of greed and avarice and gluttony and hedonism. Unfulfilled, they often deteriorate to colluding in obscure dealings with corrupt officials. You can find these hangers-on in every pub and bar from the farthest Russian north to the warm waters of Bulgaria, the same dogged look, the same mane of yellowing hair, the old-cut suits and sole-worn shoes and the drooling eagerness to gossip and to profit.

Contrast these has beens to the bureaucratic breed. Ever the laptopped, they travel first class and reside in five star luxurious hotels strewn among the decrepitude of their surrounding. Unashamed, they flaunt shimmering utility vehicles and satellite cellular phones in the face of the unemployed and downtrodden they came ostensibly to help. Occupied mainly by scanning the daily paper and solving simple crossword puzzles, they disrupt their onerous routine only to wine and dine venal officials on mutually fattening expense accounts. They are the malignancy of Bretton Woods, a cancerous growth of well intended aid, the hideous face of altruism. Their organizations are the dumping grounds of the inept and the unwanted, the professional failures and the embarrassingly corrupt, the egregiously ignorant and the narcissistically immature. They tax the resources of their hosts as all parasites do and give very little in return. Their advice is often wrong and almost invariably leads to adversity and woe. They tend to overstep their mandate and supplant elected offices and their humiliated occupants. They dictate and intervene and threaten and determine with the callousness of those who lose no thing when their "advice" goes awry. In time, they move on from one political carcass to another, birds of prey with metal wings and the sated satisfaction of the well fed and the multi-salaried. Earning in a day what others earn in two months - they often hold their mission and its objects in contempt and scorn. They are content to climb the autistic ladder that is a multilateral institution. The rare are recruited by the private sector as third rate lobbyists.

The suborned politicians of this region have good use for these emissaries of defective micromanagement. They hide their thefts and their incompetence behind a fig leaf of "they told me to". They blame their failures, their patently erroneous decisions, their marked inabilities - on the negative externalities of the international community. An elaborate sign language of winks and nods develops in the execrable, fungal intimacy between native bureaucracy and foreign supervisors. The "advisors" and "country managers" and "resident officers" often come themselves from shrines of good governance and civil society, the likes of China and India and Saudi Arabia or worse. They understand the secret language of power and quid pro quo. What better than a fat and satiated cat to guard the skinny and famished ones? So, they collaborate in the most lamentable of manners, eyes closed, ears plugged, mouth stapled. The bureaucrats author delusional science fiction, delirious potpourris of wishful thinking and grotesque projections, the customary backslapping and mutual admiration. And the politicians pretend to listen, patiently ignoring the more arcane lingo and outlandish offers, waiting for the aliens to take off to their planet and allow them to proceed with plundering and loot.

The third type of expert foreigners are members of academe or business corporations (the distinction quite blurred in the United States). The infamous Harvard affair in Russia exposed the profit motives of these self appointed and self-proclaimed do gooders. It also elucidated their moral standard - rather the lack thereof. Scores of Western consultancies set shop in CEE and southeast Europe - accountancies, law firms, the odd professional. Western know how on anything from wood processing to canning, from intellectual property to real estate and from publishing to brewing can be obtained. Ultimately, this breed of entrepreneur-consultants represents the biggest hope. True, profit motivated and all too willing to cross the lines for client, God and country - still, their thinking is a sound one, their ethos genuine, their goals are realistic and they seem to know the path. In their ruthless application of the admixture of drive and dream, they often lead the way - obtaining finance, converting others to the cause, constructing projects, educating, preaching and teaching and hectoring and, in this arduous, often derided process, falling in love with land and people.

Export and Import Transactions

I. The Export Transaction and Its Documents

The Transaction

- Finding a market for the goods (market research)
- Selecting the marketing channels
- Negotiations
- Pricing
- Distribution channels
- Order
- Contract
- Commercial Invoice

Commercial Invoice must include (minimum):

- Payment Terms
- Mode of Payment
- Division of Costs
- Details of Carrier
- Details of Receiving Party
- Details of Buyer
- Other Details

For best results use the ECE (Economic Commission for Europe) Standard Commercial Invoice

Packing List must include (minimum):

- Contents of the Packaging (=of the shipment)
- If more than one package or outer and inner packing – all contents per each packing and per each package must be detailed separately
- Permits and Licenses
- Export licenses if needed
- Standards certificates
- Labeling
- Quality control certificates (highest is ISO, such as ISO-9002 or ISO-9000)
- Health and phytosanitary certificates
- Veterinary certificates
- Other permits, licenses and certificates
- Service Providers
- Marine Transport
- Air Transport
- Land Transport (lorry, train)
- Insurance
- Warehousing
- Banking and other Financial Services (factoring, forfeiting, etc.)
- Airway Bill of Lading (ABL)
- (More details later – see appendices for samples)
- Holder of ABL does not own goods
- Air Transport Contract not effected – but ABL proof of existence of such contract, including weight, measurements, number of packages and invoice.
- Marine Bill of Lading (MBL)
- Proof of receipt of goods in a certain condition
- Proof of existence of transport contract
- MBL facilitates the transfer of ownership

Negotiable, transferable and assignable

Subject to the Hague conditions and MUST INCLUDE:

- Name and address of sender
- Port of loading and Port of discharge
- Date of lading and place of issuance of bill of lading
- Name of vessel and number of voyage
- Identity marks of cargo
- Description of goods – number of packing units, weight, volume
- Condition of goods – statement of carrier (if not stated – the goods are in good condition)
- "Clean on Board" not "Foul"

Types of Bills of Lading (BL)

- Shipped BL – Goods are on deck of ship
- Received for Shipment – Prior to loading onto ship
- Direct BL – From origin to destination, transshipment not allowed
- Ocean Through BL – In case of transit involving a few carriers. In such a case, each carrier imposes its own conditions on each leg of the voyage and for the limited duration it handles the cargo.
- Pure Through BL – First carrier must transport from port of loading to a mid-point and is responsible for damages to the goods.
- Combined Transport BL – Pure BL which covers shipment by all means of transport (sea, air, land).
- Forwarder BL – An agent's BL. Issued by an international forwarder.
- Freight Forwarder BL – BLs of the International Forwarders Association – FIATA

Types of Insurance Policies (IP)

The IP is prepared by the insurance agent or the insurance company.

- Open Time IP – One time IP, used in air/marine transport. Policy expires with the completion of the transport (with delivery).
- Open IP – Open or current policy used to insure a number of shipments. Payment of premium only for actual shipments. Entails a declaration by the insured to the insurer pertaining to each and every shipment on a pre-determined basis (ad hoc, weekly, monthly and so on).

The rights of the insured party are NOT effected if it BONA FIDE forgot or had no time to declare to the insurer as per above, or if it gave the insurer a declaration containing wrong information. The right declaration can be filed even after the goods are lost or delivered.

Types of Certificates of Origin (CO)

Required by the authorities as a basis for customs duties and taxes discounts or exemptions under trade agreements.

Some destination require CO per each shipment. Others require CO only for specific goods. Sometimes the buyer demands a CO.

The exporter sends the CO to the buyer separately or with the goods.

Issued by the Chamber of Commerce, or by the Customs, or by the exporter itself or by its forwarder in trust.

- EUR1 – To the European Union
- FORM A – To the USA / NAFTA (the customs union of the USA, Canada and Mexico)
- CO

Warehouse Receipt proves warehousing of goods in the port area. Needed prior to commencement of the release of the goods by the customs.

- Orders
- Inquiry
- Indication / Quotation
- Order
- Firm Order
- Acceptance (the order becomes a contract by accepting it)
- Revolving Orders are considered contracts

Order through an agent – identical to order issued directly by a buyer (Important: demand from the agent proof of agency or representation, such as a power of attorney)

Should include:

1. Price of Goods (including price ex factory, shipment / transport – freight costs, insurance, port taxes and expenses, other taxes, customs costs, forwarding costs, costs of issuing certificates, permits and licenses)

IMPORTANT: Make sure WHO pays WHAT

2. Specifications of Goods – Type of goods, quality, packing, number of units / quantity per package, packing sub-units

IMPORTANT: Prepare a sample for the buyer – which will be WORSE than actually delivered goods.

3. Quantity and Delivery Terms

If it is an on-going (revolving) order – get from the buyer a projection of its purchases in the future.

TIME OF DELIVERY IS CRITICAL !!!

4. Mode and Method of Payment

Transaction Documents

- Documents demanded by the authorities (permits, licenses, standards and quality certificates, veterinary certificates, health certificates, labeling, etc.)
- Transaction documents (bill of lading, certificate of origin, commercial invoice and specifications, port and customs clearances, banking documents, etc.)
- Packing, Freight and Insurance
- Define outer and inner packing and sub-packing (materials, shape, size)
- Quantities
- Measurements
- Quality

IMPORTANT – Get freight offers from a few forwarders/carriers and make sure ALL the components are included in the price quoted!!!

Remember:

All costs, including the insurance premiums, are negotiable.

USE an insurance agent or an insurance expert within your company. Insurance is a complicated subject and the insurance companies do their best not to pay on claims.

Proforma Invoice (PI)

Is actually an order and constructed as a commercial invoice –

But a commercial invoice MUST be provided separately.

Seller sends PI in duplicate (=2 copies)

Buyer signs one copy and returns it to seller

Buyer can prepare order or PI on its letterhead and send it to seller

Must include mode of payment

Sale Contract

Use in case of a complicated transaction, the provision of services (or of goods which contain a service element – for example, maintenance or training)

Sole Distributorship Contract

In case of doubt, use the ICC (international Chamber of Commerce) Model Contract (see appendix).

A distributor BUYS the goods and distributes them through a network of sub-distributors. He participates in advertising, marketing and sale promotion of the products he distributes. In return, he gets exclusivity for a certain territory, for a prescribed period of time and under certain terms and conditions. He does not distribute competing products and he uses a brandname.

An agent get a commission on sales generated through him – but does NOT buy the goods.

The Sole Distributorship contract MUST include:

- Definition of territory and products
- Commitment to act bona fide and with best efforts
- Roles of the distributor
- Non competition clause
- Distributorship and distribution channels
- Fairs, exhibitions, advertising, marketing and sales promotion
- Delivery terms and retail price list
- Sales plan and minimum sales obligations
- Sub-distributors and agents
- Information exchange
- Prices to distributor (distributor price list)
- Sales outside the territory
- Brandnames and Trademarks – protection and allowed usage
- Inventories and spare parts levels, maintenance and service

- Exclusivity
- Direct sales (by the supplier in the territory of the distributor)
- Updates and upgrades
- Validity and Expiry of the contract
- Termination of the contract
- Compensation for damages in case of early termination of the contract
- Obligation to return documents and inventory to supplier in case of termination of the contract

Agency Contract

In case of doubt, use the ICC Model Contract (see appendix).

A Del Credere Agent undertakes to compensate the producer / manufacturer if the buyers (clients) default.

MUST include as a minimum:

- Appointment of the agent by the seller
- First right of refusal regarding new products
- Exclusion of OEM (sale to a third party which rebrands the goods with his own brand)
- Type of clients the agent may sell to
- Exact geographical definition of the territory
- Exclusivity (or lack of it)
- Bona fide collaboration and commercial fairness
- The roles and functions of the agent
- Endorsement and adoption of orders concluded by the agent with buyers
- No competition clause
- Marketing, advertising, fairs and exhibitions
- Minimal sales targets

- Sub-agency
- Obligation to exchange information
- Financial arrangements (Del Credere, other)
- Trademarks and brandnames
- Complaints of clients and buyers
- Right of seller to sell directly in territory of the agent
- Special clients / buyers
- Fees and commissions and formulas for their calculation
- Right of seller to reject business
- Expiry or termination date or absence thereof
- Survival clauses and unfinished business in case of termination of the contract

II. The Process of Exporting

Generalized Process of Export

Order received

Letter of Credit or other payment document opened

Production and pre-export phases

Preparation of documents (EUR1, FORM A, specified invoice, licenses and permits, certificates of origin, etc.)

Instructions to forwarder and customs agent

Checking the prices of freight, insurance and forwarding

Commercial export (at the port facilities or customs terminal)

Receipt of documents (bill of lading, confirmed certificate of origin, etc.)

Presentation of documents at the bank and their transfer to the buyer's bank

Payment received

The Phases of the Export Process:

Phase A – Decision

Phase B – Preparations

Phase C – Performance

Phase D – Post shipment

Phase A – DECISION

Collect Information (internet, specialized databases, market research, meetings, travel, fairs and so on)

Proforma Invoice

Production, quantity, quality, delivery terms, licensing

Price offer (firm offer)

Sale or Supply Contract

MAKE SURE THAT …

You are allowed to export the goods (no export restrictions on your goods)

Is there credit available for purchasing imported and domestically produced raw materials and parts – going into your exported goods?

Can you honour the order? Do you have sufficient capacity, the right manpower, the needed financing? It is better to say no than to renege on a contract.

Phase B – PREPARATIONS

Import of raw materials / parts (imported or foreign inputs)

Purchase of imported raw materials / parts in the local markets (domestic or local inputs)

Financing the imports

Financing the production

Production

Preparation of documentation

Engaging customs agents and international forwarders

Insurance

Quality certification

Export license

Freight and transport arrangements

Certificate of origin

Consular confirmation

Phase C – PERFORMANCE

Forwarding instructions to the customs agent

Packing

Withdrawal by customs agent

Preparation of invoice and specifications

Preparation of VAT claimback

Inspection of exported goods by authorities

Warehousing at the port

Custom clearance

Inspection of exported goods by the client

Port clearance

Authorization to load

Loading and release of documents

Receipt of bill of lading

Receipt of confirmed certificate of origin

Receipt of other documents

Phase D – Post Shipment

Financing the documents (=receiving payment)

Presentation of documents in local bank

Statistical registration

Tax and port tax rebates (in some countries)

Pricing the Exported Goods

Fixed Costs (Overhead) – Administration, rent, accounting, amortization / depreciation, etc. Should be divided by man-hours or product units to determine their contribution to the costs.

PLUS

Variable Costs – Directly related to the production process. Wages, raw materials, fuel, etc. Increases with increased production.

Incoterms Costs – See Incoterms hereunder

Transporting the goods from factory to export port or terminal

Shipping the goods from export port or terminal to import port or terminal

Transporting the goods from import port or terminal to buyer.

III. Incoterms

Incoterms

Last determined by the ICC in 1994. There is also a 1936 American version.

Used by all parties to an international trade transaction: buyer, seller, banks, financial institutions, agents, forwarders, insurance companies, carriers, government authorities, lawyers and courts.

See Appendix for detailed analyses of all 13 Incoterms

EXW (Ex Works) – Seller provides goods in his factory yard. Buyer is responsible for all the rest, including loading the goods onto trucks in the seller's yards. Best to add: "loaded upon departing vehicle".

FCA (Free Carrier) – Seller provides export licenses, customs clearances and port documents to first carrier (determined by buyer) in an agreed location within the export country. Useful for MultiModal Transport (MMT) in land, air, or sea. Seller pays all port and customs inspection expenses. Seller's responsibility ends with delivery to carrier. Buyer pays all expenses from point of delivery (transport, insurance, special inspections).

FAS (Free Alongside Ship) **–** Seller delivers goods to a loading quay, alongside a ship, in an agreed port in export country. Buyer obliged to clear goods for export after having received loading documents from seller. Buyer pays all port expenses and expenses related to required documentation. Use only for marine freight.

FOB (Free On Board) – Seller delivers customs-cleared goods with bill of lading, export license, all taxes and duties paid clean (unharmed) on board a vessel. Seller pays all expenses until goods are clean on board. Buyer determines carrier and pays the carriage (including loading expenses if part of the transport costs). Marine freight only. Best to add: "stowed and trimmed".

Buyer must insure itself when using an "F" Incoterm.

CFR (Cost and Freight) – Seller pays all expenses and transport costs to port of discharge. But responsibility for damage or loss or additional expenses is buyer's after goods loaded and stowed under deck. Seller obtains customs and port clearances, licenses, contracts with the carrier and with the insurance company regarding transport of goods to the point of loading. Buyer must obtain the import licenses, release the goods in port of discharge, issue insurance and pay for transit and inspection of goods. Marine freight only.

CIF (Cost, Insurance, Freight) – Seller arranges marine freight insurance for buyer and provides buyer with valid insurance policy in addition to obligations under **CFR**. Unless otherwise agreed, seller buys a limited "C" policy.

Best to add: "free out". **It is important to mention the type of insurance and coverage sought by buyer.**

CPT (Carriage Paid To) – Similar to CFR but when MMT involved (car, train, ship and then airplane, for instance). Instead of On Board – use First Carrier.

CIP (Carriage and Insurance Paid To) – Similar to CIF but when MMT is involved. Responsibility reverts to buyer when goods delivered to First Carrier.

DAF (Delivered At Frontier) – Seller to deliver export cleared goods at a precise point at the border of either import or export country. Buyer obliged to clear goods through customs terminal, to obtain import license and to bear all import related duties, fees and charges. Seller must inform buyer ETD (Expected Time of Delivery) and precise location of delivery.

If preceded by international marine or air transport, point of delivery will follow the Main Carriage (used in train transport).

DES (Delivered Ex Ship) – Marine freight only. Seller must deliver export cleared goods to buyer on board a ship in port of discharge but has no responsibility to clear the goods for import in the destination country, to unload them and to ship them to final destination within the buyer's country.

DEQ (Delivered Ex Quay) – Marine freight only. Seller must deliver goods buyer outside the quay after unloading them from the ship and clearing them for import through port authorities and customs. Seller pays import taxes and port expenses. Seller must provide buyer with bill of lading and gate pass. Buyer must transport goods to his yards and if he does not must pay demurrage and warehousing.

DDU (Delivered Duty Unpaid) – Seller must deliver goods to buyer in a location within the destination country but buyer must clear them for import through the port and customs authorities. Buyers must pay all taxes and expenses related to the clearance.

DDP (Delivered Duty Paid) – Seller must deliver goods directly to buyer's location (or to any other address) after having fully cleared them for import and fully paid all taxes and expenditures related to such clearance. Best to add: "DDP-VAT unpaid" in case seller does not agree to pay the VAT.

IMPORTANT!!!

The buyer and the seller must include all special conditions, not covered by the Incoterms – in their sale contract or order or commercial invoice.

Even if you include an Incoterm in a contract it is advised, to remove doubt, to also include a detailed list of rights obligations of the parties (=an agreed interpretation of the Incoterm). Always mention the version of Incoterms used (for instance: "FOB – Incoterms 1990").

The transfer of responsibility to the goods from seller to buyer does NOT constitute a transfer of title (ownership) to the goods.

There are Exit Contracts (seller delivers to buyer's carrier in country of origin of the goods and such a delivery ends the seller's responsibility) – All the Incoterms which start with the letters E, F and C. For example: CIF does NOT mean that the seller is responsible to deliver the goods in a port in the destination country – only that it has to pay for the voyage and for the insurance.

There are Delivery Contracts (seller delivers to buyer in country of destination and is responsible to them until they are delivered there) – All the Incoterms, which start with the letter D.

Insurance

This is why insurance is critical (policy types A, B, or C).

It must include:

- Location in which the policy becomes valid
- Location at which the policy expires
- Extensions to the basic policy
- Political risks
- Value of coverage and types of coverage (replacement value, damages, etc.)
- Insurance of loss of profits
- The policy's currency
- Currency hedging

Important

The buyer must provide full specifications of packing of goods

If the parties use a C Incoterm, the buyer is usually responsible for costs associated with an inspection of the goods by the authorities of the country of origin (**PSI** –

Pre Shipment Inspection). If the buyer demands an inspection (quality and quantity controls) – it must be stated clearly who will bear the cost. If not specified – the buyer shall bear it.

It is recommended to use FCA when goods are not delivered to the carrier on quay or on board. Buyer must arrange the transport and provide the seller with exact instructions.

"FOB Airport" should not be used. FOB is ONLY for marine transportation. For air transport use FCA.

Incoterms in conjunction with Bill of Lading (BL)

When CIF or CFR is used, use "on board BL" (goods have been loaded on board ship).

If goods shipped in containers, carrier may issue "Received for Shipment" (when he receives the goods and prior to their loading on board) – instead of BL.

It is preferable to use CPT or CIP if BL not required to conclude the transaction.

If goods arrive prior to original BL – they are delivered to buyer against a bank guarantee. Avoid it as it negates the function of the BL.

Non Negotiable Waybills and Receipts

If a waybill is non-negotiable, there is no need to present its original to obtain delivery of the goods.

The following are non-negotiable:

- Liner Waybill
- Ocean Waybill
- Data Freight Receipt
- Cargo Key Receipt
- Sea Waybill

All air waybills are non-negotiable. Only the seller can instruct the carrier (not the buyer or his bank). Importers dislike non-negotiable waybills (unless explicitly stated that they are irrevocable). The names of the parties in the waybill must be irrevocable – otherwise, the seller can change them.

BLs, Receipts and Waybills

Let us call all waybills and receipts – as well as bills of lading – transport documents (TD).

TDs are delivered to the buyer or to the seller according to instructions given to the carrier (never mind who paid for the carriage). The seller might get them to prove delivery. The buyer needs them to release the goods (to instruct the carrier).

TDs can be divisible (article A8 of Incoterms) in case one TD covers goods deliverable to many buyers.

Buyers responsible to release the goods and accept delivery – or to compensate seller for any damages.

Buyer is liable for damages to the goods after the transfer of responsibility from seller to buyer **("Price Risk")**.

It is recommended to use "Force Majeure" articles in sales contracts.

Some countries oblige exporters and importers to insure the goods in their own countries (to minimize foreign exchange outlays).

Rules of Use of Incoterms

1. Use **DEQ, DES, CIF, FOB** and **FAS** only in marine carriage and for marine freight.
2. Use **CPT, CIP, FCA** universally except if goods are in bulk of carried in chartered vessels.
3. Be clear: how are the goods to be transported, who has the obligation to have them loaded, who pays for what, who is responsible to clear the goods, to release them and to unload them and so on.
4. Be clear: how much insurance you require and what type (**A, B, C**)
5. What restrictions and special demands would you like to impose on the carriage and the carrier.
6. Include **"Force Majeure"** and validity, expiry and termination clauses
7. Indicate which Incoterms version is used (example: FOB-Incoterms 1990).
8. The Incoterms **CPT, CIP, CFR** and **CIF** deal only with the transport aspect of the transaction – not with the transfer of responsibility or ownership.

IV. Payment

Payment

Payments schedule (when?)

Payment mode or method of payment (how?)

Place of payment (where?)

Currency of payment (which?)

Payments Forms

Advance payments (cash in advance)

Open account credit

Cash Against Documents (**CAD**)

Documents for collection, Cash on Delivery (**COD**)

Letter of Credit or Documentary Credit (**L/C**)

General Principles of Payment

If cash was paid in advance by buyer, seller will give buyer the documents, courier them to the buyer or airmail them (Captain Mail them).

COD – the carrier delivers the good against cash (collect).

But in all other forms of payment:

The carrier of the goods is hired by either the seller or the buyer to carry the goods, in accordance with instructions, to a destination.

The seller sends the goods to a bank in geographical proximity to the final destination of the goods.

The transport documents (bill of lading, waybill, receipt) are sent to that **CONSIGNEE** bank.

The consignee bank – having received the transport documents, the commercial invoice, the certificate of origin, the insurance policy and other documents, invites the buyer to buy (to redeem) these documents (with which he can get the goods).

The buyer pays the bank and the bank endorses the bill of lading and instructs the carrier (if the BL is non-negotiable) to give the goods to the buyer.

The buyer pays the carrier, presents the endorsed bill of lading and gets a delivery order with which the buyers releases the goods, having paid customs, duties, taxes and port expenses. He receives a gate pass which allows him to load the goods to his lorries and transport them to his yards.

Open Account

Either with big, reliable clients, or with agents, distributors, subsidiaries which maintain a consignment warehouse or a forward warehouse.

Use **Exchange Note –** A financial instrument in which the seller instructs the buyer to pay his bank for the goods. The buyer signs the note. Buyer's signature confirms receipt of the goods in good order and the buyer's debt. Exchange notes are transferable, negotiable, endoreseable and assignable.

It is a stand-alone document which does not refer to the underlying transaction.

It is recommended to date the exchange note (on its back) and thus transform it into a **Time Note**.

Cash On Delivery (COD)

Payment with delivery of goods.

Exporters which maintain warehouses in destination countries – use COD.

Payment can be in cash, deposit receipt, bank guarantee, bankers' acceptance.

Be careful to receive payment only by your authorized representative.

Cash Against Documents

1. Contract
2. Carriage of goods to port of discharge
3. Documents (commercial invoice, bill of lading, insurance policy, certificate of origin) transferred by to seller's bank for collection
4. Seller's bank (usually through carrier) transfers documents to buyer's bank
5. Buyer's bank (the consignee) invites buyer to receive endorsed (ownership transferred to buyer) documents
6. Buyer deposits payment (or arranges credit line) for the goods in his bank
7. Goods delivered to buyer (using the endorsed documents)
8. Buyer's bank transfers the payment to seller's bank
9. Seller's bank credits seller's account with the payment minus fees and charges and commissions

If bank endorses documents to buyer prior to receipt of payment – the bank assumes the buyer's obligation to pay.

CAD not to be used with branded or customized goods (buyer might refuse the goods and if they are branded or customized – they cannot be sold to another buyer).

Banker's or Bank's Acceptance (Accept)

Exporter can ask buyer to provide a bank draft. An acceptance stamp and signature on the draft ("Accept") transforms it into an obligation of the bank itself to pay, on a given date to bearer.

Both Exchange Notes and Bankers' Acceptances are traded in special exchanges in the world.

Letter of Credit and Documentary Credit

A letter in which a bank undertakes to pay the exporter if and when the exporter meets certain terms and conditions enumerated within the L/C.

The bank's commitment is usually irrevocable (the L/C should contain this word: "irrevocable" – although it is irrevocable even by default).

If the exporter fulfils all the conditions of the L/C - the bank will pay, regardless of the situation of the buyer. If the seller did not comply with the conditions in the L/C, the bank will pay only if buyer expressly agrees to it.

IMPORTANT

1. The letter of credit is only as good as the issuing bank
2. Check: are the conditions of the L/C identical to the conditions specified in the sale contract, the commercial invoice or the order?

UCP-500

These are the uniform rules of international payments determined by the ICC in Paris, France:

1. Importer signs sales contract which includes prices, schedules of delivery and payment, types of packing, modes of carriage, volume, documents to be exchanged and more. Importer gets pro-forma invoice from exporter.
2. Based on the pro-forma invoice, Importer asks his bank to open letter of credit in favor of Exporter. Importer instructs the opening bank which details to add to the L/C which are not included in the Sales Contract or in the pro-forma invoice. Such details may include: permission or prohibition of transit, transshipment, division of the L/C, part shipment, the number of copies of the documents, certificates of origin, the coverage amount of the insurance policy, should the policy be endorsed and so on.
3. The bank uses its letter of credit form and incorporate all the terms and conditions of the sales contract in the letter of credit.
4. The Importer's bank send the details of the L/C to the Exporter's bank (the Correspondent Bank).
5. The Correspondent Bank informs the Exporter that an L/C was opened in the Exporter's favor and conveys to the Exporter the details of the L/C.

6. Exporter compares the conditions of the L/C to the conditions of the sales contract and especially whether the Importer's Bank has irrevocably agreed to accept the Correspondent Bank's signature regarding the receipt of the documents.
7. Exporter consults his bank and others whether the Importer's bank is a prime, world bank of good standing.
8. Exporter makes sure the L/C is valid and corresponds to the timetables agreed with the Importer regarding both the delivery of the goods and payments. Another question: can the documents be negotiated or transferred within the term of the L/C? Can the Exporter accept all the restrictions and limitations of the L/C? Are there any impossible conditions (for instance, in contravention of the foreign exchange regime) or wrong details (name of a port which does not exist, etc.).
9. If the L/C is accepted by the Exporter, he starts production and manufacturing operations. When the goods are ready, Exporter contacts a carrier. After the goods are loaded, Exporter gets a bill of lading, a certificate of origin EUR1 or FORM A signed by the Customs, an export list and other documents.
10. Exporter presents documents to his bank which checks whether all required documents have been presented and whether they comply with the conditions of the L/C. The correspondent bank then issues an **ACCEPTANCE.** The L/C then becomes a bank guarantee.
11. If the correspondent bank is also the confirming bank, it also pays the Exporter.

12. The correspondent bank transfers the documents and the acceptance to the opening bank.
13. The opening bank checks the documents. But if the correspondent bank is also the confirming bank – even if the documents are wrong or faulty – the opening bank must pay.
14. The opening bank transfers the payment to the correspondent and confirming bank.
15. The opening bank informs the Importer that the documents arrived. Importer deposits payment with the opening bank (or opens a credit line with it).
16. Importer gets from the opening bank the documents endorsed.
17. Importer clears the goods and takes delivery of them through the carrier (he gets a **delivery order** from the carrier, having settled all outstanding accounts with carrier).

Settlement by Acceptance

1. Seller transfers documents to correspondent bank with a note made out to the bank (the bank is the note's beneficiary).
2. Correspondent bank confirms acceptance of dated note to the seller.
3. Opening bank gets the document.
4. Opening bank credits correspondent bank.

Settlement by Negotiation

1. Seller transfers documents to correspondent bank with a note made out to the buyer (the buyer is the beneficiary of the note).

2. The correspondent bank pays seller against documents and note.
3. Correspondent bank transfers documents and note to opening bank.
4. Opening bank credits correspondent bank.

Letters of Credit - Form, Structure and Details

1. Number and ID (this number must be placed on all subsequent documentation pertaining to the same transaction.
2. Names and details of buyer, seller, opening bank (buyer's bank), correspondent bank.
3. Description of goods – usually the proforma invoice is attached and this sentence is then added: "In accordance with proforma invoice number … dated … herewith attached to this letter of credit and which constitutes an integral and inseparable part thereof".
4. Total cost or price.
5. A list of documents (with the presentation of which by the seller payment to the seller will be effected):

    a. Commercial invoice, including a list of the goods, details of buyer and seller and signatures.
    b. Packing list signed by seller.
    c. Insurance policy including its type, the coverage it affords, amount covered. The policy's beneficiary must be the opening (importer's) bank and it must be fully endorseable.
    d. Detailed billways, receipts or bill of lading: who is entitled to receive delivery of the

goods, who pays for the carriage, is carriage prepaid and where, etc.

   e. Other documents.

6. Dates – when was the L/C opened, how long is it valid, date of loading and date of presentation of documents at the bank (maximum 21 days after loading of goods, if not otherwise specified).
7. Special instructions: is transit or transshipment allowed (best to write "transshipment allowed"), is part shipment allowed (best to write "part shipment or partial shipment allowed").

If carriage or delivery not according to L/C – **L/C will NOT BE PAID!!!**

Types and Specifications of Documentary Credits

Confirmed versus Unconfirmed

Opening bank uses a bank in the Exporter's country (usually the correspondent bank) to interface with the exporter.

The corresponding bank informs exporter about opening of L/C and checks and verifies the exporter's documentation after goods have been loaded (such verification subject to opening bank's consent).

Sometimes the correspondent bank verifies the documents AND pays for them – this is known as **CONFIRMATION**. With a confirmed L/C, the correspondent bank must pay the exporter upon verification of the documents. The exporter pays a confirmation fee.

Transferable and Divisible

An L/C that can be transferred to or be paid in parts to sub-contractors and suppliers of the Exporter. Only one transfer is allowed:

1. The name and details (address, etc.) of first beneficiary can be changed to name and details of second beneficiary.
2. The amount of transferred credit must be smaller than original amount of credit.
3. The period of validity of the L/C or its parts can be altered.
4. The percentage of insurance can be increased.
5. The details of the new L/Cs issued on basis of original L/C can be different to details of original L/C – as long as new L/C are less (in amount) or shorter (in period) or partial and do not expand the original L/C or otherwise enhance it.

Revolving

For a series of identical transactions with known delivery and payment schedules.

If irrevocable, cannot be revoked even if revolving and even if the buyer went bankrupt. The bank is responsible to pay.

Counter Credit (Back to Back)

The L/C is pledged by the Exporter to his bank (the corresponding bank) or (more often) to another bank against receipt of credit from the bank. This credit is then used to pay suppliers.

The exporter's obligation to pay the back to back credit it received from its bank – is NOT dependent upon the payment of the L/C used as a collateral.

V. Shipping

a. Packing and transportation of goods to port or terminal
b. Marine transport
c. Air transport
d. International forwarding and customs agency
e. Cargo insurance
f. Credit insurance
g. Prevention of loss and damages
h. Labeling
i. Land export and import

Packing

Cardboard (two or three waves)

Crate (wood with or without cardboard)

Wooden boxes (heavy and expensive)

Barrels (metal, plastic, wood; for the transportation of fluids; fluids must fit the material of the barrel)

Sacks (jute, paper, plastic, cloth)

The Goods can be transported …

Loose (each unit – box, barrel, etc. – separately)

Unitizing (one unit composed of sub-units) – shrink, containers, big bags or semi bulk, stretch, etc.

Marine Transport

The carriage fee or rate + charges, fees, levies, duties and commissions = carriage tariff

Influenced by:

Fixed and variable transport costs

(such as the distance traveled, expenses and fees in various ports, balancing the cargo, frequency, size and type of vessel, properties of the goods, modes of loading and warehousing, volume/weight ratio, transport risks, possible damage to cargo, size of cargo and its composition, etc.)

But "Likes are not treated as likes" – different prices are quoted for similar situations.

This is because of additional costs related to the **market in the goods and to the marine transport marketplace**.

The carriage fee is determined also by "what the traffic can bear" – how in demand are the goods, how valuable they are, etc.

The conditions of the global marketplace in marine transport and the competition in it also determine the quoted price – as well as fees, levies, charges, commissions and taxes in the various ports and in the various origin and destination countries. Changes of technology also influence prices.

Tariffs are determined as **CLASS RATE** – a class of transport, which includes many types of cargo with the same rate or

A COMMODITY RATE – specifically tailored to every type of cargo and multiplied by the weight or the mass (volume). Payment is according to the higher of the weight and the mass.

To this the exporter should add charges (such as the **Heavy Lift Charge** or the **Extra Length Charge**) and other levies…

...such as the **CAF (Currency Adjustment Factor** – a currency hedge in favor of the shipowner);

...the **BAF (Bunker Adjustment Factor** – a percentage of the rate intended to offset certain expenses of the ship operator);

War Risk (or Political Risk – to offset a high insurance premium);

Congestion Surcharge (to offset expenses which are the result of long periods of waiting at the port) or

THC (Terminal Handling Charges – imposed by the port itself for the right to anchor).

Containers

Door to Door (House to House)

An empty container is deposited with the exporter in a pre-determined date.

The Exporter fills it and transports it to the harbor.

In the destination country – the container is deposited with the importer.

He empties it, returns it to the port.

Pier to House

In the port of discharge, cargo and goods from different suppliers are concentrated in one container which is then sent to the importer / buyer.

House to Pier

Like House to House – but because the container contains goods for various buyers, the container itself is not sent to any single buyer.

Pier to Pier

Cargoes reach the port, get containerized by the agent in the port of loading. In the port of discharge, it is emptied and each cargo is sent separately to each buyer.

Consolidation

Transporting the cargoes of a few sellers in one container.

REMEMBER !!!

Compare Prices – you will always find a cheaper alternative!!!

Types of Ships

Liner – operate in regular lines with regular vessels in pre-determined dates

Charter(ed) –

Voyage Charter – Cargo owner charters a vessel to transport the cargo from port of loading to port of unloading

Time Charter – Cargo owner or shipping company charters a vessel for a defined period of time (upto a few years)

Bareboat Charter – Long term (5-15 years) charter (common in the transport of fuel and grains). The lessee takes care of the cargo, of operating the vessel and its crew

Container ships – Built like a beehive with cells the size of containers

RORO – Cargo rolled on wheeled carriages under deck (for transporting vehicles, etc.)

Multi Purpose Boat

Tankers (fluids, liquids, fuel)

Bulk – Transports grains or chemicals in bulk

Lash – Carry with them big platforms or rafts

Conference

All shipowners are organized in a cartel called "Conference"

Marine Bill of Lading (MBL)

Serves as a receipt for the cargo, proof of existence of a carriage contract and proof of ownership. It is negotiable and endorseable.

Under the Hague principles, a bill of lading (BL) must include the following:

a. Name and address of shipper / exporter
b. Port of loading and port of discharge
c. Date of loading and place of issuance of BL
d. Name of vessel (ocean liner, etc.) and voyage number
e. Cargo identification marks
f. Description of goods – number of units, weight, volume (mass)
g. Condition of goods (if not filled – no external or visible damage)
h. BL must be "clean on board" not "foul"

A Marine Bill of Lading must include these to be valid:

a. The words "bill of lading" and the words "lading" or "shipped" (which prove that goods have been loaded on board vessel)
b. Date of loading

c. Confirmation of the shipping company
d. Numbers of original bills of lading, if any
e. The words "Clean on Board"
f. Name of the shipper
g. Name of the consignee or "To Order" (of the shipper) together with endorsement of the shipper
h. Name of vessel
i. Port of loading, final destination and is re-loading required
j. Name of parties to be notified upon arrival to the port of discharge
k. Marks and numbers stamped on the packages
l. Abbreviated description of the goods (weight, number of units and volume / mass)
m. How many original copies of the MBL are there and is the presentation of all original copies required to in order to release the goods

Types of Marine Bills of Lading

Shipped MBL – Goods were loaded and carrier received them in good order

Direct MBL – No transshipment allowed

Ocean Through MBL – Transit MBL. When more than one carrier handles the goods, each one is responsible for the goods only during his tenure and under the terms and conditions of his contract

Pure Through MBL – Pure transit MBL. The first carrier must transport the goods from the port of loading to the port of discharge through an intermediate port and is responsible for damages

Combined Transport BL – Covering all modes of transport (not only sea)

Forwarder BL – Issued by an agent, an international forwarder

Freight Forwarder BL – Issued by FIATA, the international organization of forwarders

IMPORTANT

The Hague Principles regulate the legal relationship between carrier and shipper from loading to discharge.

It covers only exported goods, carried by vessels by sea

It applies only when a transport contract has been incorporated in the BL

It does not cover goods (such as animals) **on deck**

Air Transport

Types of Transport Tariffs

Air transport tariffs are indicated by IATA – but often these tariffs are ignored. SHOP AROUND.

Minimum Rate – not in accordance with actual weight (when under 45 kg.)

General cargo Rate (GCR) – for all kinds of cargo

Specific Commodity Rate (SCR) – per a minimum weight of a specific type of cargo and valid for a limited period of time. Cheaper than GCR.

Unit Load Device (ULD) – Special tariff for cargo transported as a unit on a surface or in a container. Only weight is limited (maximum and minimum)

The tariff is derived from:

1. Destination of cargo
2. Type of goods – SCRs can be negotiated with the local IATA representative
3. Minimum Rate
4. Weight / Mass (volume) ratio (every 6 cu.m. equal 1000 kg.) – if W/M exceeds this ratio – payment will be according to weight

REMEMBER

Try to exceed the minimum rate and the minimum weight

Negotiate an SCR or a ULD wherever possible

Make sure that the W/M ration does not exceed the allowed ratio

Airway Bill

Issued by the air carrier.

Mainly a confirmation of transport – not of ownership or any right to goods.

Absence of airway bill does not effect validity of contract of air carriage or the applicability of the treaty – but may prevent carrier from resorting to exemptions and other restrictions in the treaty.

Airway bill is proof of weight, measurements, quantity and packing. It is also a carriage invoice, an insurance policy (if insurance taken out by carrier) and a customs declaration (if no other declaration is required by law).

Not negotiable and ownership cannot be transferred by its endorsement or transfer.

Only consignee can accept delivery at discharge. Buyer appears under "also notify" when bank is consignee and fiduciary on behalf of seller. Buyer receives power of attorney from bank to release and clear the goods.

Issued in three original duplicates to shipper, consignee and carrier.

International Forwarding and Customs Agency

The international organization of forwarders – FIATA – created a document system called **FBL (Forwarder's Bill of Lading -** equivalent to MBL). The forwarder responsible for goods door to door (house to house).

FCR (Forwarder's Certificate of Receipt) – A receipt issued by forwarder confirming receipt of goods at the factory to be carried to destination.

FWR (Forwarder's Warehouse Receipt) – Receipt issued by forwarder that it received goods in a warehouse to be carried to destination.

Airfreight Forwarder – As opposed to marine forwarders, airfreight forwarders have to comply with certain professional and financial conditions. Some of them are IATA forwarders – with minimal volume of activity, proven acquaintance with airfreight rules, skilled staff and so on. IATA forwarders get 5% of carrier's rate and are allowed to issue airway bills to shippers on behalf of air carriers.

An airfreight forwarder:

Arranges a number of shipments, unites them and passes them to the aircraft, handles commercial export / import operations for exporter / importer, prepares all paperwork, takes care of transit from one aircraft to another and of air insurance (if client demands it), consolidates cargoes, issues airway bills and selects routes.

Customs Agent deals with goods only within the port while an international forwarder handles the goods from door to door.

Customs Agent deals with the following:

Reserving space in a vessel, coordination of acceptance of containers, provision of information regarding prices, routes, schedules, preparation of documents for exporter including BL, CO and all other documents demanded by the customs. The agent appraises and classifies the goods for customs purposes, obtains a gate pass and arranges the transportation of the goods to the buyer's location.

The buyer is responsible for the activities of the agent.

Cargo Insurance

About 0.15% of value of cargo, except if dangerous or fragile cargo.

One Time Policy expires with completion of transport.

Open Policy or Current Policy – see above.

REMEMBER

Insurance is cheap – use it abundantly.

Insure the cost, the profit, the carriage rates, the marine insurance premium, port expenses and land transport, customs agency, import taxes and so on.

Double marine insurance is allowed.

Marine insurance is subject to the **London Clauses**. **Institute Cargo Clauses** deal with general cargo.

A Clauses Coverage – All risks insurance against loss or damage caused by random event which happens outside the cargo and effects it.

Does not cover loss or damage which is the result of intentional behaviour of the insured, general leakage, loss or vaporization of mass or weight, normal wear and tear, inappropriate packing or preparation of insured goods, breach of contractual schedules and obligations by insured or owners, charterers or operators of vessel, inherent defects, war, nuclear fusion or fission, radioactive material, incapacitation of vessel known to insured at time of loading.

B Clauses Coverage – loss or damage due to fire, explosion, shipwreck, capsizing, derailment of a land vehicle, collision or contact with another body except water, unloading in distress, earthquake, volcanic eruption or thunder, general average, penetration of sea, lake, or river water into the ship's warehouses, lift, etc., total loss of cargo which fell in the sea during unloading of loading.

C Clauses Coverage – covers only catastrophic marine disasters such as fire, explosion, shipwreck, drowning, capsizing, derailment, collision, unloading in distress, general average or dumping in the sea.

Credit Insurance

Both private and state companies (such as ECGD in the United Kingdom, COFACE in France and OPIC in the USA) provide insurance:

- Against the credit risks of the buyer
- Against political risks (war, terror, acts of state)
- Against financial risks (non convertibility, non repatriation)

Credit risks insurance policy serves as collateral. It is pledged against credit, which goes towards financing the production of the goods and working capital.

Credit insurance firms check and rate clients (or rely on credit rating agencies such as Moody's, Fitch-IBCA for banks or Dun and Bradstreet). They issue policies guaranteeing payment to the supplier / exporter in case of the buyer's bankruptcy, refusal to pay, default, nationalization and expropriation, etc.

Insurance is provided mainly or only to firms registered in the domicile of the insurance company or in another member of the same customs union or trade block (EU, EFTA, etc.) – so, it is recommended to establish subsidiaries in these territories to be eligible.

Premiums range between 0.5-0.7% per insurance unit for a period of 90 days.

Prevention of Loss and Damage

Use only new packings suitable to the goods

Fit crates and cardboard boxes with metal corners

Use shrink wherever possible, tie and strengthen everything massively

Do not paste labels with descriptions, pictures, brandnames, trademarks or labels on the packages – these attract thieves. Mark the packing with letters and numbers on at least two of its sides. Proper packing is an implied warranty in the carriage contract and an expressed warranty in a marine/ air insurance policy.

Mark the packages with instructions: "Fragile", "Printed", "Handle with Care", "Avoid X-rays" and so on.

The standard marking of cargo should include:

1. Initials or abbreviated name of consignee (full name and address required in case of road or rail transport)
2. Reference number (order number or similar). Avoid indicating the date

3. Name of port and final destination and "via" in case of transit
4. Package number out of total (example: 2/20)
5. Mark the packages Big, Clear and Brief (BCB)
6. Use metal, plastic or strong cloth tags – do not use cardboard or wood tags
7. Marks bags and sacks with sealing liquid
8. Mark dangerous and radioactive materials with warnings, the chemical composition and the shipper's name
9. Use Latin letters as well as local alphabets – a maximum of 10 lines of 17 characters each
10. It is advisable – but not required – to mark gross weight in case of air transport. Net weight and measurements are not required at all – unless chemicals or dangerous materials are involved.
11. Some countries demand to mark the name of country of origin, number of import license, etc. – pay attention to local regulations

Change your markings often.

Use big packages to pack smaller and non-uniform packages in.

Leave no empty space inside the package – fill empty spaces with paper, Styrofoam, pad the goods and tie them tightly.

Do not overfill the crates, sacks, or boxes.

Do not concentrate the goods in one part of the package (internally) – spread them evenly.

Place light cargo on heavy cargo.

Separate types of packings (cardboard boxes from crates, etc.)

Do not leave any space between the wall of the container and the packaged goods.

VI. More on Documents

Invoice

Must include:

- Country of Origin
- Place and date of preparation, number of invoice, reference to order number
- Names, addresses and other details of buyer and seller (and consignee if not the buyer), address for delivery of documents
- Type of carriage (sea, land, air, multimodal)
- Port of loading
- Port of discharge
- Final destination
- Commercial conditions and schedules (delivery and payment)
- Number of packages, their description and markings (numbers, etc.), statistical classification
- Description of goods according to type, quality, special properties, composition in percentages of each material
- Amount of goods in units / weight / volume
- Gross, net and net net and measurements of each package

- The price agreed between the parties, costs of freight and insurance
- Conditions of shipment, dispatch and payment, including all discounts, fees, commissions and charges
- Exporter number if any
- Stamp and signature of seller plus declaration that all the above is true

Packing List (Specifications)

The first part includes name of firm, date, address of buyer and, sometimes name of bank, payment conditions, etc.

The second part contains very detailed description of the goods and their packing. Some countries demand the inclusion of special units of weights and measurements, method of marking, customs classification and so on.

Insurance Policy

Includes the value of the goods, details regarding the mode(s) of transport, points of departure and arrival, details of the agency or insurance company to be contacted in the destination country in case of damage.

Must include the following details to be valid:

- Name of insurer
- Policy number
- Details of carrier
- Route from exit to entry
- Total value insured and type of currency
- Conditions of the policy

- Details of agent in destination country
- Jurisdiction in case of disputes
- Description of goods and their packing
- Date of issuance of insurance
- Method of calculation of the premium (marine insurance, war surcharge, registration, policy, credit if payment of premium is post dated)

Bill of Lading

Contains description of goods, their quantity and quality ("clean on board" or "foul").

Airway bills include an invoice to be paid by buyer or seller.

If seller pays, the bill will say "prepaid" – if buyer is to pay, it will say "collect".

In case of marine bill of lading, a detailed invoice is issued to seller.

Certificate of Origin

EUR1

Issued at the request of the buyer.

Confirmed by the chamber of commerce, the customs, or the exporter or his agent / forwarder – or any other body authorized by them.

Must be printed without corrections.

Must conform to commercial invoice.

Must include:

- Name and full address of exporter
- Name and full address of consignee
- Description of goods and their packing
- Weight of goods in kg. Or volume in liters
- Numbers of relevant invoices
- Declaration of exporter that goods conform to rules of origin stipulated in the agreement under which the certificate of origin is issued

FORM A

Like EUR1 but:

- Authorities do not need to confirm it
- The percentage / amount of value added of the goods must be declared (or "P" in case the goods are also produced in the destination country)

Consular Confirmation or Consular Invoice

Demanded mainly by developing countries.

Includes full description of goods in language of destination country – including quantities, monetary values and a sworn affidavit of the exporter attesting to the veracity of the data.

Appendix II: Incoterms In-Depth

Documentary Credits and INCOTERMS - International Commercial Terms

1. Incoterms are part of international sales contracts. They regulate:

A. Carriage of goods from seller to buyer
B. Export and import clearances
C. Division of costs and risks between the parties

2. Important acronyms: Electronic Data Interchange (EDI), Electronic Data Interchange for Administration Commerce and Transport (EDIFACT) and Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID).

Internet: GE - TPN

3. Electronic Bills of Lading – use the CMI Uniform Rules.

4. As a result of the container revolution and cargo unitization, the incoterms FCA, CIP and CPT were developed. Emphasis shifted from means of conveyance to the place of carriage. FOR / FOT / FOBA were omitted.

5. Case Study: warehouse to warehouse insurance and the FOB point - where is delivery effected?

CIF - seller exposed to claims for failing to reach the ships rail on time.

6. The mirror method - the 10 headings – see Appendix of Incoterms.

7. INCOTERMS - part of larger picture (deal with delivery and with nothing after delivery - not with

quantity, costs of loading / discharging, clearance, transport, risks of loss / damage and insurance against them, title, quality breach of contract or price). There are: Contract of sale, applicable law, custom of trade.

Example: an FOB Buyer would insure the goods despite the fact that Incoterms do not oblige him to do so - difference between obligation and commonsense.

8. Specific reference required. Example: trading with a US firm (UCC - AFDT).

9. CISG - Contracts for the International Sale of Goods: POD where breach is determined in conjunction with Incoterms (concerning delivery).

10. D-terms: seller's delivery obligation is extended to the country of destination (arrival contract).

E-terms, F-terms, C-terms: seller fulfils delivery obligation in his country (shipment contract).

11. The common error: there is no connection between risks, costs and delivery.

12. F-terms: Free of risks

C-terms: Costs borne after critical risk point reached

D-terms: Destination

C-TERMS: 2 points of interest: delivery and risk / costs

13. FCA buyer to instruct seller how to hand over goods – and wher

FCL Full loads (railway wagon / container) vs. LCL break bulk

14. FOB additional service

Seller contracts for carriage - though he has no obligation to do so

15. FOB The port decides how to distribute loading

16. FAS Seller does not have the obligation to clear goods for exports (unlike FOB!)

17. C-terms Do not stipulate arrival date! seller obliged to ship good
so that they COULD ARRIVE!

18. CFR, CIF Only by sea! A8 demands bill of lading / sea waybill
If Buyer wants to sell in transit - he will be unable because of lack of
the right document Þ breach of seller

19. CIF, CIP Minimum Cover vs. all risk and political

Appendix III: More about Modes of Payment

SIGHT DRAFT (=COD) - Document against payment

- Original shipping document attached --> CB (collecting bank)

- Original bill of lading made to the order of the shipper and endorsed by him blank, or to the order of CB

- Notification to drawer of draft about payment

TIME DRAFT

- Like sight drafts but paid X days after acceptance

- The CB holds and presents for payment

BANK GUARANTEE dependent on underlying obligation or independent (=note)

- Bid bonds } dependent

- Performance bonds } dependent

- Advance Payment bonds } dependent

- Payment Bonds } independent but with recourse and stoppable by court injunction

LOCs

DLC - Documentary

FLC - Financial

SLC - Standby
- CLEAN (Self-contained)
- REGULAR (Dependent on an event)

FACTORING AND FORFAIT / EMC

COLLECTION

CREDIT PROTECTION

FINANCING (=LOAN / Credit line) on Approved Accounts

Recourse Factoring: Collection + Financing

How to choose a Factor?

Profile of Users of Factoring

Restricted access to credit

High or low net worth

Satisfied customers

Credit - worthy customers

Successful products / services

Factoring Services

Conventional Min 2 ½ %, 3 days (5% per 30 day invoice)

Weekly agings, daily collection reports

Credit services, fees prorated daily,

2-weekly reserve releases, 24 hour funding

No hidden fees / long term contracts

Debt Consolidation Payment to creditors when company is in default

Maturity On pre-approved account debtors

Financing / Sale - Leaseback (for bankrupt companies) including equipment

How does It Work

Bring invoice + delivery slip

Receive upto 80% of the face amount

Receive the balance (reserve) when the invoice is paid

Appendix IV: International Trade – An Introduction

1. **Globalisation** - economic interdependence of nations.

2. **Imported products** = imported employment = internal unemployment

3. **Ricardo's** theory of **Comparative Advantage**

4. **Absolute advantage** - fewer resources to produce the same products

Comparative Advantage - it take less to produce the same in terms of other goods

5. **<u>Two country / two goods model - mutual absolute advantages</u>**

<u>Phase A</u>: Mutual absolute advantage

<u>Macedonia</u> <u>USA</u>

Wine 6 2

Tobacco 2 6

<u>Phase B</u>: Land allocation for equal unit production

<u>Macedonia</u> <u>USA</u> <u>Totals</u>

Wine 25 x 6 = 150 75 x 2 = 150 300

Tobacco 75 x 2 = 150 25 x 6 = 150 300

<u>Phase C</u>: International trading

<u>Macedonia</u> <u>USA</u> <u>Totals</u>

Wine 100 x 6 = 600 0 600
(Mac. sells 300 to USA)

Tobacco 0 100 x 6 = 600 600
(USA sells 300 to Mac.)

7. **Trade** enables countries to **move beyond** previous resource and productivity **constraints**.

8. **<u>Two country / two goods model - unilateral absolute advantages</u>**

<u>Phase A</u>:

<u>Macedonia</u> <u>USA Totals</u>

Wine 50 x 6 = 300 75 x 1 = 75 375

Tobacco 50 x 6 = 300 25 x 3 = 75 375

<u>Phase B</u>: Land allocation for equal unit production

<u>Macedonia</u> <u>USA</u> <u>Totals</u>

Wine 75 x 6 = 450 0 450
(Mac. sells 100 to USA)

Tobacco 25 x 6 = 150 100 x 3 = 300 450
(USA sells 200 to Mac.)

9. **<u>Explanation</u>**: The **opportunity cost** of 3 bales of **tobacco** in **Macedonia** is 3 litres of **wine** - in **USA**, only 1 liter.

The **opportunity cost** of 1 litre of **wine** in **Macedonia** is 1 bale of **tobacco** - and in the **USA** it is 3 **bales**.

10. When countries **specialize** in production of goods in which they have a **comparative advantage** - they **maximize** their **combined output** and **allocate** their **resources** more **efficiently**.

11. **<u>Terms of trade</u>**: The **ratio** at which a country can trade domestic products for imported ones.

In the above example: 1 litre **wine** = 2 bales **tobacco**

Macedonia benefits because its opportunity cost is 1 = 1

(it would get 1 bale domestically by giving up 1 litre)

USA benefits because its opportunity cost is 1 = 3

(it would have to give up 3 bales domestically to get 1 litre)

12. **Exchange rates** determine the terms of trade.

For any pair of countries, there is a **range of exchange rates** which can lead to both countries **realizing gains from specialization and comparative advantage**.

Within that range, the exchange rate will **determine which country gains the most** from trade.

13. **Two country /two good world**

Macedonia USA

Wine 3 DM $ 1

Tobacco 4 DM $ 2

Exchange rate Price of DM Result

$ 1 = 1 DM $ 1 Macedonia imports both

$ 1 = 2 DM $ 0.5 Macedonia imports wine

$ 1 = 2.1 DM $ 0.48 Macedonia imports wine -

$ 1 = 2.9 DM $ 0.34 USA imports tobacco

$ 1 = 3.3 DM $ 0.33 USA imports tobacco

$ 1 = 4 DM $ 0.25 USA imports both

14. **Comparative advantage** can be expressed in **terms of exchange rates**:

Instead of comparing goods directly - money is used.

In Macedonia - the production of 1 bale of tobacco costs 4/3 litres of wine.

15. **Exchanges rates** in the right ranges **drive countries to shift resources** into sectors in which they enjoy **comparative advantages**.

16. **Factor endowments** - the **quantity** of labour, land and natural resources of a country

17. **Heckscher - Ohlin theorem and the Learner corollary**

A country has a comparative advantage in the production of a product if that country is relatively well endowed with inputs (natural resources, knowledge capital, physical capital, land, skilled and unskilled labour) used intensively in the production of that product.

18. Why do countries **import and export the same product?**

Differentiation of products in response to diverse preferences / brand loyalty.

19. **Acquired (versus natural) comparative advantages**
(specific skills, goodwill)

PROTECTIONISM

1. **Protection** - shielding a sector of the economy from (foreign) competition

2. **Tariff** - tax on imports

Export subsidy - payment to encourage exports

Dumping - sale of products at prices below the costs of production

Quota - limit on quantity of imports

(mandatory and legislated or voluntary and negotiated)

3. **GATT**, the **Uruguay round**, the **WTO**, latest **multilateral WTO agreements**

4. **Free trade zones: EU, NAFTA, MERCOSUR, FTA (economic integration)**

5. **Trade barriers**

Prevent a country from **benefiting from specialization**

Push it do adopt **inefficient production techniques**

Force consumers to pay **higher prices for protected products**

6. **<u>Protection</u> <u>Counter - Argument</u>**

(A) **Saves jobs**

- Reallocation **- not disappearance**
- Retraining **and relocation**

(B) **Unfair trade practices**

Underinvestment in environment

(C) **Cheap foreign labour**

Reflects **lower productivity**

(unfair competition)

This **IS comparative advantage**

(D) Protect **national security**

Every industry uses it

(E) **Discouraging dependency**

(F) **Safeguarding infant industries**

No infant industry asked for help (allows them to **<u>acquire</u>** comparative advantage)

(H) Protection against currency fluctuations

What is proper rate?

Temporary currency overvaluation

International Trade and Exchange Rates

1. International trade is determined by exchange rates.

2. History: The gold standard, Bretton Woods (1944-1971), the snake (EMS), the Louvre accord (1985).

3. Influences on foreign exchange: central banks interventions, macroeconomic policy, statements by policymakers.

4. Balance of payments: the record of a country's transactions in goods, services & assets - current account and capital account.

5. (Merchandise exports - merchandise imports) = balance of trade (deficit or surplus) + (exports of services - imports of services) = net export / import of services + (income from investments) - (payments to investors) = net investment income + net transfer and other payments = current account

6. Increase (-) or decrease (+) in private (and in Government) assets abroad + increase (+) or decrease (-) in foreign private (and in Government) assets in the country = balance of capital account

7. (6) + statistical discrepancy = balance of payments

8. Debtor and creditor nations

9. The effect of a sustained increase in Government spending (or investment) on income (= the multiplier) - is

smaller in an open economy, some of the extra consumption goes to imports.

Multiplier = 1 / 1-(MPC-MPM) (in open economy)

10. Anything that affects consumption - affect imports (income, aftertax real wages, aftertax nonlabour income, interest rates, relative prices and the state of the economy).

11. The trade feedback effect - export increases consumption which increases imports. Imports in one country is exports in another which increases consumption and so on.

An increase in one country's economic activity leads to worldwide increase in economic activity which feeds back to that country. Its imports stimulate other countries' exports which stimulate those countries' imports and so on.

12. Prices of exports / imports are influenced by inflation.

Export prices of other countries affect a country's import prices.

Inflation is exported through export. It affects a country's import prices.

13. An increase in the price of imports affects local prices:

(A) Through stagflation: rising prices and falling output

(B) Expensive imports lead to increased demand for domestic products

14. The price feedback effect

Inflation in one country is exported to another and then re-exported to the first

15. The demand and supply for currencies

Firms, households and Government that import / export

Tourists in / out the country

Buyers of stocks, bonds or other financial instruments in / out the country

Investors in / out the country

Speculators who bet with / against a currency

16. What affects appreciation and depreciation of currencies?

The law of one price (for the same good everywhere)

For the same basket of goods - The exchange rate would be determined
by the relative price levels in the 2 countries

This is the purchasing power parity theory (PPP)

17. PPP does not account for transportation costs

Substitute products are not identical

Baskets of goods are different

18. Relative interest rates - higher rates lead to appreciation

19. Imports, like taxes and savings are a leakage from the income - consumption cycle.

Exports are like investments and Government purchases (stimulate output).

20. A depreciation stimulates exports and domestic consumption = the GDP

21. The J curve: balance of trade gets worse before its gets better
following a currency depreciation.

Exports increase, imports decrease, currency price of exports doesn't change very much (until domestic prices adjust), currency price of imports increases.

The value of imports increases, even as volume decreases, initially.

22. Expansion of money supply ® decrease in interest rates ® investment and consumption ® lower inventories ® rising income (output).

Lower demand for debt securities ® lower demand for currency ® more foreign securities bough ® currency sold and depreciates ® stimulates the economy.

Appendix V: Countertrade

COUNTERTRADE - (A) GENERAL

1. **Countertrade** - a transaction which links exports to imports in place of a financial settlement

2. **Reasons**

   A. Trade financing risky (debt crisis)
   B. Tight import credits (because of low exports)
   C. Entry into new markets (both the exporter and the importer)
   D. Products differentiation and creating competitive advantages
   E. Convertibility or political - financial problems

3. **Transaction phases**

   A. Identify target country arrangements / regulations
   B. Evaluate their attractiveness and
   C. Find the most favored one from the buyer's perspective
   D. Match your strengths with current / potential countertrade (internal / external uses for the goods, distribution network)
   E. Consider the accounting / taxation aspects
   F. Choose between in - house expertise and outside specialists
   G. Beware of risks:

      a. Quality and consistency of goods
      b. Delivery times
      c. Supplier reliability
      d. Changes in the value of goods over time

e. Negative attitude of Governments and IFIs (e.g., EXIM bank in USA)

4. **Countertrade is a marketing tool:**

A. Generating hard currency for clients
B. Helping them to market their products
C. Sharing (information, marketing, technology, production)

5. **Countertrade components**

A. Piecing together sources of finance, services and supplies in different countries to minimize hard currency net outlays of the importer.
B. Creating FOREX income for the importer through unrelated protects / new investments.
C. Partial payment in soft currencies through reinvestment of the proceeds in the importer's country.
D. Escrow accounts in foreign banks funded by the importer through export revenues (hedge until counter delivered goods are sold).

6. **Arguments in favour of countertrade**

A. International commerce - an extension of national (economic) policies.
B. (Leads to) a preference to deal with trade competition through bilateral accommodations favoring domestic exporters.
C. Uneven recovery rates and protective import policies.
D. A hedge against declining trade levels.
E. The growing third world debts.

F. Constraints on credits and debt rescheduling.
G. Dependence of developing countries on import - led growth and export expansion for debt servicing and unemployment.
H. Tool of long term industrial policy and economic planning.

7. **Factors affecting the future of countertrade**

A. Ability of world markets to accommodate counterdeliveries.
B. Nature of assets offered (raw materials, components, finished goods).
C. Streamlining of bureaucratic bottlenecks.
D. Willingness of western exporters to engage in higher risk trade.

COUNTERTRADE - (B) FORMS

1. **<u>Countertrade</u> and offset** are reciprocal arrangements.

<u>Countertrade</u> is the exchange of goods and services intended mainly to alleviate FOREX shortages of importers.

Offset is intended to advance industrial development objectives.

2. **Assets exchanged** include physical goods, services (e.g., tourism, engineering or transportation), rights (licenses, leases, etc.), lien instruments (e.g., sovereign

promissory notes), or temporary ownership (BOT - built, operate, transfer arrangements).

3. **Developed industrialized countries** emphasize technology and production processes while **developing countries** emphasize additional exports.

4. The **contractual arrangements** include cashless exchange of goods of comparable value, parallel import / export transactions with their own separate finances, production sharing / equity position.

5. **Countertrade ratio** - percent of the value of export offset by counterdeliveries

DISAGGIO - subsidy paid as a commission / discount by the exporter to a broker responsible for marketing counterdeliveries (in the hands of the broker it is AGGIO).

SWITCH - transfer of rights to countertrade goods to third parties

Protocol / link or framework contracts - side agreement linking the primary and secondary contracts in a countertrade

6. **Bilateral Government - To - Government trade agreements**

Reciprocal market access privileges (preferential terms)

A. To integrate the economies using clearing units - exporters and domestic currency by their Central bank.

B. Special political / regional trade relations.
C. Trading interests for raw materials sources.

7. **SWING** - margin of credit allowed on a bilateral clearing account (beyond which all trading stops) - usually 30%.

Clearing SWITCH - DISAGGIO driven financial operations. Bilateral imbalances are monetarised by brokerage networks through final sale products sourced from the country with the clearing arrears (or rights to products).

8. **Forms of compensatory trade arrangements**

OFFSET - in cases of purchases of military / (high cost) civilian equipment, counter - purchases are demanded as compensation.

Usually in the form of expansion of industrial capacity: coproduction, licensed production, subcontracting, overseas
investment, technology transfer, countertrade.

(IN) **DIRECT OFFSET** - articles (not) related to the sale.

BARTER - one time exchange of goods / services of equivalent value.

[examples: US - Jamaica, the dissolution of COMECON, Brokers' swaps]

BUYBACK (Compensation) - exporter receives products derived from the export.

Each leg is regulated by a separate contract.

COUNTERPURCHASE - exporter receives products unrelated to the export.

Exporter not allowed to transfer his credits and some advance purchases by exporters qualify.

UMBRELLA (Countertrade agreement) - includes multiple trading partners.

Between Western exporters and Government entity (**Evidence account**)

Between Governments concerning specific products (**Bilateral clearing**)

Countertrade used to release **blocked currencies / funds**

(Expatriation of profits against compensation)

OFFSHORE ESCROW ACCOUNTS - insulation from local banks ensure timely payments to exporters

Allowance for insufficient cash flows (production / marketing slippage)

COUNTERTRADE - (C) ANALYSIS AND PLANNING

1. **BENEFITS** (mainly intangible)

A. Locking in foreign market shares
B. Circumventing export restrictions
C. Supporting subsidiaries /affiliates
D. Depleting surplus inventory
E. Preserving production / employment levels

2. **COSTS** (mainly tangible)

A. General and administrative (handling, documentation)
B. Subsidy (DISAGGIO)
C. Financing and insurance (including holding & escrow accounts)
D. Performance / completion guarantees

3. **RISKS**

A. Expensive and partial insurance
B. Political risks and bureaucratic delays
C. Liability claims (personnel, product)
D. Property risks (direct damage or time dependent)
E. Lack of standardization
F. Shortfalls in delivery and marketing of the products
G. Losses due to delays: changes in production / export priorities

- sudden unavailability of raw materials
- crop failures
- inadequate transportation
- quality problems
- non-competitive pricing
- (arbitrary) marketing restrictions
- protectionist shifts
- contract failures of brokers / end users

4. **COUNTERMEASURES**

A. Analysis and viable pricing (maybe inflation of export prices)
B. The right contract
C. An insurance policy
D. Information about the importer, the markets and potential competitors brokers / end users
E. Recognizing anticipatory purchases and additionality requirements (transferable)
F. Separate the contracts to insulate performance and to facilitate financing, guarantees and insurance

5. **The CONTRACTS**

A. Primary sale - standard export contract + countertrade clause
B. Link contract - the countertrade contract includes:

    1. amount and period of obligation
    2. type, standards, pricing criteria of counterdeliveries
    3. names of companies providing counterdeliveries or: free choice clause
    4. transferability clause
    5. currency of payments
    6. notification and remittance procedures
    7. rights or restrictions affecting the marketing of goods
    8. non-performance penalties and damages
    9. disputes, termination, unavailability of goods

C. Counterpurchase (buyback) contract includes:

1. reference to primary contract
2. standards, specifications, pricing, handling
3. disputes, force majeure, arbitration, law, indemnities

COUNTERTRADE - (D) SUPPORT SERVICES

1. **TRADING HOUSES** have:

A. Specialists and experience
B. Financial resources
C. Positions in markets and / or marketing networks

Can help with:

A. Marketing and representation
B. Transportation, warehousing, insurance
C. Finance: credits and investment management
D. Manufacturing, upgrading

2. **BANKS** - advisory services and matchmaking, switch trading of clearing currencies and debt conversions

3. **INSURANCE** - state and private (LLOYDS, CHUBB, AIG)

4. **OTHERS** - law firms, trade consultants and information firms, export management companies, government agencies, industrial giants

F

Fimaco

Russia's Audit Chamber - with the help of the Swiss authorities and their host of dedicated investigators - may be about to solve a long standing mystery. An announcement by the Prosecutor's General Office is said to be imminent. The highest echelons of the Yeltsin entourage - perhaps even Yeltsin himself - may be implicated - or exonerated. A Russian team has been spending the better part of the last two months poring over documents and interviewing witnesses in Switzerland, France, Italy, and other European countries.

About $4.8 billion of IMF funds are alleged to have gone amiss during the implosion of the Russian financial markets in August 1998. They were supposed to prop up the banking system (especially SBS-Agro) and the ailing and sharply devalued ruble. Instead, they ended up in the bank accounts of obscure corporations - and, then, incredibly, vanished into thin air.

The person in charge of the funds in 1998 was none other than Mikhail Kasyanov, Russia's current Prime Minister - at the time, Deputy Minister of Finance for External Debt. His signature on all foreign exchange transactions - even those handled by the central bank - was mandatory. In July 2000, he was flatly accused by the Italian daily, La Reppublica, of authorizing the diversion of the disputed funds.

Following public charges made by US Treasury Secretary Robert Rubin as early as March 1999, both Russian and American media delved deeply over the years into the affair. Communist Duma Deputy Viktor Ilyukhin jumped on the bandwagon citing an obscure "trustworthy foreign source" to substantiate his indictment of Kremlin cronies and oligarchs contained in an open letter to the Prosecutor General, Yuri Skuratov.

The money trail from the Federal Reserve Bank of New York to Swiss and German subsidiaries of the Russian central Bank was comprehensively reconstructed. Still, the former Chairman of the central bank, Sergei Dubinin, called Ilyukhin's allegations and the ensuing Swiss investigations - "a black PR campaign ... a lie".

Others pointed to an outlandish coincidence: the ruble collapsed twice in Russia's post-Communist annals. Once, in 1994, when Dubinin was Minister of Finance and was forced to resign. The second time was in 1998, when Dubinin was governor of the central bank and was, again, ousted.

Dubinin himself seems to be unable to make up his mind. In one interview he says that IMF funds were used to prop up the ruble - in others, that they went into "the national pot" (i.e., the Ministry of Finance, to cover a budgetary shortfall).

The Chairman of the Federation Council at the time, Yegor Stroev, appointed an investigative committee in 1999. Its report remains classified but Stroev confirmed that IMF funds were embezzled in the wake of the 1998 forced devaluation of the ruble.

This conclusion was weakly disowned by Eleonora Mitrofanova, an auditor within the Duma's Audit Chamber who said that they discovered nothing "strictly illegal" - though, incongruously, she accused the central bank of suppressing the Chamber's damning report. The Chairman of the Chamber of Accounts, Khachim Karmokov, quoted by PwC, said that "the audits performed by the Chamber revealed no serious procedural breaches in the bank's performance".

But Nikolai Gonchar, a Duma Deputy and member of its Budget Committee, came close to branding both as liars when he said that he read a copy of the Audit Chamber report and that it found that central bank funds were siphoned off to commercial accounts in foreign banks.

The Moscow Times cited a second Audit Chamber report which revealed that the central bank was simultaneously selling dollars for rubles and extending ruble loans to a few well-connected commercial banks, thus subsidizing their dollar purchases. The central bank went as far as printing rubles to fuel this lucrative arbitrage. The dollars came from IMF disbursements.

Radio Free Europe/Radio Liberty, based on its own sources and an article in the Russian weekly "Novaya Gazeta", claims that half the money was almost instantly diverted to shell companies in Sydney and London. The other half was mostly transferred to the Bank of New York and to Credit Suisse.

Why were additional IMF funds transferred to a chaotic Russia, despite warnings by many and a testimony by a Russian official that previous tranches were squandered? Moreover, why was the money sent to the Central Bank, then embroiled in a growing scandal over the manipulation of treasury bills, known as GKO's and other debt instruments, the OFZ's - and not to the Ministry of Finance, the beneficiary of all prior transfers? The central bank did act as MinFin's agent - but circumstances were unusual, to say the least.

There isn't enough to connect the IMF funds with the money laundering affair that engulfed the Bank of New York a year later to the day, in August 1999 - though several of the personalities straddled the divide between the bank and its clients. Swiss efforts to establish a firm linkage failed as did their attempt to implicate several banks in the Italian canton of Ticino. The Swiss - in collaboration with half a dozen national investigation bureaus, including the FBI - were more successful in Italy proper, where they were able to apprehend a few dozen suspects in an elaborate undercover operation.

FIMACO's name emerged rather early in the swirl of rumors and denials. At the IMF's behest, PricewaterhouseCoopers (PwC) was commissioned by Russia's central bank to investigate the relationship between the Russian central bank and its Channel Islands offshoot, Financial Management Company Limited, immediately when the accusations surfaced.

Skuratov unearthed $50 billion in transfers of the nation's hard currency reserves from the central bank to FIMACO, which was majority-owned by Eurobank, the central bank's Paris-based daughter company. According to PwC, Eurobank was 23 percent owned by "Russian companies and private individuals".

Dubinin and his successor, Gerashchenko, admit that FIMACO was used to conceal Russia's assets from its unrelenting creditors, notably the Geneva-based Mr. Nessim Gaon, whose companies sued Russia for $600 million. Gaon succeeded to freeze Russian accounts in Switzerland and Luxemburg in 1993. PwC alerted the IMF to this pernicious practice, but to no avail.

Moreover, FIMACO paid exorbitant management fees to self-liquidating entities, used funds to fuel the speculative GKO market, disbursed non-reported profits from its activities, through "trust companies", to Russian subjects, such as schools, hospitals, and charities - and, in general, transformed itself into a mammoth slush fund and source of patronage. Russia admitted to lying to the IMF in 1996. It misstated its reserves by $1 billion.

Some of the money probably financed the fantastic salaries of Dubinin and his senior functionaries. He earned $240,000 in 1997 - when the average annual salary in Russia was less than $2000 and when Alan Greenspan, Chairman of the Federal Reserve of the USA, earned barely half as much.

Former Minister of Finance, Boris Fedorov, asked the governor of the central bank and the prime minister in 1993 to disclose how were the country's foreign exchange reserves being invested. He was told to mind his own business. To Radio Free Europe/Radio Liberty he said, six years later, that various central bank schemes were set up to "allow friends to earn handsome profits ... They allowed friends to make profits because when companies are created without any risk, and billions of dollars are transferred, somebody takes a (quite big) commission ... a minimum of tens of millions of dollars. The question is:

Who received these commissions? Was this money repatriated to the country in the form of dividends?"

Dubinin's vehement denials of FIMACO's involvement in the GKO market are disingenuous. Close to half of all foreign investment in the money-spinning market for Russian domestic bonds were placed through FIMACO's nominal parent company, Eurobank and, possibly, through its subsidiary, co-owned with FIMACO, Eurofinance Bank.

Nor is Dubinin more credible when he denies that profits and commissions were accrued in FIMACO and then drained off. FIMACO's investment management agreement with Eurobank, signed in 1993, entitled it to 0.06 percent of the managed funds per quarter.

Even accepting the central banker's ludicrous insistence that the balance never exceeded $1.4 billion - FIMACO would have earned $3.5 million per annum from management fees alone - investment profits and brokerage fees notwithstanding. Even Eurobank's president at the time, Andrei Movchan, conceded that FIMACO earned $1.7 million in management fees.

The IMF insisted that the PwC reports exonerated all the participants. It is, therefore, surprising and alarming to find that the online copies of these documents, previously made available on the IMF's Web site, were "Removed September 30, 1999 at the request of PricewaterhouseCoopers".

The cover of the main report carried a disclaimer that it was based on procedures dictated by the central bank and "...consequently, we (PwC) make no representation regarding the sufficiency of the procedures described below ... The report is based solely on financial and other information provided by, and discussions with, the persons set out in the report. The accuracy and completeness of the information on which the report is based is the sole responsibility of those persons. ... PricewaterhouseCoopers have not carried out any verification work which may be construed to represent audit procedures ... We have not been provided access to Ost West Handelsbank (the recipient of a large part of the $4.8 IMF tranche)."

The scandal may have hastened the untimely departure of the IMF's Managing Director at the time, Michel Camdessus, though this was never officially acknowledged. The US Congress was reluctant to augment the Fund's resources in view of its controversial handling of the Asian and Russian crises and contagion.

This reluctance persisted well into the new millennium. A congressional delegation, headed by James Leach (R, Iowa), Chairman of the Banking and Financial Services Committee, visited Russia in April 2000, accompanied by the FBI, to investigate the persistent contentions about the misappropriation of IMF funds.

Camdessus himself went out of his way to defend his record and reacted in an unprecedented manner to the allegations. In a letter to Le Mond, dated August 18, 1999 - and still posted on the IMF's Web site, three years later - he wrote, inadvertently admitting to serious mismanagement:

"I wish to express my indignation at the false statements, allegations, and insinuations contained in the articles and editorial commentary appearing in Le Monde on August 6, 8, and 9 on the content of the PricewaterhouseCoopers (PWC) audit report relating to the operations of the Central Bank of Russia and its subsidiary, FIMACO.

Your readers will be shocked to learn that the report in question, requested and made public at the initiative of the IMF ... (concludes that) no misuse of funds has been proven, and the report does not criticize the IMF's behavior ... I would also point out that your representation of the IMF's knowledge and actions is misleading. We did know that part of the reserves of the Central Bank of Russia was held in foreign subsidiaries, which is not an illegal practice; however, we did not learn of FIMACO's activities until this year--because the audit reports for 1993 and 1994 were not provided to us by the Central Bank of Russia.

The IMF, when apprised of the possible range of FIMACO activities, informed the Russian authorities that it would not resume lending to Russia until a report on these activities was available for review by the IMF and corrective actions had been agreed as needed ... I would add that what the IMF objected to in FIMACO's operations extends well beyond the misrepresentation of Russia's international reserves in mid-1996 and includes several other instances where transactions through it had resulted in a misleading representation of the reserves and of monetary and exchange policies. These include loans to Russian commercial banks and investments in the GKO market."

No one accepted - or accepts - the IMF's convoluted post-facto "clarifications" at face value. Nor was Dubinin's tortured sophistry - IMF funds cease to be IMF funds when they are transferred from the Ministry of Finance to the central bank - countenanced.

Even the compromised office of the Russian Prosecutor-General urged Russian officials, as late as July 2000, to re-open the investigation regarding the diversion of the funds. The IMF dismissed this sudden burst of rectitude as the rehashing of old stories. But Western officials - interviews by Radio Free Europe/Radio Liberty - begged to differ.

Yuri Skuratov, the former Prosecutor-General, ousted for undue diligence, wrote in a book he published two years ago, that only c. $500 million of the $4.8 were ever used to stabilize the ruble. Even George Bush Jr., when still a presidential candidate accused Russia's former Prime Minister Viktor Chernomyrdin of complicity in embezzling IMF funds. Chernomyrdin threatened to sue.

The rot may run even deeper. The Geneva daily "Le Temps", which has been following the affair relentlessly, accused, two years ago, Roman Abramovich, a Yeltsin-era oligarch and a member of the board of directors of Sibneft, of colluding with Runicom, Sibneft's trading arm, to misappropriate IMF funds. Swiss prosecutors raided Runicom's offices just one day after Russian Tax Police raided Sibneft's Moscow headquarters.

Absconding with IMF funds seemed to have been a pattern of behavior during Yeltsin's venal regime. The columnist Bradley Cook recounts how Aldrich Ames, the mole within the CIA, "was told by his Russian control officer during their last meeting, in November 1993, that the $130,000 in fresh $100 bills that he was being bribed with had come directly from IMF loans." Venyamin

Sokolov, who headed the Audit Chamber prior to Sergei Stepashin, informed the US Senate of $2 billion that evaporated from the coffers of the central bank in 1995.

Even the IMF reluctantly admits:

"Capital transferred abroad from Russia may represent such legal activities as exports, or illegal sources. But it is impossible to determine whether specific capital flows from Russia-legal or illegal-come from a particular inflow, such as IMF loans or export earnings. To put the scale of IMF lending to Russia into perspective, Russia's exports of goods and services averaged about $80 billion a year in recent years, which is over 25 times the average annual disbursement from the IMF since 1992."

DISCLAIMER
Sam Vaknin served in various senior capacities in Mr. Gaon's firms and advises governments in their negotiations with the IMF.

Foreign Aid

Yankee Go Home. Nato is Nazo. American trash culture. The graffiti adorn every wall, the contempt seems to be universal. America and Americans are perceived to be uglier than ever before. It borders on hatred and xenophobia. Are we talking about Serbia in the midst of its Kosovo baptizing by fire? Not really. America-bashing seems to be a phenomenon engulfing rich (Czech Republic) and poor (Macedonia), the lawful (Greece) and the lawless (Russia), the Western orientated (Bulgaria) and the devoutly Slavophile (Serbia). Often, America (and Britain, its Anglo-Saxon sidekick) stand as proxies and fall guys for this ephemeral ghoul, the West. At other times, the distinctions are finer and France or Scandinavia, for instance, are excluded from the general outcry and condemnation.

Americans - these patriarchs of spin doctoring and image making - complain about the yawning discrepancy between facts and perceptions. America is by far the most generous nation on earth, they say (and it is). It recurrently risks the lives of its soldiers and diplomats in the service of worthy causes the world over. It often endures economic damage as it seeks to tame and educate unwieldy tyrants - the cost of weaponry, the exclusion of American business from whole regions of the globe. Its agenda is meritorious and virtuous. It champions human rights, civil society and peace. It actively engages in the enforcement of the former and in the pursuit of the latter. Never before in human history has a superpower put its prowess and clout to more deserving and selfless use. And it is all true.

But America gives without grace and takes without shame. It is a nation founded on contracts, on quid pro quo, on haggling and on litigation. It is Mammon gone amok, law-abiding gone cancerous and commerce gone haywire. Money has replaced all values combined and fear substitutes for conscience. Its barons are robbers, its serial killers are celebrities, its politicians corrupted by the twin infections of campaign finance and narrow interests. Its diplomacy is the conduit through which it spreads its rough hewn, frontiersmen, bottom line and sound bite culture.

Thus, its "aid" is always strings-attached. Even when not explicit, the payback is imminent and immanent. Goods can be bought with American money only from American manufacturers. The recipient countries are used as dumping grounds for surpluses, be they agricultural or military. A swarm of advisors and do-gooders is in place to secure American interests and markets, to deflect adversaries, to intervene in local politics, brutally, if needed. As a result, American charity, this fabulous beast, is derided as a new form of American colonialism. Broken promises and keen trade protectionism only aggravate the feeling that the West is more interested in photo opportunities than in business opportunities. It seems to be less concerned with the welfare of the assisted than with the expense accounts of the assistants. Rather than where most needed, grant money and provisions flow in the direction of waiting TV cameras.

Even the "natives" of CEE and the Balkans accept that Western diplomacy is the long arm of its business community. What they find harder to digest is the double moral standard, the hypocrisy, the preaching and the hectoring, the bad and uninformed advice foisted upon them by third rate dropouts advisors and fourth rate third world bankers. What they reject is the pompous likes of Blair - hair artistically dishevelled in squalid refugee camps - lecturing, preaching and beseeching while conveniently ignoring aid pledges he solemnly made a while before. What they abhor is Germans reprimanding them for political corruption, Frenchmen upbraiding them for nepotism and cronyism and Britons teaching them health care administration. Or Americans swearing by their selflessness, objectivity and lack of ulterior motives. America plays by different rules, exempt from international law and institutions. In short, the indigenous resent being considered stupid.

The "multi"-lateral institutions (such as the IMF, the WTO and World Bank) are long arms of the USA and, to a lesser extent, of Europe. These are rich men's clubs. Their main aim is to sustain the criminal fool's paradise that is Central and Eastern Europe and the Balkans. They turn a blind eye to corrupt politicians who do their bidding and another blind eye to violations of every right imaginable - as long as a swampish stability is maintained. They are the sotto voce juggernauts which, in the name of free marketry and civil society, prepare the way for American and Western business. The little good they do is lost in their partiality, ignorance and shortsightedness. They are their master's voice.

Perhaps the West - more so the Anglo-Saxon contingent - should try the refreshing opposite of unbridled narcissism. Perhaps it should give freely and accept nothing in return, not even gratitude. Perhaps it should no longer twist arms and threaten, let multilateral institutions be really multilateral and encourage pluralism through tolerance. More gratitude and business come the way of those who seek them not. Omar al-Khayam, the Persian poet, said: "IF you want to have the bird, set her free". But then the USA is not very likely to listen to an Iranian, is it?

A common, guttural cry of "Eureka" echoed as the peoples of East Europe and the Balkan emerged from the Communist steam bath. It was at once an expression of joy and disbelief. That the West should be willing to bankroll the unravelling of a failed social experiment, freely entered into, exceeded the wildest imaginings. That it would do so indefinitely and with no strings attached was a downright outlandish fortuity.

Transition in the post communist countries was coupled with a hubristic and haughty conviction in the transforming powers of the Western values, Western technology, and Western economics. The natives - awe struck and grateful - were supposed to assimilate these endowments and thus become honorary Westerners ("white men"). Where osmosis and immitation failed - bayonets and bombs were called upon. These were later replaced by soft credits and economic micromanagement by a host of multilateral institutions.

Accustomed to Pavolvian interactions, adept at manipulating "the system", experts in all manner of make belief - the shrewd denizens of the East exercised the reflexive levers of the Great Democracies. They adopted stratagems whose sole purpose was to extract additional aid, to foster a dependency of giving, to emotionally extort. In one sentence: they learned how to corrupt the donors.

The most obvious subterfuge involved the mindless repetition of imported mantras. Possessed of the same glazed eyes and furled lips, the loyal members of a perfidious nomenklatura uttered with the same seemingly perfervid conviction the catechism of a new religion. Yesterday communism - today capitalism, unblushingly, unhesitatingly, cynically. Yesterday, a recondite dictatorship of the proletariat or, more often, a personality cult - today "democracy". Yesterday - brotherhood and unity, today - genocidal "self determination". Yesterday - genocidal inclinations, today - a "growth and stability pact". If required to bark in the nude in order to secure the flow of unsupervised funding (mainly to their pockets), these besuited "gentlemen" would have done so with self-sacrificial ardour, no doubt.

When it dawned upon them that the West is willing to pay for every phase of self-betterment, for every stage of self-improvement, for every functioning institution and law passed - this venal class (the soi-disant "elite" in government, in industry and academe) embarked on a gargantuan blackmail plot. The inventors of the most contorted and impervious bureaucracies ever, have recreated them. They have transformed the simplest tasks of reform into tortuous, hellish processes, mired in a miasma of numerous committees and deluged by cavils, captious "working" papers and memoranda of stupefying trumpery. They have stalled and retraced, reversed and regressed, opined and debated, refused and accepted grudgingly. The very processes of transformation and transition - a simulacrum to begin with - acquired an aura of somnolent lassitude and the nightmarish quality of ensnarement. And they made the West bribe them into yielding that which was ostensibly in their very own interest. Every act of legislation was preceded and followed by dollops of foreign cash. Every ministry abolished was conditioned upon more aid. Every court established, every bloodletting firm privatized, every bank sold, every system made more efficient, every procedure simplified, every tender concluded and every foreign investor spared - had a tariff. "Pay or else ..." was the overt message - and the West preferred to pay and to appease, as it has always done.

The money lavished on these "new democracies" was routed rather conspicuously into the private bank accounts of the thin layer of vituperable "leaders", "academics" and "businessmen" (often the same people). One third cigarette smugglers, one third uncommon criminals and one third cynical con-artists, these people looted the coffers of their states. The IMF - this sanctuary of fourth rate economists from third world countries, as I am never wont of mentioning - collaborated with the US government, the European Union and the World Bank in covering up this stark reality. They turned a common blind eye to the diversion of billions in aid and credits to mysterious bank accounts in dubious tax havens. They ignored fake trading deals, itinerant investment houses, shady investors and shoddy accounting. They expressed merely polite concern over blatant cronyism and rampant nepotism. They kept pouring money into the rapidly growing black hole that Eastern Europe and the Balkan have become. They pretended not to know and feigned surprise when confronted with the facts. In their complicity, they have encouraged the emergence of a criminal class of unprecedented proportions, hold and penetration in many of the countries within their remit.

To qualify to participate in this grand larceny, one needed only to have a "sovereign" "state". Sovereign states are entitled to hold shares in multilateral financial institutions and to receive international aid and credits. In other words: sovereignty is the key to instant riches. The unregenerate skulks that pass for political parties in many countries in East Europe and the Balkan (though not in all of them - there are exceptions), carved up the territory. This led to a suspicious proliferation of "republics", each with its own access to international funds. It also led to "wars" among these emergent entities.

Recent revelations regarding the close and cordial co-operation between Croatia's late president, Franjo Tudjman and Yugoslavia's current strongman, Slobodan Milosevic - ostensibly, bitter enemies - expose the role that warfare and instability played in increasing the flow of aid (both civil and military) to belligerent countries.

The more unstable the region, the more ominous its rhetoric, the more fractured its geopolitics - the more money flowed in. It was the right kind of money: multilateral - not multinational, public - not private, deliberately ignorant - not judiciously cognizant. It was the "quantum fund" - capable of "tunnelling" (as the Czechs called it) - vanishing in one place (the public purse) and appearing in another (the private wallet) simultaneously. Even the exception - the never-enforced sanctions against Yugoslavia - served to enrich its cankerous ruling class by way of smuggling and monopolies.

And why did the West collaborate in this charade? Why did it compromise its goodwill, its carefully crafted institutions, its principles and ethos? The short and the long of it is: to get rid of a nuisance at a minimal cost. It is much cheaper to grease the palms of a deciding few - than to embark on the winding path of true and painful growth. It is more convenient to co-opt a political leader than to confront an angry mob. It is by far easier to throw money at a problem than to solve it.

It was not a sinister conspiracy of the Great Powers as many would have it. Nor was it the result of foresight, insight, perspicacity, or planning. It was a typical improvident European default, adopted by a succession of lacklustre and lame American administrations. It enriched the few and impoverished the many. It fostered anti-Western sentiments. It provoked skirmishes that provoked wars that led to massacres. To reverse it would require more resources than should have been committed in the first place. These are not forthcoming. The West is again misleading and deceiving and collaborating to defraud the peoples of these unfortunate netherlands. It again promises prosperity it cannot deliver, growth it will not guarantee and stability it cannot ensure. This prestidigitation is bound to lead to ever larger bills and to the attrition of good will of both donor and recipient. Never before was such a unique historical opportunity so thoroughly missed. The consequences may well be as unprecedented.

Foreign Direct Investment (FDI)

The role of foreign direct investment (FDI) in promoting growth and sustainable development has never been substantiated. There isn't even an agreed definition of the beast. In most developing countries, other capital flows - such as remittances - are larger and more predictable than FDI and ODA (Official Development Assistance).

Several studies indicate that domestic investment projects have more beneficial trickle-down effects on local economies. Be that as it may, close to two-thirds of FDI is among rich countries and in the form of mergers and acquisitions (M&A). All said and done, FDI constitutes a mere 2% of global GDP.

FDI does not automatically translate to net foreign exchange inflows. To start with, many multinational and transnational "investors" borrow money locally at favorable interest rates and thus finance their projects. This constitutes unfair competition with local firms and crowds the domestic private sector out of the credit markets, displacing its investments in the process.

Many transnational corporations are net consumers of savings, draining the local pool and leaving other entrepreneurs high and dry. Foreign banks tend to collude in this reallocation of financial wherewithal by exclusively catering to the needs of the less risky segments of the business scene (read: foreign investors).

Additionally, the more profitable the project, the smaller the net inflow of foreign funds. In some developing countries, profits repatriated by multinationals exceed total FDI. This untoward outcome is exacerbated by principal and interest repayments where investments are financed with debt and by the outflow of royalties, dividends, and fees. This is not to mention the sucking sound produced by quasi-legal and outright illegal practices such as transfer pricing and other mutations of creative accounting.

Moreover, most developing countries are no longer in need of foreign exchange. "Third and fourth world" countries control three quarters of the global pool of foreign exchange reserves. The "poor" (the South) now lend to the rich (the North) and are in the enviable position of net creditors. The West drains the bulk of the savings of the South and East, mostly in order to finance the insatiable consumption of its denizens and to prop up a variety of indigenous asset bubbles.

Still, as any first year student of orthodox economics would tell you, FDI is not about foreign exchange. FDI encourages the transfer of management skills, intellectual property, and technology. It creates jobs and improves the quality of goods and services produced in the economy. Above all, it gives a boost to the export sector.

All more or less true. Yet, the proponents of FDI get their causes and effects in a tangle. FDI does not foster growth and stability. It follows both. Foreign investors are attracted to success stories, they are drawn to countries already growing, politically stable, and with a sizable purchasing power.

Foreign investors of all stripes jump ship with the first sign of contagion, unrest, and declining fortunes. In this respect, FDI and portfolio investment are equally unreliable. Studies have demonstrated how multinationals hurry to repatriate earnings and repay inter-firm loans with the early harbingers of trouble. FDI is, therefore, partly pro-cyclical.

What about employment? Is FDI the panacea it is made out to be?

Far from it. Foreign-owned projects are capital-intensive and labor-efficient. They invest in machinery and intellectual property, not in wages. Skilled workers get paid well above the local norm, all others languish. Most multinationals employ subcontractors and these, to do their job, frequently haul entire workforces across continents. The natives rarely benefit and when they do find employment it is short-term and badly paid. M&A, which, as you may recall, constitute 60-70% of all FDI are notorious for inexorably generating job losses.

FDI buttresses the government's budgetary bottom line but developing countries invariably being governed by kleptocracies, most of the money tends to vanish in deep pockets, greased palms, and Swiss or Cypriot bank accounts. Such "contributions" to the hitherto impoverished economy tend to inflate asset bubbles (mainly in real estate) and prolong unsustainable and pernicious consumption booms followed by painful busts.

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Foreign Direct Investment (FDI) (in Central and Eastern Europe)

How will the credit crunch of 2007 affect foreign direct investment in Central and Eastern Europe? What if it develops into a full scale recession in the West and especially in the USA?

It is instructive to study the effects on the region of a previous recession at the beginning of the decade (2000-2002).

The brief global recession of the early years of this decade - which was neither prolonged, nor trenchant and all-pervasive, as widely predicted - had little effect on Central and Eastern Europe's traditional export markets.

The region were spared the first phase of financial gloom which affected mainly mergers, acquisitions and initial public offerings. Few multinationals scrapped projects, scaled back overseas expansion and cancelled long-planned investments.

According to a 2003 report by the Vienna Institute of Economic Studies, FDI flows to the countries of central Europe were halved in the first quarter of 2002, despite their looming membership in the European Union (realized in May 2004). During 1999-2003 export transactions were frequently delayed and privatizations attracted scant interest.Net FDI flows in 2003, says the EBRD, came to a mere 7.2 billion euros, compared to 22.6 billion euros in the preceding year.

The Vienna Institute erroneously predicted a particularly bleak year for Poland and a Czech economy redeemed only by sales of state assets in the energy sector. Yet its statistics failed to cover reinvested profits. These amounted to $1.5-2 billion in Hungary alone - equal to its average annual FDI.

In reality, the picture was mixed. Forecasts prepared in November 2002 by the United Nations Conference for Trade and Development (UNCTAD) showed marked declines in FDI in Moldova, Estonia, Hungary, Poland, Slovakia, Macedonia and Ukraine. Flows rose in Albania, Bulgaria, the Czech Republic, Latvia, Lithuania and Slovenia, and remained unchanged in Bosnia and Herzegovina, Croatia, Romania and Russia, said UNCTAD.

Foreign direct investment (FDI) in Lithuania grew by at least 15 percent in 2003. Its FDI stock - accumulated in its decade of independence - exceeded c. $4 billion, or c. $1000 per capita, as early as end-2002. Pace has picked up dramatically in the past six years in many second-tier investment destinations in central and east Europe, including Slovakia, and formerly war-torn Macedonia and Armenia. Of the latter's $600 million in post-communist foreign inflows - two thirds have been placed since 1999.

Prime investment locales, like the Czech Republic, or Hungary, are still attracting enthusiastic fund managers, multinationals and bankers from all over the world. In a startling inversion of roles, Russia became a net exporter of FDI. According to official figures - which are thought to under-report the facts by half - Russia invested abroad more than $3 billion every single year since 2000. This is double the figure in 1999 and translates into $300-500 million in annual net outflows of foreign direct investment.

Moreover, the bulk of Russian capital spending abroad is directed at rich, industrialized countries. The republics of the former Soviet Union see very little of it, though Russian stakes there have been growing by 25 percent annually ever since the 1998 meltdown. Russia's energy behemoths compete, for instance, with western mineral and oil extraction companies in Kazakhstan and Azerbaijan.

Levels of worldwide FDI declined by more than 50 percent - to c. $730 billion - between 2000 and 2001. Yet, astoundingly, the major downturn in emerging markets' FDI in 1999-2002 had largely bypassed the region. Net private capital flows - both FDI and portfolio investment - shot up six-fold from $1 billion in 2000 to $6 billion a year later. Most of the surge occurred in the Balkans and the Commonwealth of Independent States (CIS).

According to the European Bank for Reconstruction and Development (EBRD) in its Transition Report Updates, the region grew by 4.3 percent in 2001 and by 3.3 percent p.a. the years after. In 2006 alone, eastern Europe's GDP shot up by 6.2% and FDI flows amounted to $50 billion. This performance as projected to have been repeated in 2007. This is way more than most developed and emerging markets managed. Eight countries in central and east Europe drew rating upgrades, only two (Moldova and Poland) were downgraded.

Some countries fared better than others. Slovakia sold, in March 2002, 49 percent of its gas transport company for $2.7 billion. Slovenia booked yet another record year in 2002 due to the long-deferred privatization of its banking sector and to the sale to foreign investors of assets originally privatized to cronies, insiders and communist-era managers. The Slovenian Business Weekly correctly expected the country to draw in more than $600 million in 2002 - up 50 percent on 2001.

In the western Balkans, only Croatia stood out as an inviting and modernization-bent prospect. Yugoslavia (Serbia and Montenegro) reawakened, too. It has privatized cement companies and rationalized the banking sector with a view to becoming a preferred FDI destination. In the first 6 months of 2002, it garnered $100 million in realized deals and another $60 million in commitments.

Ironically, during the brief global recession, Romania and Bulgaria (both of which joined the European Union - EU - in 2007) were laggards, though intermittent privatization in both countries was counterbalanced by cheap and skilled workforces in their growing and labor-intensive economies. Macedonia spent those years futilely reviewing, with a view to annulling, at least 30 suspect privatization deals. This did not endear its kleptocracy to anyhow reluctant multinationals.

Per capita, FDI stock is highest in the Czech Republic ($3000), Estonia ($2600) and Hungary ($2400). These are followed by Slovenia ($2000), Slovakia ($1800), Croatia ($1700) and Poland ($1200). All, with the curious exception of Croatia, have joined the EU in 2004.

The total realized FDI in 2000-2002 in central Europe amounted to more than $50 billion, with Poland and the much smaller Czech Republic attracting the most ($14 billion each), followed by the Slovak Republic ($7 billion) and Hungary ($5 billion). The regional FDI stock comes to a respectable $100 billion.

Southeastern Europe (the politically correct name for the Balkans), excluding Greece and Turkey, attracted rather less - c. $12 billion in realized FDI in 2000-2. Croatia topped the list with $3.8 billion, followed by Romania ($3.3 billion), Bulgaria ($2.3 billion), Macedonia ($1.1 billion), Yugoslavia ($0.7 billion) and Albania and Bosnia-Herzegovina ($0.5 billion each).

Yet, the Balkans, impoverished and war-scarred as it is, accumulated a surprising $22 billion in FDI stock. According to the 2003 Investment Guide for Southeast Europe, published by the Bulgarian Industrial Forum, the share of FDI per GDP is much higher in the Balkans than it is, for example, in Russia. In 2001, the ratio was c. 5 percent in Bulgaria, 7.5 percent in Croatia and about 12 percent in Macedonia.

The former USSR as a whole enjoyed $57 billion in FDI between 1991-2002. The bulk of it went to Russia ($23 billion) and the Baltic states ($8 billion). In 1999-2002, Ukraine absorbed $1.9 billion in FDI flows - one half the receipts of the puny Baltic trio: Lithuania, Latvia and Estonia. Belarus and Moldova scarcely registered, each of them with barely above three fifths the FDI in Albania, or ravaged and precariously balanced Bosnia-Herzegovina.

The weight of FDI in the local economies cannot be overstated. Two fifths of the exports of countries as disparate as the Czech Republic and Romania are produced by foreign affiliates. In some countries - like Romania - 40 percent of all sales are generated by foreign-owned subsidiaries. The banking sectors of many - including Bulgaria, Croatia, the Czech Republic and Macedonia - are mostly owned by outside financial institutions.

Foreigners bring access to global markets, knowledge and management skills and techniques. They often transfer technology and train a cadre of local executives to take over once the expats are gone. And, of course, they provide capital - their own, or gleaned from foreign banks and investors, both private and through the capital markets in the west.

Initially, foreign investors provoked paranoid xenophobia almost everywhere in these formerly hermetically sealed polities. Deficient legal and regulatory frameworks, rapacious insiders, venal politicians, militant workers, opaque and politically compromised institutions, disadvantageous tax regimes and a hostile press obstructed their work during the first half of the 1990s.

Yet, gradually, the denizens of these countries came to realize the advantages of FDI. Workers noticed the higher wages paid by foreign-owned plants and offices. The emergent class of shareholders, invariably members of the powerful nomenclature, having sucked their firms dry, sought to pass the carcasses to willing overseas investors. Currently - with a few notable exceptions, such as Belarus - multinationals and money managers are actively courted by eager governments and keen indigenous firms.

Proofs of this grassroots turnaround in sentiment and priorities abound.

FDI is a good proxy for a country's integration with the global economy. It is an important component in A.T. Kearney and Foreign Policy Magazine's Globalization Index. The Czech Republic made it in 2002 to the 15th place (of 62 countries), higher than New Zealand, Germany, Malaysia, Israel and Spain, for instance.

Croatia in 22nd rung and Hungary in the 23rd slot compare to Australia (21) and outflanked the likes of Italy (24), Greece (26) and Korea (28). Slovenia was not far behind (25), followed by Slovakia (27), Poland (32) and Romania (40). Even hidebound Ukraine made it to the 42nd place, ahead of Sri Lanka (44), Thailand (47), Argentina (48) and Mexico (49). Russia lagged the rest at the 45th location.

A.T. Kearney's Global Business Policy Council - a select group of corporate leaders from the world's largest 1000 corporations - publishes the FDI Confidence Index. It tracks FDI intentions and preferences. Its September 2002 edition ranked 60 countries which, together, account for nine tenths of global FDI flows. The companies interviewed were responsible for $18 trillion in sales and seven out of every ten FDI dollars.

Revealingly, central and east European countries made it to the first 25 places. Poland, right after Australia, preceded Japan, Brazil, India and Hong-Kong, for instance. The Czech Republic, Hungary and Russia - closely grouped together - were found more alluring than Hong-Kong, the Netherlands, Thailand, South Korea, Singapore, Belgium, Taiwan and Austria. Russia - whose economy improved dramatically since 1998 - leaped from beyond the pale (i.e., below the top 25) to 17th place. Hungary moved from 21 to 16.

The report concludes with these incredible projections:

"Russia ... could well be a target for almost as many first-time investments as the United States ... China, Russia, Mexico and Poland combined ... are expected to accumulate about one quarter of all proposed new investment commitments."

This is part of a more comprehensive trend:

"Europe has become the most attractive destination for first time investments. More than one third of global executives are expected to commit investments for the first time in Europe over the next three years 2003-6 (especially in) Russia, Poland and the Czech Republic."

A relatively new phenomenon is cross-border investments by one country in transition in another's economy and enterprises. At four percent of Slovene FDI stock, the Czech Republic has invested in Slovenia as much as the United States, or the United Kingdom. Slovenes and

Bulgarians have ploughed capital into the banking, industrial and food processing sectors in Macedonia. Hungarians in Serbia, Czechs in Romania, Croats in Slovenia - are common sights.

Traditional FDI destinations feel threatened by the surging reputation of central and, to a lesser extent, east Europe. In a series of articles he published on radio Free Europe/Radio Liberty prior to the EU's enlargement eastwards, Breffni O'Rourke summed up Irish anxieties expressed by his interviewees thus:

"There's a certain unease developing in Ireland as the 10 Central and Eastern European candidate countries move toward full membership in the European Union. The Irish are not unaware that the Czechs are heirs to a fine tradition of precision manufacturing; that the Poles are considered quick-thinking and innovative; that Bulgarians have a way with computers; that the Baltic nations have powerful Scandinavian supporters; and that Romania has extraordinarily low costs to offer investors. In fact, rising costs - in comparison to the Eastern candidate nations - are one of Ireland's main worries. The question troubling the Irish is: Could incoming Eastern member states prove so attractive for foreign investment that the country would find itself eclipsed?"

According to UNCTAD, global FDI flows amounted to a record 1.5 trillion USD in 2007. Southeast Europe and the CIS (Commonwealth of Independent States) enjoyed robust, record-setting inflows, the seventh year in a row (up 41% on 2006 to a new record of 98 billion USD), emanating mainly from transnational corporations. Capital went to both extraction industries and privatization deals.

But 2007 appears to have been the swan song of FDI. Cross-border M&A (Mergers and Acquisitions) activity - the locomotive of FDI - virtually collapsed in the last quarter of 2007. Increasing risk aversion throughout the global financial system may result in the drying up of credit. Inflation - or, rather, stagflation - is again rearing its ugly head. Wildly fluctuating exchange rate won't help, either.

Part II. The Republic of Macedonia - A Case Study (2007)

Ever since its reluctant declaration of independence in 1991, Macedonia occupied the bottom of the list of countries in transition from Communism, as far as absolute dollar figures of FDI go. At 80.6 million USD, FDI in 2003 barely budged from previous years. In 2004, FDI reached 139.5 million USD, only to shrink to 116.2 million USD in 2005. Discounting the sale of ESM, the electricity utility, FDI remained static in 2006 (total FDI was 350.7 million USD or 124.7 million USD, without ESM).

Yet, this is a misleading picture. Macedonia was and is no worse off than other countries in Eastern Europe.

According to UNCTAD's World Investment Report 2007, FDI in Macedonia, as a percentage of gross fixed capital formation, shot up from 9.7% in the decade of the 1990s to 32.4% in 2006 (compared to 36.4%, the southeast European average; 20.8% the average of all countries in transition; and 12.6% the global average figure).

Macedonia's FDI stock reached 2.437 billion USD, or 39% of GDP (compared to 42.2% as the southeast

European average; 25.3% the average of all countries in transition; and 24.8% the global average figure).

Macedonia's Inward FDI Performance Index, based on 12 economic and policy variables, climbed from the 86th to the 64th place out of 141 economies surveyed. Its Inward FDI Potential Index also improved from 115 to 106.

Throughout this period, foreign enterprises, profitable overall, consistently hired new employees and wages in the sector stabilized at c. twice the average salaries in local businesses.

Thus, as far as FDI goes, Macedonia's performance, though far from stellar, was and is **above the regional and global averages**. The World Bank put it succinctly, as it summarized the period ***PRIOR*** to the assumption of power by the new government:

"Macedonia's rankings either improved or stayed steady for all available scored rankings, and it tracked closely with the regional averages for all rankings. According to the World Economic Forum's Global Competitiveness Report for 2006-07, the three most problematic factors for doing business are inefficient government bureaucracy, access to financing, and corruption. Macedonia was one of the top 10 Doing Business reformers, jumping up 21 places. The most significant improvements were in the following indicators: Starting a Business (where the paid-in minimum capital requirements were dropped from 111%

to 0% of GNI per capita), Dealing with Licenses, and Trading Across Borders."

Other indicators lead to the same conclusion: **while Macedonia's image and perception as a business destination and the business climate have improved considerably under Gruevski's government, in reality, not much else has changed.**

Consider the following numbers, pertaining to Macedonia:

Control of Corruption Indicator, published by the World Bank: 113 (2006) vs. 111 (2007)

Country Credit Rating, published by Institutional investor: 85 (2006) vs. 84 (2007)

Index of Economic Freedom, published by The Heritage Foundation and the Wall Street Journal: 75 (2006) vs. 71 (2007)

Quality of National Business Environment Ranking, issued by the World Economic Forum in its Global Competitiveness Report: 87 out of 121 countries.

Only the World Bank's Doing Business Ranking jumped from 96 (2006) to 75 (2007). Yet, even this indicator hides some unpalatable truths: Macedonia has deteriorated in certain respects. It is more difficult and cumbersome to hire workers, to register property, to obtain credit, to protect investor rights, and to enforce contracts. In any case, this indicator has more to do with public relations, expectations, and psychology, rather than with the hard facts on the ground.

And the hard facts are:

Macedonia is not ready to absorb and accommodate foreign investors and their capital. It still has a long way to go. This government has put the cart before the horses;

The youthful, populist, and inexperienced administration is overwhelmed and ill-equipped to deal with its obligations towards and promises to foreign investors. Decision-making bottlenecks (especially in the office of Vice-Premier Zoran Stavreski) conspire with red tape and blatant favoritism to render nightmarish both greenfield and brownfield ventures.

In a long-running arbitration, the country was slapped with multimillion dollar damages payable to the Greek investors in Okta. This did not deter the government from conflicting vocally and publicly with Macedonia's other large investor, the Austrian EVN, owner of the electricity utility;

To its credit, the government has reformed the tax system, introduced a flat tax, and reduced the tax rates, all laudable. But it is still illegal for foreigners to own land and real estate (as individuals) and all but impossible to trade in the local stock exchange. The government has only now resorted to tackling these archaic limitations;

The country is dysfunctional. No institution works properly: the cadastre, the courts, law enforcement agencies, the civil service are all in chaotic disarray. Even the banking system, despite a decade of FDI, is rudimentary. Infrastructure of all sorts is dismal, though improving. The government's anti-corruption drive is much lauded but highly politicized and one-sided, aimed as it is exclusively at the hapless politicians of the opposition. Macedonia's laws are not geared to welcome and assimilate foreign investment, foreigner businessmen, and foreign workers;

Macedonia lacks skilled manpower. The education deficit is pervasive. More than half the adult population has eight years of schooling or less. A multi-generational brain drain saps the country's vitality and prospects in the global information economy of the 21st century. Contrary to the government's claims in its "Invest in Macedonia" campaign, costs and taxes associated with wages are among the highest in the world.

The country suffers from other problems: a huge informal economy, skyrocketing consumer and enterprise indebtedness, ominous asset bubbles in both the stock exchange and the real estate market, a crippled middle class and crippling poverty and unemployment rates, an unmanageable and increasing trade deficit (c. 20% of GDP), and a whopping current account deficit offset only by remittances from Macedonian workers abroad. The global credit crunch constitutes a major threat to polities with such precarious finances.

Geopolitical instability (in Kosovo) is exacerbated by the current Macedonian regime's jingoism, its overt and manipulative religiosity, and greenhorn fickleness. Within the last year, Macedonia has considerably retarded its chances to enter NATO and the European Union (EU), having clashed unnecessarily and spectacularly with Greece, Serbia, Bulgaria, and the Albanian minority at home.

Despite a slew of expensive PR and advertising campaigns; the appointments of two ministers and the formation of a special agency to deal with FDI; incessant trips abroad by every functionary, from the prime minister down; and innovative marketing initiatives - FDI figures for 2007, at c. 180 million USD (c. 3% of GDP), are a major disappointment. Moreover, a sizable part of Macedonia's FDI is in construction, retail, financial services, and trade, economic sectors with minimal contribution to future growth.

In comparison, FDI doubled in decrepit, post-bellum Serbia, to 4.5 billion USD in 2006. Croatia garnered 3.6 billion USD (2.7 billion euro) - twice the 2005 figure. Even strife-torn Bosnia-Herzegovina, under a EU peacekeeping mission, attracted 2.9 billion USD (2 billion euros). Bulgaria absorbed 6.5 billion USD. FDI amounted to 10% of Balkan GDP in 2006.

The conclusion is inescapable: Macedonia has failed in its bid to attract FDI. This is not the first time that Macedonian politicians and their downtrodden and destitute people prefer the fantasy of foreign saviors to the hard slog of painful and much-needed reforms at home. The current prime minister, Gruevski, served in the government of Ljubco Georgievski, whose nostrum and panacea to Macedonia's economic woes was dollops of money, supposed to be funneled via illusive Taiwanese investors. The person most identified with this policy, Vasil Tupurkovski, now faces criminal charges.

Gruevski can learn many lessons from the debacles wrought by his predecessors. It is not too late to get his priorities straight: reforms, education, domestic investment, and employment first, and only then an open invitation to foreigners to come and invest in Macedonia.

Football

The Champions League is a rich man's club, complain football teams from nine south and east European countries. They are bent on setting up an alternative dubbed the "Eastern League". The revolt is led by Dinamo Bucharest and Greece's Olympiakos Pireu and has been joined by 14 other clubs: Steaua and Rapid from Romania, The Turkish Galatasaray Istanbul and Besiktas PAOK Salonic of Greece, the Serbian Steaua and Partizan Belgrade, Hajduk Split from Croatia, the Cyrpiot Apoel Nicosia, Maribor from Slovenia, the Bulgarian teams TSKA Sofia and Levski Sofia and the Ukrainian contributions of Shakhtor Donestk and Dinamo Kiev.

It is partly about pride and partly about money.

In the past decade eastern footballers, trounced by well-heeled competitors from the West, consistently failed to qualify to participate in the Union of European Football Associations Cup and the Champions League games. This translates into a loss of up to a million dollars per team per year as they miss out on lucrative advertising and broadcasting deals when they are matched against giants from Spain, Germany, Italy, or even England.

The Eastern League is not a done deal, though. It first has to be voted on and recognized by both the Federation of International Football Associations and UEFA, the world and European football federations, respectively. This may prove to be a tall order. The game is still organized as an old-fashioned cartel, with each regional association envious of its market share and clout.

Still, football in the eastern nether regions is in dire straits. As its economics worsen - the inventiveness of managers and players alike blossoms. in January, the Bulgarian Levski club offered, with great fanfare, 250,000 of its shares to fans, aiming to break the Guinness Book of Records entry of Manchester United.

It was promptly castigated for ripping off the innocent. The "free" shares, found out embittered takers, came attached to a season's ticket at full price. Alternatively, would be shareholders were asked to purchase a club membership for $25 - a few days wages in the impoverished country. Quoted by the newswires Presstext.Europe and Newsfox, a Levski official Todor Batkov said that "real fans must give and not take from the club".

Football teams in the former communist countries realize that it is either big time or no time at all.

Romanian club Universitatea Craiova has recently courted Paul Gascoigne, a British asset known more for his exploits off-field than for anything he has accomplished on it. The figure floated was $170,000 - a fortune in Romanian terms, where the average annual intake is rarely about $2000.

Omnipotent president Islam Karimov of Uzbekistan granted immediate citizenship - by a constitutionally dubious presidential decree - to Bulgarian football striker Georgi Georgiev and defender Alexsi Dionisiev. This allowed them to keep their Bulgarian passports even as they played for the host country in the World Cup.

Football has always been about politics. Violence inspired by virulent nationalism often vents itself most visibly in bilateral matches.

In a typical case last year, three police officers were wounded and nine Bosnian Serb fans were detained in the wake of a riot following the first football match since 1992 between Borac from Republika Srpska and Zeleznicar from Sarajevo. The Muslim-Croat team and fans required police escort out of Banja Luka to escape the wrath of the local yobs. Borac had to play two games to empty stadiums and part with $1500 in fines.

The Bosnian Football Federation - representing 14 clubs from the Croat-Muslim parts of the divided country - teamed up in May last year with 6 counterparts in Republika Srpska. They formed a joint league and a common professional association. Moreover, the two entities already fielded a joint team in the Olympic games in 2000 and maintain a single basketball federation. Yet, even this apparent reconciliation failed to prevent the outpouring of hostilities.

Nor is football-related aggression confined to zealous nationalists. Slovak fans taunted black English players Emile Heskey and Ashley Cole with racist slogans in October last year. The vast majority of the crowd - and the medical teams on the sidelines - balefully recited "monkey, monkey" at the top of their lungs for minutes on end.

Quoted by Radio Free Europe/Radio Liberty, Michal Vesecka, a research fellow with the Slovak Institute for Public Affairs, linked the abuse to problems in cultural development and identity:

"Slovakia is a country that is the most ethnically heterogeneous in Central Europe, but the 'culture of tolerance' is not as well developed [here] as in the European Union, or even with respect to neighboring countries like the Czech Republic and Hungary ... [Slovakia] is still a country that is trying to solve its own identity problem, and precisely [during] such times, the people are relatively aggressive toward those people who are different."

Add to this combustible mixture crumbling economies and all-pervasive disillusionment and the spillover to football is hardly a surprise. The game is an inseparable part of daily life in many of these polities where life is unbearably drab, economic opportunities are rare and cultural diversions even scarcer.

For instance, football associations offer a cornucopia of sinecures to cronies and relatives of all degrees and colors. Hence the high turnover and ubiquitous venality which characterize these murky bodies.

Both UEFA and FIFA have warned the Azerbaijan Football Federation Association that it must settle a five years old simmering dispute or else face the suspension of all financial aid and, ultimately, expulsion. AFFA's president Fuad Musaev refuses to go, despite pressure from the government above and at least nine clubs below. This resulted in a boycott by said disgruntled of the national football championship and a feeble attempt to organize an alternative.

Foreign Policy, Economic Instruments of

Foreign aid, foreign trade and foreign direct investment (FDI) have become weapons of mass persuasion, deployed in the building of both the pro-war, pro-American coalition of the willing and the French-led counter "coalition of the squealing".

By now it is clear that the United States will have to bear the bulk of the direct costs of the actual fighting, optimistically pegged at c. $200 billion. The previous skirmish in Iraq in 1991 consumed $80 billion in 2002 terms - nine tenths of which were shelled out by grateful allies, such as Saudi Arabia and Japan.

Even so, the USA had to forgive $7 billion of Egyptian debt. According to the General Accounting Office, another $3 billion were parceled at the time among Turkey, Israel and other collaborators, partly in the form of donations of surplus materiel and partly in subsidized military sales.

This time around, old and newfound friends - such as Jordan, an erstwhile staunch supporter of Saddam Hussein - are likely to carve up c. $10 billion between them, says the Atlanta Journal-Constitution. Jordan alone has demanded $1 billion.

According to the Knight Ridder Newspapers, in February 2003, an Israeli delegation has requested an extra $4-5 billion in military aid over the next 2-3 years plus $8 billion in loan guarantees. Israel, the largest American foreign and military aid recipient, is already collecting c. $3 billion annually. It is followed by Egypt with $1.3 billion a year - another rumored beneficiary of $1 billion in American largesse.

Turkey stands to receive c. $6 billion for making itself available (however reluctantly, belatedly, and fitfully) as staging grounds for the forces attacking Iraq. Another $20 billion in loan guarantees and $1 billion in Saudi and Kuwaiti oil have been mooted.

In the thick of the tough bargaining, with Turkey demurring and refusing to grant the USA access to its territory, the International Monetary Fund - thought by many to be the long arm of US foreign policy - suddenly halted the disbursement of money under a two years old standby arrangement with the impoverished country.

It implausibly claimed to have just unearthed breaches of the agreement by the Turkish authorities. This systemic non-compliance was being meticulously chronicled - and scrupulously ignored by the IMF - for well over a year now by both indigenous and foreign media alike.

Days after a common statement in support of the American stance, the IMF clinched a standby arrangement with Macedonia, the first in two turbulent years. On the same day, Bulgaria received glowing - and counterfactual - reviews from yet another IMF mission, clearing the way for the release of a tranche of $36 million out of a loan of $330 million. Bulgaria has also received $130 million in direct US aid between 2001-3, mainly through the Support for East European Democracy (SEED) program.

But the IMF is only one tool in the administration's shed. President Bush has increased America's foreign aid by an unprecedented 50 percent between 2003-6 to $15 billion. A similar amount was made available between 2003-8 to tackle AIDS, mainly in Africa.

Half this increase was ploughed into a Millennium Challenge Account. It will benefit countries committed to democracy, free trade, good governance, purging corruption and nurturing the private sector. By 2005, the Account contained close to $5 billion and is being replenished annually to maintain this level.

This expensive charm offensive was intended to lure and neutralize the natural constituencies of the pacifistic camp: non government organizations, activists, development experts, developing countries and international organizations.

As the war drew nearer, the E10 - the elected members of the Security Council - also cashed in their chips.

The United States has softened its position on trade tariffs in its negotiations of a free trade agreement with Chile. Immigration regulations were relaxed to allow in more Mexican seasonal workers. Chile received $2 million in military aid and Mexico $44 million in development finance.

US companies cooperated with Angola on the development of offshore oilfields in the politically contentious exclave of Cabinda. Guinea and Cameroon absorbed dollops of development aid. Currently, Angola receives c. $19 million in development assistance.

Cameroon already benefits from military training and surplus US arms under the Excess Defense Articles (EDA) program as well as enjoying trade benefits in the framework of the Africa Growth and Opportunity Act. Guinea gets c. $26 million in economic aid annually plus $3 million in military grants and trade concessions.

The United States has also pledged to cause Iraq to pay its outstanding debts, mainly to countries in Central and East Europe, notably to Russia and Bulgaria. Iraq owes the Russian Federation alone close to $9 billion. Some of the Russian contracts with the Iraqi oil industry, thought to be worth dozens of billions of dollars, may even be honored by the victors, promised the Bush administration. It reneged on both promises. Debt relief reduced Iraq's debt by 90% and all Saddam Hussein era contracts were vitiated.

Thus, the outlays on warfare are likely be dwarfed by the price tag of the avaricious constituents of president Bush's ramshackle coalition. New York Times columnist Paul Krugman aptly christened this mass bribery, "The Martial Plan". Quoting "some observers", he wrote:

"The administration has turned the regular foreign aid budget into a tool of war diplomacy. Small countries that currently have seats on the U.N. Security Council have suddenly received favorable treatment for aid requests, in an obvious attempt to influence their votes. Cynics say that the 'coalition of the willing' President Bush spoke of turns out to be a 'coalition of the bought off' instead'."

But this is nothing new. When Yemen cast its vote against a November 1990 United Nations Security Council resolution authorizing the use of force to evict Iraq from Kuwait - the United states scratched $700 million in aid to the renegade country over the following decade.

Nor is the United States famous for keeping its antebellum promises.

Turkey complains that the USA has still to honor its aid commitments made prior to the first Gulf War. Hence its insistence on written guarantees, signed by the president himself. Similarly, vigorous pledges to the contrary aside, the Bush administration has allocated a pittance to the reconstruction of Afghanistan in its budgets - and only after it is prompted to by an astounded Congress.

Macedonia hasn't been paid in full for NATO's presence on its soil during the Kosovo conflict in 1999. Though it enjoyed $1 billion in forgiven debt and some cash, Pakistan is still waiting for quotas on its textiles to be eased, based on an agreement it reached with the Bush administration prior to the campaign to oust the Taliban.

Congress is a convenient scapegoat. Asked whether Turkey could rely on a further dose of American undertakings, Richard Boucher, a State Department spokesman, responded truthfully: "I think everybody is familiar with our congressional process."

Yet, the USA, despite all its shortcomings, is the only game in town. The European Union cannot be thought of as an alternative benefactor.

Even when it promotes the rare coherent foreign policy regarding the Middle East, the European Union is no match to America's pecuniary determination and wellhoned pragmatism. In 2002, EU spending within the Euro-Mediterranean Partnership amounted to a meager $700 million.

The EU signed association agreements with some countries in the region and in North Africa. The "Barcelona Process", launched in 1995, is supposed to culminate by 2010 in a free trade zone incorporating the European Union, Algeria, Morocco, Tunisia, Egypt, Israel, Jordan, Lebanon, the Palestinian Authority, Syria and Turkey. Libya has an observer status and Cyprus and Malta have joined the EU in the meantime.

According to the International Trade Monitor, published by the Theodore Goddard law firm, the Agadir Agreement, the first intra-Mediterranean free trade compact, was concluded In March 2003 between Egypt, Jordan, Morocco and Tunisia. It is a clear achievement of the EU.

The European Union signed a Cooperation Agreement with Yemen and, in 1989, with the Gulf Cooperation Council, comprising Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates and Oman. A more comprehensive free trade agreement covering goods, services, government procurement and intellectual property rights is in the works. The GCC has recently established a customs union as well.

Despite the acrimony over Iran's not-so-civilian nuclear program, the EU may soon ink a similar set of treaties with Iran with which the EU has a balanced trade position - c. $7 billion of imports versus a little less in exports.

The EU's annual imports from Iraq - at c. $4 billion - are more than 50 percent higher than they were prior to Iraq's invasion of Kuwait in 1990. It purchases more than one quarter of Iraq's exports. The EU exports to Iraq close to $2 billion worth of goods, far less than it did in the 1980s, but still a considerable value and one fifth of the country's imports. EU aid to Iraq since 1991 exceeds $300 million.

But Europe's emphasis on trade and regional integration as foreign policy instruments in the Mediterranean is largely impracticable. America's cash is far more effective. Charlene Barshefsky, the former United States trade representative from 1997 to 2001, explained why in an opinion piece in the New York Times:

"The Middle East ... has more trade barriers than any other part of the world. Muslim countries in the region trade less with one another than do African countries, and much less than do Asian, Latin American or European countries. This reflects both high trade barriers ... and the deep isolation Iran, Iraq and Libya have brought on themselves through violence and support for terrorist groups ... 8 of (the region's) 11 largest economies remain outside the WTO."

Moreover, in typical EU fashion, the Europeans benefit from their relationships in the region disproportionately.

Bilateral EU-GCC trade, for instance, amounts to a respectable $50 billion annually - but European investment in the region declined precipitously from $3 billion in 1999 to half that in 2000. The GCC, on its part, has been consistently investing $4-5 billion annually in the EU economies.

It also runs an annual trade deficit of c. $9 billion with the EU. Destitute Yemen alone imports $600 million from the EU and exports a meager $100 million to it. The imbalance is partly attributable to European non-tariff trade barriers such as sanitary regulations and to EU-wide export subsidies.

Nor does European development aid compensate for the EU's egregious trade protectionism. Since 1978, the EU has ploughed only $210 million into Yemen's economy, for instance. A third of this amount was in the form of food support. The EU is providing only one fifth of the total donor assistance to the country.

In the meantime, the USA is busy signing trade agreements with all and sundry, subverting what little leverage the EU could have possessed. In the footsteps of a free trade agreement with Israel, America has concluded one with Jordan in 2000. The kingdom's exports to the United States responded by soaring from $16 million in 1998 to c. $400 million in 2002. Washington negotiated a similar deal with Morocco. It is usurping the EU's role on its own turf. Who can blame French former president Jacques Chirac for blowing his lid?

Free Content – See: Viral Marketing

Free Zones

Ukrainian President, Leonid Kuchma, told, last week, an assembly of senior customs service officials that "it is necessary to put an end to (Ukraine's 11 free economic and 9 priority) zones (and) liquidate them completely. (They) have become semi-criminal zones, and this refers not only to the Donetsk zone. You pull the meat that

Europe doesn't want to eat into these zones and sell it there without [paying] taxes".

According to UNIAN, the Ukrainian news agency, Kuchma was fuming at the mighty and unaccountable oligarchs situated in the country's eastern coal-mining center and their collaborators in the Ukrainian Security Service (SBU) and other law enforcement agencies. The zones dismally failed to attract foreign direct investment, or foster economic growth, he bitterly observed.

The International Monetary Fund (IMF) concurs as does the European Union. The future status of special economic zones is hotly contested in the accession negotiations with the Czech Republic, Poland, Hungary and Malta. Nor is the criminalization of such zones a Ukrainian deviation. Russia's Deputy Interior Minister, Vladimir Vasiliev, admitted last year that Russia's mafia now focuses its unwelcome attentions on its ubiquitous free economic zones.

Yet, the proliferation of these fiscal monstrosities - tax free, low customs, export processing, flexible labor delimited regions - is likely to continue. Even bastions of free trade make profligate use of them as do all the countries of the rich world.

According to a November 2002 report titled "Employment and social policy in respect of export processing zones" and published by the United Nations' International Labor Organization (ILO), the number of countries with export processing zones surged from 25 in 1975 to 116 last year. The number of such havens jumped to 3000 from a mere 79.

A January 2002 amendment to Estonia's value added tax law allows its fishermen to export to Russia more than $100 million worth of catch via tax free enclaves. Virtually all the countries of central, east and southeast Europe (the Balkans) either toyed with the idea, or established such zones, the first being Russia, Poland and Bulgaria.

Even hidebound and xenophobic Belarus founded in 2000 four Free Economic Zones (FEZs), located in Brest, Minsk, Gomel-Raton and Vitebsk, to, in its words, "attract foreign investment, promote high-tech manufacturing and increase economic diversification". The zones, claim the authorities, have been a success. The Brest one drew in excess of $120 million in investments and has created 5000 new jobs.

Multilateral lenders and international trade partners are unhappy. Exemptions from taxes and customs duties amount to overt export subventions. The goods thus subsidized often end up in the local market, unfairly competing with both indigenous producers and importers.

Responding to such pressures, Kyrgyzstan now requires enterprises located within the free-economic zone to pay customs and other taxes on goods they sell domestically. Both the European Union and the United States expressed extreme displeasure at the formation of Macedonia's Taiwan-financed free zone in Bunardzik in 1999.

It has since flopped and has been leased last September for 30 years to Ital Mak Furnir, an improbable German-Italian-Macedonian partnership. The only occupant of the sole building constructed in the zone by the Taiwanese is rented to the NATO mission in Macedonia - hardly a business enterprise.

The free economic zone of the Russian exclave of Kaliningrad, formed in 1992 and revamped in both 1996 and in 1997, under the new law on Free Economic Zones, shares a similar fate. Lithuania's industrial parks are not successful either. The free zone of Kukuljanovo in the industrial zone of Bakar, about 17 km from the Port of Rijeka Free Zone in Croatia, actually serves as a trans-shipment and off-shore area, rather than a classic export processing district. It is one of 13 such fiscal havens.

Tax free, customs and export processing territories - though they may enhance employment, as they did in China, for one - distort the economic decisions of investors, manufacturers, importers and exporters. Budget revenues are adversely affected. The zones attract shady "industrialists" and "financiers" who set up fronts for illicit activities, such as smuggling, unauthorized assembly of consumer goods, or piracy of intellectual piracy.

These extraterritorial hubs are major centers of money laundering, parallel imports of shoddy or counterfeit goods and forbidden re-importation of merchandise originally sold to poor, developing countries at substantial discounts, or provided as international aid.

The Ukrainian Vice-Premier Kozachenko estimated, last May, that one fifth of all meat sold in Ukraine was smuggled through the special zones, reported UkInform. Most of it is unfit for human consumption. The impoverished country lost $56 million in customs duties on these products in 2001 alone. In the meantime, the local meat industry is "choking" in the words of Yuri Melnik, Deputy State Secretary for the Ministry of Agrarian Policy.

Yet, the undermining of local production is not the only impact on oft-struggling host economies. According to the ILO, throughput from special zones accounts for 80 percent of all the merchandise exports of the Czech Republic and Hungary. But very little of this abundance trickles down:

"Legal restrictions on trade union rights in a few EPZ operating countries, the lack of enforcement of labour legislation and the absence of workers' organizations representation were among the factors noted as undermining the ability of zones to upgrade skills, improve working conditions and productivity and thereby to become more dynamic and internationally competitive platforms."

And the contribution of these zones to economic growth and subsequent prosperity? Dubious, at best. The ILO concludes:

"(There is a) lack of reliable ... statistics regarding the costs and benefits of zones. While some data exist relating to the amount of investment, exports and employment in zones, there is very little ... on the quality, cost and duration of those jobs, on the degree of skill and technology transfer and on the opportunity cost of the fiscal incentives and infrastructure costs. (We don't know) why export processing zones (EPZs) have failed to take off in some countries. While political stability and investment in the basic infrastructure in ports, airports, roads, water, sanitation and power supply are necessary conditions for EPZs, they are not sufficient on their own to attract FDI. Macroeconomic conditions such as extreme inflation and high interest rates (are important) ... Research suggests that zones are most effective when they form part of an integrated economic strategy that includes fiscal incentives, investments in infrastructure, technology and human capital, and the creation of linkages into the local economy. It is important for EPZs to upgrade their activities to higher value-added products and services (requiring a more skilled workforce) and find their niche in the international production network ... (EPZs strategies must, therefore, be) continually adapt(ed)."

The countries of east Europe and The Balkans lack the skills and experience to do so - and the money needed to hire international consultants to monitor and modify the zones' performance and characteristics. Hence the hitherto abysmal performance of these contraptions - and the emerging trend to disassemble them.

Future and Futurology

We construct maps of the world around us, using cognitive models, organizational principles, and narratives that we acquire in the process of socialization. These are augmented by an incessant bombardment of conceptual, ideational, and ideological frameworks emanating from the media, from peers and role models, from authority figures, and from the state. We take our universe for granted, an immutable and inevitable entity. It is anything but. Only change and transformation are guaranteed constants - the rest of it is an elaborate and anxiety-reducing illusion.

Consider these self-evident "truths" and "certainties":

1. After centuries of warfare, ***Europe is finally pacified***. War in the foreseeable future is not in store. The European Union heralds not only economic prosperity but also long-term peaceful coexistence.

Yet, Europe faces a serious identity crisis. Is it Christian in essence or can it also encompass the likes of an increasingly-Muslim Turkey? Is it a geographical (continental) entity or a cultural one? Is enlargement a time bomb, incorporating as it does tens of millions of new denizens, thoroughly demoralized, impoverished, and criminalized by decades of Soviet repression? How likely are these tensions to lead not only to the disintegration of the EU but to a new war between, let's say Russia and Germany, or Italy and Austria, or Britain and France? Ridiculous? Revisit your history books.

Read more about Europe after communism - click HERE to download the e-book "The Belgian Curtain".

Many articles about Europe and the European Union - click HERE and HERE to read them.

2. The ***United States*** is the only superpower and a budding Empire. In 50 years time it may be challenged by China and India, but until then it stands invincible. Its economic growth prospects are awesome.

Yet, the USA faces enormous social torsion brought about by the polarization of its politics and by considerable social and economic tensions and imbalances. The deterioration in its global image and its growing isolation contribute to a growing paranoia and jingoism. While each of these dimensions is nothing new, the combination is reminiscent of the 1840s-1850s, just prior to the Civil War.

Is the United States headed for limb-tearing inner conflict and disintegration?

This scenario, considered by many implausible if not outlandish, is explored in a series of articles - click HERE to read them.

3. The ***Internet***, hitherto a semi-anarchic free-for-all, is likely to go through the same cycle experienced by other networked media, such as the radio and the telegraph. In other words, it will end up being both heavily regulated and owned by commercial interests. Throwbacks to its early philosophy of communal cross-pollination and exuberant exchange of ideas, digital goods, information, and opinion will dwindle and vanish. The Internet as a horizontal network where all nodes are equipotent will be replaced by a vertical, hierarchical, largely corporate structure with heavy government intrusion and oversight.

Read essays about the future of the Internet - click HERE.

4. The period between 1789 (the French Revolution) and 1989 (the demise of Communism) is likely to be remembered as a liberal and atheistic intermezzo, separating two vast eons of religiosity and conservatism. God is now being rediscovered in every corner of the Earth and with it intolerance, prejudice, superstition, as well as strong sentiments against science and the values of the Enlightenment. We are on the threshold of the ***New Dark Ages***.

Read about the New Dark Ages - click HERE.

5. The quasi-religious, cult-like fad of ***Environmentalism*** is going to be thoroughly debunked. Read a detailed analysis of why and how - click HERE.

6. Our view of ***Western liberal democracy*** as a panacea applicable to all at all times and in all places will undergo a revision in light of accumulated historical evidence. Democracy seems to function well in conditions of economic and social stability and growth. When things go awry, however, democratic processes give rise to Hitlers and Milosevices (both elected with overwhelming majorities multiple times).

The gradual disillusionment with parties and politicians will lead to the re-emergence of collectivist, centralized and authoritarian polities, on the one hand and to the rise of anarchist and multifocal governance models, on the other hand.

More about democracy in this article -click HERE.

More about anarchism in this article -click HERE.

7. The ingenious principle of ***limited liability*** and the legal entity known as the ***corporation*** have been with us for more than three centuries and served magnificently in facilitating the optimal allocation of capital and the diversification of risk. Yet, the emergence of sharp conflicts of interest between a class of professional managers and the diffuse ownership represented by (mainly public) shareholders - known as the agent-principal problem - spell the end of both and the dawn of a new era.

Read about the Agent-Principal Conundrum in this article - click HERE.

Read about risk and moral hazard in this article - click HERE.

8. As our understanding of the brain and our knowledge of genetics deepen, the idea of ***mental illness*** is going to be discarded as so much superstition and myth. It is going to replaced with medical models of brain dysfunctions and maladaptive gene expressions. Abnormal psychology is going to be thoroughly medicalized and reduced to underlying brain structures, biochemical processes and reactions, bodily mechanisms, and faulty genes.

Read more about this brave new world in this article - click HERE.

9. As offices and homes merge, mobility increases, wireless access to data is made available anywhere and everywhere, computing becomes ubiquitous, the distinction between ***work and leisure*** will vanish.

Read more about the convergence and confluence of labor and leisure in this article - click HERE.

10. Our privacy is threatened by a host of intrusive Big Brother technologies coupled with a growing paranoia and siege mentality in an increasingly hostile world, populated by hackers, criminals, terrorists, and plain whackos. Some countries - such as China - are trying to suppress political dissent by disruptively prying into their citizens' lives. We have already incrementally surrendered large swathes of our hitherto private domain in exchange for fleeting, illusory, and usually untenable personal "safety".

As we try to reclaim this lost territory, we are likely to give rise to ***privacy industries***: computer anonymizers, safe (anonymous) browsers, face transplants, electronic shields, firewalls, how-to-vanish-and-start-a-new-life-elsewhere consultants and so on.

Read more about the conflict between private and public in this article - click HERE.

11. As the population ages in the developed countries of the West, ***crime*** is on the decline there. But, as if to maintain the homeostasis of evil, it is on the rise in poor and developing countries. A few decades from now, violent and physical property crimes will so be rare in the West as to become newsworthy and so common in the rest of the world as to go unnoticed.

Should we legalize some "crimes"? - Read about it in this article - click HERE.

12. In historical terms, our ***megalopolises and conurbations*** are novelties. But their monstrous size makes them dependent on two flows: (1) of goods and surplus labor from the world outside (2) of services and waste products to their environment.

There is a critical mass beyond which this bilateral exchange is unsustainable. Modern cities are, therefore, likely to fragment into urban islands: gated communities, slums, strips, technology parks and "valleys", belts, and so on. The various parts will maintain a tenuous relationship but will gradually grow apart.

This will be the dominant strand in a wider trend: the atomization of society, the disintegration of social cells, from the nuclear family to the extended human habitat, the metropolis. People will grow apart, have fewer intimate friends and relationships, and will interact mostly in cyberspace or by virtual means, both wired and wireless.

Read about this inexorable process in this article - click HERE.

13. The commodity of the future is not raw or even processed information. The commodity of the future is guided and structured access to information repositories and databases. Search engines like Google and Yahoo already represent enormous economic value because they serve as the gateway to the Internet and, gradually, to the Deep Web. They not only list information sources but make implicit decisions for us regarding their relative merits and guide us inexorably to selections driven by impersonal, value-laden, judgmental algorithms. Search engines are one example of active, semi-intelligent information gateways.

Read more about the Deep Web in this article - click HERE.

14. Inflation and the business cycle seem to have been conquered for good. In reality, though, we are faced with the distinct possibility of a global depression coupled with soaring inflation (known together as stagflation). This is owing to enormous and unsustainable imbalances in global savings, debt, and capital and asset markets.

Still, economists are bound to change their traditional view of inflation. Japan's experience in 1990-2006 taught us that better moderate inflation than deflation.

Read about the changing image of inflation in this article - click HERE.

Note - How to Make a Successful Prediction

Many futurologists - professional (Toffler) and less so (Naisbitt) - tried their hand at predicting the future. They proved quite successful at foretelling major trends but not as lucky in delineating their details. This is because, inevitably, every futurologist has to resort to crude tools such as extrapolation. The modern day versions of the biblical prophets are much better informed - and this, precisely, seems to be the problem. The informational clutter obscures the outlines of the more pertinent elements.

The futurologist has to divine which of a host of changes which occur in his times and place ushers in a new era. Since the speed at which human societies change has radically accelerated, the futurologist's work has become more compounded and less certain.

It is better to stick to truisms, however banal. True and tried is the key to successful (and, therefore, useful) predictions. What can we rely upon which is immutable and invariant, not dependent on cultural context, technological level, or geopolitical developments?

Human nature, naturally.

Yet, the introduction of human nature into the prognostic equation may further complicate it. Human nature is, arguably, the most complex thing in the universe. It is characteristically unpredictable and behaviourally stochastic. It is not the kind of paradigm conducive to clear-cut, unequivocal, unambiguous forecasts.

This is why it is advisable to isolate two or three axes around which human nature - or its more explicit manifestations - revolves. These organizational principles must possess comprehensive explanatory powers, on the one hand and exhibit some kind of synergy, on the other hand.

I propose such a trio of dimensions: Individuality, Collectivism and Time.

Human yearning for uniqueness and idiosyncrasy, for distinction and self sufficiency, for independence and self expression commences early, in one's formative years, in the form of the twin psychological processes of Individuation and Separation

Collectivism is the human propensity to agglomerate, to stick together, to assemble, the herd instincts and the group behaviours.

Time is the principle which bridges and links individual and society. It is an emergent property of society. In other words, it arises only when people assemble together and have the chance to compare themselves to others. I am not referring to Time in the physical sense. No, I am talking about the more complex, ritualistic, Social Time, derived from individual and collective memory (biography and history) and from intergenerational interactions.

Individuals are devoid and bereft of any notions or feelings of Social Time when they lack a basis for comparison with others and access to the collective memory.

In this sense, people are surprisingly like subatomic particles - both possess no "Time" property. Particles are Time symmetric in the sense that the equations describing their behaviour and evolution are equally valid backwards and forward in Time. The introduction of negative (backward flowing) Time does not alter the results of computations.

It is only when masses of particles are observed that an asymmetry of Time (a directional flow) becomes discernible and relevant to the description of reality. In other words, Time "erupts" or "emerges" as the complexity of physical systems increases (see "Time asymmetry Re-Visited by the same author, 1983, available through UMI. Abstract in:
http://samvak.tripod.com/time.html).

Mankind's history (past), its present and, in all likelihood, its future are characterized by an incessant struggle between these three principles. One generation witnesses the successful onslaught of individualism and declares, with hubris, the end of history. Another witnesses the "Revolt of the (collective) Masses" and produces doomsayers such as Jose Ortega y Gasset.

The 20th century was and is no exception. True, due to accelerated technological innovation, it was the most "visible" and well-scrutinized century. Still, as Barbara Tuchman pointedly titled her masterwork, it was merely a Distant Mirror of other centuries. Or, in the words of Proverbs: "Whatever was, it shall be again".

The 20th century witnessed major breakthroughs in both technological progress and in the dissemination of newly invented technologies, which lent succor to individualism.

This is a new development. Past technologies assisted in forging alliances and collectives. Agricultural technology encouraged collaboration, not individuation, differentiation or fragmentation.

Not so the new technologies. It would seem that the human race has opted for increasing isolation to be fostered by TELE-communication. Telecommunications gives the illusion of on-going communication but without preserving important elements such as direct human contact, replete with smells, noises, body language and facial expressions. Telecommunications reduces communication to the exchange of verbal or written information, the bare skeleton of any exchange.

The advent of each new technology was preceded by the development of a social tendency or trend. For instance: computers packed more and more number crunching power because business wanted to downsize and increase productivity.

The inventors of the computer explicitly stated that they wanted it to replace humans and are still toying with the idea of artificial intelligence, completely substituting for humans. The case of robots as substitutes for humans is even clearer.

These innovations revolutionized the workplace. They were coupled with "lean and mean" management theories and management fads. Re-engineering, downsizing, just in time inventory and production management, outsourcing -

all emphasized a trimming of the work force. Thus, whereas once, enterprises were proud of the amount of employment which they generated - today it is cause for shame. This psychological shift is no less than misanthropic.

This misanthropy manifests itself in other labour market innovations: telecommuting and flexiwork, for instance - but also in forms of distance interaction, such as distant learning.

As with all other social sea changes, the language pertaining to the emotional correlates and the motivation behind these shifts is highly euphemistic. Where interpersonal communication is minimized - it is called telecommunications. Where it is abolished it is amazingly labelled "interactivity"!

We are terrified of what is happening - isolation, loneliness, alienation, self absorption, self sufficiency, the disintegration of the social fabric - so we give it neutral or appealing labels, negating the horrific content. Computers are "user-friendly", when we talk to our computer we are "interacting", and the solitary activity of typing on a computer screen is called "chatting".

We need our fellow beings less and less. We do not see them anymore, they had become gradually transparent, reduced to bodiless voices, to incorporeal typed messages. Humans are thus dehumanized, converted to bi-dimensional representations, to mere functions. This is an extremely dangerous development. Already people tend to confuse reality with its representation through media images. Actors are misperceived to be the characters that they play in a TV series, wars are fought with video game-like elegance and sleekness.

Even social functions which used to require expertise - and, therefore, the direct interaction of humans - can today be performed by a single person, equipped with the right hardware and software.

The internet is the epitome and apex of this last trend.

Read my essay - ***Internet A Medium or a Message***.

Still, here I would like to discuss an astounding revolution that goes largely unnoticed: personal publishing.

Today, anyone, using very basic equipment can publish and unleash his work upon tens of millions of unsuspecting potential readers. Only 500 years ago this would have been unimaginable even as a fantasy. Only 50 years ago this would have been attributed to a particularly active imagination. Only 10 years ago, it cost upward of 50,000 USD to construct a website.

The consequences of this revolution are unfathomable. It surpasses the print revolution in its importance. Ultimately, personal publishing - and not the dissemination of information or e-commerce - will be the main use of the internet, in my view.

Still, in the context of this article, I wish to emphasize the solipsism and the solitude entailed by this invention. The most labour intensive, human interaction: the authorship of a manuscript, its editing and publishing, will be stripped of all human involvement, barring that of the author. Granted, the author can correspond with his audience more easily but this, again, is the lonely, disembodied kind of "contact".

Transportation made humanity more mobile, it fractured and fragmented all social cells (including the nuclear family) and created malignant variants of social structures. The nuclear family became the extended nuclear family with a few parents and non-blood-related children.

Multiple careers, multiple sexual and emotional partners, multiple families, multiple allegiances and loyalties, seemed, at first, to be a step in the right direction of pluralism. But humans need certainty and, where they miss it, a backlash develops.

This backlash is attributed to the human need to find stability, predictability, emotional dependability and commitment where there is none. This is done by faking the real thing, by mutating, by imitating and by resenting anything which threatens the viability of the illusion.

Patriotism mutates to nationalism, racism or Volkism. Religion is metamorphesizes to ideology, cults, or sects. Sex is mistaken for love, love becomes addictive or obsessive dependence. Other addictions (workaholism, alcoholism, drug abuse and a host of other, hitherto unheard of, obsessive compulsive disorders) provide the addict with meaning and order in his life.

The picture is not rosier on the collectivist side of the fence.

Each of the aforementioned phenomena has a collectivist aspect or parallel. This duality permeates the experience of being human. Humans are torn between these two conflicting instincts and by way of socialization, imitation and assimilation, they act herd-like, en masse. Weber analysed the phenomenon of leadership, that individual which defines the parameters for the behaviour of the herd, the "software", so to speak. He exercises his authority through charismatic and bureaucratic mechanisms.

Thus, the Internet has a collectivist aspect. It is the first step towards a collective brain. It maintains the memory of the race, conveys its thought impulses, directs its cognitive processes (using its hardware and software constraints as guideposts).

Telecommunication and transportation did eliminate the old, well rooted concepts of space-time (as opposed to what many social thinkers say) - but there was no philosophical or conceptual adaptation to be made. The difference between using a car and using a quick horse was like the difference between walking on foot and riding that horse. The human mind was already flexible enough to accommodate this.

What telecommunications and transportation did do was to minimize the world to the scope of a "global village" as predicted by Marshal McLuhan and others. A village is a cohesive social unit and the emphasis should be on the word "social". Again the duality is there : the technologies that separate - unite.

This Orwellian NewSpeak is all pervasive and permeates the very fabric of both current technologies and social fashions. It is in the root of the confusion which constantly leads us to culture-wars. In this century culture wars were waged by religion-like ideologies (Communism, Nazism, Nationalism and - no comparison intended - Environmentalism, Capitalism, Feminism and Multi-Culturalism). These mass ideologies (the quantitative factor enhanced their religious tint) could not have existed in an age with no telecommunication and speedy transport. Yet, the same advantages were available (in principle, over time, after a fight) to their opponents, who belonged, usually, to the individualistic camp. A dissident in Russia uses the same tools to disintegrate the collective as the apparatchik uses to integrate it. Ideologies clashed in the technological battlefields and were toppled by the very technology which made them possible. This dialectic is interesting because this is the first time in human history that none of the sides could claim a monopoly over technology. The economic reasons cited for the collapse of Communism, for instance, are secondary: what people were really protesting was lack of access to technology and to its benefits. Consumption and Consumerism are by products of the religion of Science.

Far from the madding poles of the human dichotomy an eternal, unifying principle was long neglected.

Humans will always fight over which approach should prevail : individuality or collectivism. Humans will never notice how ambiguous and equivocal their arguments and technology are. They will forever fail to behold the seeds of the destruction of their camp sawn by their very own technology, actions and statements. In short: humans will never admit to being androgynous or bisexual. They will insist upon a clear sexual identity, this strong the process of differentiation is.

But the principle that unites humans, no matter which camp they might belong to, when, or where is the principle of Time.

Humans crave Time and consume Time the way carnivores consume meat and even more voraciously. This obsession with Time is a result of the cognitive acknowledgement of death. Humans seems to be the only sentient animal which knows that it one day shall end. This is a harrowing thought. It is impossible to cope with it but through awesome mechanisms of denial and repression. In this permanent subconscious warfare, memory is a major weapon and the preservation of memory constitutes a handy illusion of victory over death. Admittedly, memory has real adaptive and survival value.

He who remembers dangers will, undoubtedly live longer, for instance.

In human societies, memory used to be preserved by the old. Until very recently, books were a rare and very expensive commodity virtually unavailable to the masses. Thus humans depended upon their elders to remember and to pass on the store of life saving and life preserving data.

This dependence made social cohesiveness, interdependence and closeness inevitable. The young lived with the old (who also owned the property) and had to continue to do so in order to survive. Extended families, settlements led by the elders of the community and communities were but a few collectivist social results.

With the dissemination of information and knowledge, the potential of the young to judge their elders actions and decisions has finally materialized.

The elders lost their advantage (memory). Being older, they were naturally less endowed than the young. The elders were ill-equipped to cope with the kaleidoscopic quality of today's world and its ever changing terms. More nimble, as knowledgeable, more vigorous and with a longer time ahead of them in which they could engage in trial and error learning - the young prevailed.

So did individualism and the technology which was directed by it.

This is the real and only revolution of this century: the reversal of our Time orientation. While hitherto we were taught to respect the old and the past - we are now conditioned to admire the young, get rid of the old and look forward to a future perfect.

G

Game Theory

Consider this:

Could Western management techniques be successfully implemented in the countries of Central and Eastern Europe (CEE)? Granted, they have to be adapted, modified and cannot be imported in their entirety. But their crux, their inalienable nucleus – can this be transported and transplanted in CEE? Theory provides us with a positive answer. Human agents are the same everywhere and are mostly rational. Practice begs to differ. Basic concepts such as the money value of time or the moral and legal meaning of property are non existent. The legal, political and economic environments are all unpredictable. As a result, economic players will prefer to maximize their utility immediately (steal from the workplace, for instance) – than to wait for longer term (potentially, larger) benefits. Warrants (stock options) convertible to the company's shares constitute a strong workplace incentive in the West (because there is an horizon and they increase the employee's welfare in the long term). Where the future is speculation – speculation withers. Stock options or a small stake in his firm, will only encourage the employee to blackmail the other shareholders by paralysing the firm, to abuse his new position and will be interpreted as immunity, conferred from above, from the consequences of illegal activities. The very allocation of options or shares will be interpreted as a sign of weakness, dependence and need, to be exploited. Hierarchy is equated with slavery and employees will rather harm their long term interests than follow instructions or be subjected to criticism – never mind how constructive. The employees in CEE regard the corporate environment as a conflict zone, a zero sum game (in which the gains by some equal the losses to others). In the West, the employees participate in the increase in the firm's value. The difference between these attitudes is irreconcilable.

Now, let us consider this:

An entrepreneur is a person who is gifted at identifying the unsatisfied needs of a market, at mobilizing and organizing the resources required to satisfy those needs and at defining a long-term strategy of development and marketing. As the enterprise grows, two processes combine to denude the entrepreneur of some of his initial functions. The firm has ever growing needs for capital: financial, human, assets and so on. Additionally, the company begins (or should begin) to interface and interact with older, better established firms. Thus, the company is forced to create its first management team: a general manager with the right doses of respectability, connections and skills, a chief financial officer, a host of consultants and so on. In theory – if all our properly motivated financially – all these players (entrepreneurs and managers) will seek to maximize the value of the firm. What happens, in reality, is that both work to minimize it, each for its own reasons. The managers seek to maximize their short-term utility by securing enormous pay packages and other forms of company-dilapidating compensation. The entrepreneurs feel that they are "strangled", "shackled", "held back" by bureaucracy and they "rebel". They oust the management, or undermine it, turning it into an ineffective representative relic. They assume real, though informal, control of the firm. They do so by defining a new set of strategic goals for the firm, which call for the institution of an entrepreneurial rather than a bureaucratic type of management. These cycles of initiative-consolidation-new initiative-revolution-consolidation are the dynamos of company growth. Growth leads to maximization of value. However, the players don't know or do not fully believe that they are in the process of maximizing the company's worth. On the contrary, consciously, the managers say: "Let's maximize the benefits that we derive from this company, as long as we are still here." The entrepreneurs-owners say: "We cannot tolerate this stifling bureaucracy any longer. We prefer to have a smaller company – but all ours." The growth cycles forces the entrepreneurs to dilute their holdings (in order to raise the capital necessary to finance their initiatives). This dilution (the fracturing of the ownership structure) is what brings the last cycle to its end. The holdings of the entrepreneurs are too small to materialize a coup against the management. The management then prevails and the entrepreneurs are neutralized and move on to establish another start-up. The only thing that they leave behind them is their names and their heirs.

We can use Game Theory methods to analyse both these situations. Wherever we have economic players bargaining for the allocation of scarce resources in order to attain their utility functions, to secure the outcomes and consequences (the value, the preference, that the player attaches to his outcomes) which are right for them – we can use Game Theory (GT).

A short recap of the basic tenets of the theory might be in order.

GT deals with interactions between agents, whether conscious and intelligent – or Dennettic. A Dennettic Agent (DA) is an agent that acts so as to influence the future allocation of resources, but does not need to be either conscious or deliberative to do so. A Game is the set of acts committed by 1 to n rational DA and one a-rational (not irrational but devoid of rationality) DA (nature, a random mechanism). At least 1 DA in a Game must control the result of the set of acts and the DAs must be (at least potentially) at conflict, whole or partial. This is not to say that all the DAs aspire to the same things. They have different priorities and preferences. They rank the likely outcomes of their acts differently. They engage Strategies to obtain their highest ranked outcome. A Strategy is a vector, which details the acts, with which the DA will react in response to all the (possible) acts by the other DAs. An agent is said to be rational if his Strategy does guarantee the attainment of his most preferred goal. Nature is involved by assigning probabilities to the outcomes. An outcome, therefore, is an allocation of resources resulting from the acts of the agents. An agent is said to control the situation if its acts matter to others to the extent that at least one of them is forced to alter at least one vector (Strategy). The Consequence to the agent is the value of a function that assigns real numbers to each of the outcomes. The consequence represents a list of outcomes, prioritized, ranked. It is also known as an ordinal utility function. If the function includes relative numerical importance measures (not only real numbers) – we call it a Cardinal Utility Function.

Games, naturally, can consist of one player, two players and more than two players (n-players). They can be zero (or fixed) - sum (the sum of benefits is fixed and whatever gains made by one of the players are lost by the others).

They can be nonzero-sum (the amount of benefits to all players can increase or decrease). Games can be cooperative (where some of the players or all of them form coalitions) – or non-cooperative (competitive). For some of the games, the solutions are called Nash equilibria. They are sets of strategies constructed so that an agent which adopts them (and, as a result, secures a certain outcome) will have no incentive to switch over to other strategies (given the strategies of all other players). Nash equilibria (solutions) are the most stable (it is where the system "settles down", to borrow from Chaos Theory) – but they are not guaranteed to be the most desirable. Consider the famous "Prisoners' Dilemma" in which both players play rationally and reach the Nash equilibrium only to discover that they could have done much better by collaborating (that is, by playing irrationally). Instead, they adopt the "Paretto-dominated", or the "Paretto-optimal", sub-optimal solution. Any outside interference with the game (for instance, legislation) will be construed as creating a NEW game, not as pushing the players to adopt a "Paretto-superior" solution.

The behaviour of the players reveals to us their order of preferences. This is called "Preference Ordering" or "Revealed Preference Theory". Agents are faced with sets of possible states of the world (=allocations of resources, to be more economically inclined). These are called "Bundles". In certain cases they can trade their bundles, swap them with others. The evidence of these swaps will inevitably reveal to us the order of priorities of the agent. All the bundles that enjoy the same ranking by a given agent – are this agent's "Indifference Sets". The construction of an Ordinal Utility Function is, thus, made simple. The indifference sets are numbered from 1 to n. These ordinals do not reveal the INTENSITY or the

RELATIVE INTENSITY of a preference – merely its location in a list. However, techniques are available to transform the ordinal utility function – into a cardinal one.

A Stable Strategy is similar to a Nash solution – though not identical mathematically. There is currently no comprehensive theory of Information Dynamics. Game Theory is limited to the aspects of competition and exchange of information (cooperation). Strategies that lead to better results (independently of other agents) are dominant and where all the agents have dominant strategies – a solution is established. Thus, the Nash equilibrium is applicable to games that are repeated and wherein each agent reacts to the acts of other agents. The agent is influenced by others – but does not influence them (he is negligible). The agent continues to adapt in this way – until no longer able to improve his position. The Nash solution is less available in cases of cooperation and is not unique as a solution. In most cases, the players will adopt a minimax strategy (in zero-sum games) or maximin strategies (in nonzero-sum games). These strategies guarantee that the loser will not lose more than the value of the game and that the winner will gain at least this value. The solution is the "Saddle Point".

The distinction between zero-sum games (ZSG) and nonzero-sum games (NZSG) is not trivial. A player playing a ZSG cannot gain if prohibited to use certain strategies. This is not the case in NZSGs. In ZSG, the player does not benefit from exposing his strategy to his rival and is never harmed by having foreknowledge of his rival's strategy. Not so in NZSGs: at times, a player stands to gain by revealing his plans to the "enemy". A player can actually be harmed by NOT declaring his strategy or by gaining acquaintance with the enemy's stratagems. The very ability to communicate, the level of communication and the order of communication – are important in cooperative cases. A Nash solution:

1. Is not dependent upon any utility function;
2. It is impossible for two players to improve the Nash solution (=their position) simultaneously (=the Paretto optimality);
3. Is not influenced by the introduction of irrelevant (not very gainful) alternatives; and
4. Is symmetric (reversing the roles of the players does not affect the solution).

The limitations of this approach are immediately evident. It is definitely not geared to cope well with more complex, multi-player, semi-cooperative (semi-competitive), imperfect information situations.

Von Neumann proved that there is a solution for every ZSG with 2 players, though it might require the implementation of mixed strategies (strategies with probabilities attached to every move and outcome). Together with the economist Morgenstern, he developed an approach to coalitions (cooperative efforts of one or more players – a coalition of one player is possible). Every coalition has a value – a minimal amount that the coalition can secure using solely its own efforts and resources. The function describing this value is super-additive (the value of a coalition which is comprised of two sub-coalitions equals, at least, the sum of the values of the two sub-coalitions). Coalitions can be epiphenomenal: their value can be higher than the combined values of their constituents. The amounts paid to the players equal the value of the coalition and each player stands to get an amount no smaller than any amount that he would have made on his own. A set of payments to the players, describing the division of the coalition's value amongst them, is the "imputation", a single outcome of a strategy. A strategy is, therefore, dominant, if: (1) each player is getting more under the strategy than under any other strategy and (2) the players in the coalition receive a total payment that does not exceed the value of the coalition. Rational players are likely to prefer the dominant strategy and to enforce it. Thus, the solution to an n-players game is a set of imputations. No single imputation in the solution must be dominant (=better). They should all lead to equally desirable results. On the other hand, all the imputations outside the solution should be dominated. Some games are without solution (Lucas, 1967).

Auman and Maschler tried to establish what is the right payoff to the members of a coalition. They went about it by enlarging upon the concept of bargaining (threats, bluffs, offers and counter-offers). Every imputation was examined, separately, whether it belongs in the solution (=yields the highest ranked outcome) or not, regardless of the other imputations in the solution. But in their theory, every member had the right to "object" to the inclusion of other members in the coalition by suggesting a different, exclusionary, coalition in which the members stand to gain a larger payoff. The player about to be excluded can "counter-argue" by demonstrating the existence of yet another coalition in which the members will get at least as much as in the first coalition and in the coalition proposed by his adversary, the "objector". Each coalition has, at least, one solution.

The Game in GT is an idealized concept. Some of the assumptions can – and should be argued against. The number of agents in any game is assumed to be finite and a finite number of steps is mostly incorporated into the assumptions. Omissions are not treated as acts (though negative ones). All agents are negligible in their relationship to others (have no discernible influence on them) – yet are influenced by them (their strategies are not – but the specific moves that they select – are). The comparison of utilities is not the result of any ranking – because no universal ranking is possible. Actually, no ranking common to two or n players is possible (rankings are bound to differ among players). Many of the problems are linked to the variant of rationality used in GT. It is comprised of a clarity of preferences on behalf of the rational agent and relies on the people's tendency to converge and cluster around the right answer / move. This, however, is only a tendency. Some of the time, players select the wrong moves. It would have been much wiser to assume that there are no pure strategies, that all of them are mixed. Game Theory would have done well to borrow mathematical techniques from quantum mechanics. For instance: strategies could have been described as wave functions with probability distributions. The same treatment could be accorded to the cardinal utility function. Obviously, the highest ranking (smallest ordinal) preference should have had the biggest probability attached to it – or could be treated as the collapse event. But these are more or less known, even trivial, objections. Some of them cannot be overcome. We must idealize the world in order to be able to relate to it scientifically at all. The idealization process entails the incorporation of gross inaccuracies into the model and the ignorance of other elements. The surprise is that the approximation yields results, which tally closely with reality – in view of its mutilation, affected by the model.

There are more serious problems, philosophical in nature.

It is generally agreed that "changing" the game can – and very often does – move the players from a non-cooperative mode (leading to Paretto-dominated results, which are never desirable) – to a cooperative one. A government can force its citizens to cooperate and to obey the law. It can enforce this cooperation. This is often called a Hobbesian dilemma. It arises even in a population made up entirely of altruists. Different utility functions and the process of bargaining are likely to drive these good souls to threaten to become egoists unless other altruists adopt their utility function (their preferences, their bundles). Nash proved that there is an allocation of possible utility functions to these agents so that the equilibrium strategy for each one of them will be this kind of threat. This is a clear social Hobbesian dilemma: the equilibrium is absolute egoism despite the fact that all the players are altruists. This implies that we can learn very little about the outcomes of competitive situations from acquainting ourselves with the psychological facts pertaining to the players. The agents, in this example, are not selfish or irrational – and, still, they deteriorate in their behaviour, to utter egotism. A complete set of utility functions – including details regarding how much they know about one another's utility functions – defines the available equilibrium strategies. The altruists in our example are prisoners of the logic of the game. Only an "outside" power can release them from their predicament and permit them to materialize their true nature. Gauthier said that morally-constrained agents are more likely to evade Paretto-dominated outcomes in competitive games – than agents who are constrained only rationally. But this is unconvincing without the existence of an Hobesian enforcement mechanism (a state is the most common one). Players would do better to avoid Paretto dominated outcomes by imposing the constraints of such a mechanism upon their available strategies. Paretto optimality is defined as efficiency, when there is no state of things (a different distribution of resources) in which at least one player is better off – with all the other no worse off. "Better off" read: "with his preference satisfied". This definitely could lead to cooperation (to avoid a bad outcome) – but it cannot be shown to lead to the formation of morality, however basic. Criminals can achieve their goals in splendid cooperation and be content, but that does not make it more moral. Game theory is agent neutral, it is utilitarianism at its apex. It does not prescribe to the agent what is "good" – only what is "right". It is the ultimate proof that effort at reconciling utilitarianism with more deontological, agent relative, approaches are dubious, in the best of cases. Teleology, in other words, in no guarantee of morality.

Acts are either means to an end or ends in themselves. This is no infinite regression. There is bound to be an holy grail (happiness?) in the role of the ultimate end. A more commonsense view would be to regard acts as means and states of affairs as ends. This, in turn, leads to a teleological outlook: acts are right or wrong in accordance with their effectiveness at securing the achievement of the right goals. Deontology (and its stronger version, absolutism) constrain the means. It states that there is a permitted subset of means, all the other being immoral and, in effect, forbidden. Game Theory is out to shatter both the notion of a finite chain of means and ends culminating in an ultimate end – and of the deontological view. It is consequentialist but devoid of any value judgement.

Game Theory pretends that human actions are breakable into much smaller "molecules" called games. Human acts within these games are means to achieving ends but the ends are improbable in their finality. The means are segments of "strategies": prescient and omniscient renditions of the possible moves of all the players. Aside from the fact that it involves mnemic causation (direct and deterministic influence by past events) and a similar influence by the utility function (which really pertains to the future) – it is highly implausible. Additionally, Game Theory is mired in an internal contradiction: on the one hand it solemnly teaches us that the psychology of the players is absolutely of no consequence. On the other, it hastens to explicitly and axiomatically postulate their rationality and implicitly (and no less axiomatically) their benefit-seeking behaviour (though this aspect is much more muted). This leads to absolutely outlandish results: irrational behaviour leads to total cooperation, bounded rationality leads to more realistic patterns of cooperation and competition (coopetition) and an unmitigated rational behaviour leads to disaster (also known as Paretto dominated outcomes).

Moreover, Game Theory refuses to acknowledge that real games are dynamic, not static. The very concepts of strategy, utility function and extensive (tree like) representation are static. The dynamic is retrospective, not prospective. To be dynamic, the game must include all the information about all the actors, all their strategies, all their utility functions. Each game is a subset of a higher level game, a private case of an implicit game which is constantly played in the background, so to say. This is a hyper-game of which all games are but derivatives. It incorporates all the physically possible moves of all the players. An outside agency with enforcement powers (the state, the police, the courts, the law) are introduced by the players. In this sense, they are not really an outside event which has the effect of altering the game fundamentally. They are part and parcel of the strategies available to the players and cannot be arbitrarily ruled out. On the contrary, their introduction as part of a dominant strategy will simplify Game theory and make it much more applicable. In other words: players can choose to compete, to cooperate and to cooperate in the formation of an outside agency. There is no logical or mathematical reason to exclude the latter possibility. The ability to thus influence the game is a legitimate part of any real life strategy. Game Theory assumes that the game is a given – and the players have to optimize their results within it. It should open itself to the inclusion of game altering or redefining moves by the players as an integral part of their strategies. After all, games entail the existence of some agreement to play and this means that the players accept some rules (this is the role of the prosecutor in the Prisoners' Dilemma). If some outside rules (of the game) are permissible – why not allow the "risk" that all the players will agree to form an outside, lawfully binding, arbitration and enforcement agency – as part of the game? Such an agency will be nothing if not the embodiment, the materialization of one of the rules, a move in the players' strategies, leading them to more optimal or superior outcomes as far as their utility functions are concerned. Bargaining inevitably leads to an agreement regarding a decision making procedure. An outside agency, which enforces cooperation and some moral code, is such a decision making procedure. It is not an "outside" agency in the true, physical, sense. It does not "alter" the game (not to mention its rules). It IS the game, it is a procedure, a way to resolve conflicts, an integral part of any solution and imputation, the herald of cooperation, a representative of some of the will of all the players and, therefore, a part both of their utility functions and of their strategies to obtain their preferred outcomes. Really, these outside agencies ARE the desired outcomes. Once Game Theory digests this observation, it could tackle reality rather than its own idealized contraptions.

Germany, Economy of

On Monday, the unthinkable happened. The European Commission has initiated "excessive budget deficit" procedures against the two biggest members of the European Union, France and Germany, for having breached the budget deficit targets prescribed by the much-reviled Stability Pact. This seems to have vindicated the voices in both countries who blame their economic woes on the stringent requirements of the compact intended to stabilize the euro.

Yet, the Stability Pact is merely a convenient scapegoat. It is because Germany brazenly -and wisely - ignored it that it is being cited by the Commission. Still, despite an alarming budget deficit of close to 4 percent of gross domestic product (GDP) this year and a transfer from Brussels of 0.25 percent of GDP as flood aid, the German economy is stagnant.

It is set to grow by 0.5 percent this year and by 1.5 percent in 2003, says the government. Not so, counter its own council of independent economic advisors, the "five wise men". Growth this year will be a paltry 0.2 percent and next year, fingers crossed, 1 percent.

The IMF is more optimistic. Growth in 2003 will be 1.75 percent, it predicted last week. Even so, German GDP is growing at 3 GDP points below trend. The excess capacity translates to deflationary pressures on prices and to rising unemployment, currently at over 4 million people, or almost 10 percent. One of every six adults in the eastern Lander is out of work.

The much-observed monthly index of business expectations, published by the ZEW Institute, predicts a nosedive in economic activity in the first half of 2003. Moody's have just downgraded the rating of yet another German household name, the Allianz insurance group.

German banks are caught in a worrisome spiral of loans gone sour, interest rates set stiflingly high by the European Central Bank (ECB), the removal of state subsidies and yet another looming recession. Business confidence is extinct, unemployment and bankruptcies soaring. More than 1000 firms go belly up every week - three times the rate in 1992.

The two pillars of the German economy - the small, family-owned, businesses (Mittelstand) and the export industries - are in dire shape. Eurostat, the European Union's statistics bureau, has just announced that industrial output in the eurozone during the third quarter actually contracted by 0.1 percent. In the USA, Germany's other big export destination, if one takes intermediate goods into account, the anodyne "recovery" relies entirely on the ominous profligacy of ever less solvent consumers.

Germany's problems - like Japan's - are structural. It is ageing fast. It is inordinately expensive. It is bureaucratic. Its banks are tottering, unable to create new credits. The state is overweening and interventionary. Many of the country's industries are already uncompetitive.

Germany's labor markets are rigid, its capital markets either dissolute or ossified. The scandal-ridden small caps Neuer Markt was closed down this year, having lost more than 90 percent of its value since March 2000. Both the average German and decision-makers are loth to reform a virulent system of prodigal social welfare coupled with all-pervasive rent-seeking by various industries, especially in construction, banking, the media and agriculture. Germany is living off a past of miraculous wealth creation. But the signs are that it may have exhausted the principal.

Germany faces a series of painful choices between unpalatable alternatives. The Minister of Finance, Hans Eichel, must either hike taxes - including on wages, in contravention of campaign promises only two months ago - or lose control over the public finances.

According to new proposals, pension contributions will go from 19.1 to 19.5 percent. Another idea is to set a minimum corporate profit tax, thus preventing businesses from using accumulated tax credits. A host of business-friendly tax loopholes and deductibles will be abolished. These measures will surely discourage hiring and investments and may cause long-suffering multinationals - both German and foreign - to relocate.

German household debt is higher than in America. But taxes on capital gains and interest - about to be raised - discourage savings. This will be further compounded by the ballooning deficits of both central and state budgets. Even if all the right ideas are implemented, including massive spending cuts, the government, according to Business Week, will have to borrow $32 billion this year - crowding out the private sector.

Fiscal largesse is considered to be an automatic stabilizer in a recessionary economy. But whether it is depends on how much new money is included in government spending and how productively it is targeted. Japan's river of squandered supplementary budget packages, for instance, did little to revive the moribund economy.

In an apocalyptic analysis published last week, The Economist warned that Germany is under a serious threat of deflation. It endured an asset bubble, it has large private sector debts, a weak banking system, structural rigidities, it suffers from political and social paralysis and a shrinking and ageing population. "Our analysis suggests that Germany has more symptoms of the Japanese disease than America." - concluded the paper somberly.

Germany is luckier and more resilient than Japan, though. It is subject, willy-nilly, to intense competition within the single market and thus is being forced to shape up. Its banks, though in crisis, are far more robust than Japan's. Business inventories may be already declining.

Furthermore, most of Germany's excess spending goes on welfare benefits. Poor people consume more of their disposable income than does the middle class. Thus, welfare checks almost immediately translate into consumption. Even the IMF warned Germany last week not to cut its budget deficit too fast lest it damages a hesitant economic recovery.

Moreover, interest rates in the eurozone - and the euro's exchange rate - are bound to come down as fiscal rectitude is restored and industrial production plummets. German business confidence largely hinges on the ECB's inflation-obsessed policies.

A relaxation in monetary policy will result in an export-led investment mini-boom and a reversal of the rising trend of unemployment. Declining oil prices as the Iraqi conflict unwinds one way or the other will help a nascent recovery. Should the government implement its own recommendations for labor-market and pensions reforms, it will have removed growth-stifling rigidities.

Yet, averting recession and the much-feared risk of deflation would do nothing to tackle the fundamental problems faced by the German economy. According to the Financial Times Deutschland, the Bundesbank warned on Monday that the government's budget plans will actually harm prospects for long term growth.

Hobbled by a partisan, opposition-controlled, upper house and an election victory barely snatched from the jaws of defeat, there is little Gerhard Schroeder, the embattled Chancellor, would be able to do to counter the increasingly militant and strike-happy unions.

The two axes of Germany's multiple problems are its monstrous welfare system and no less overwhelming red tape and bureaucracy. Employees and workers pay one seventh of their wages to finance only the increasingly troubled healthcare system. Another fifth goes into retirement funds. According to The Economist. labor costs are set to grow to an unsustainable 42 percent of gross wages next year.

The welfare state is sacrosanct. Schroeder himself admitted as much last month. In a speech to the nation, he taunted the opposition. Voters re-elected him, he boasted, because he "expressly did not decide to scrap the welfare state, cut benefits indiscriminately and roll back employees' rights" - though "some entitlements, rules and allowances of the German welfare state" must be reconsidered, he added, incongruously. The opposition promptly - and somewhat justly - accused him of "electoral fraud" for hiding the true state of the economy and making false campaign promises.

German workers indeed want more of the same, as the re-elected Chancellor has astutely observed. IG Metall, Germany's largest trade union, called for both the provisions of the Stability Pact and the ECB's monetary policy to be relaxed to allow for "offensive impulses (read: more government spending) against the stagnant economy." German workers, concerned with job security and bent on escalating wages, actually prevent the creation of new jobs for the unemployed by opposing the formation of part time and contract "mini-jobs".

Germans are wealthy. Average annual income, according to the BBC, is $25,500. The unemployed in Germany are better off than many workers in Britain. But, as work ethic, good corporate and state governance and plant modernization increased throughout Europe, they declined in Germany, David Marsh, of the Droege Group in Düsseldorf told the BBC. Since unification, 12 years ago, Germany has avoided facing reality by embarking on a borrowing binge, partly to finance a net annual transfer of 4 percent of GDP to the former East Germany.

In all fairness, west Germany's performance is still impressive. It is being dragged down by the eastern parts whose productivity, compared to the west's, is one third lower and unit labor costs one tenth higher. Unemployment in the east is double the west's, the infrastructure is decrepit and brain drain is ubiquitous.

Germany will survive. But the gradual decline of the third largest economy in the world and the most prominent in Europe might have serious geopolitical implications. The first to pay a heavy price would be the economies of central and eastern Europe. Germany is by far their largest export market and Germans the biggest foreign investors. It absorbs close to 40 percent of the exports of Poland, the Czech Republic and Austria.

Germany also holds a majority of the sovereign and private sector debts of these countries - more than half of Russia's $140 billion in external debt, for instance. During the devastating floods, according to Stratfor, the strategic forecasting consultancy, Germany was able to call on $172 million in Russian obligations. These links within an emerging common economic sphere are mutually-beneficial. Hence Germany's avid sponsorship of EU enlargement.

Central and eastern European polities will not be the only casualties of a German meltdown. The European Union itself will suffer greatly. Germany and France form the economic core of the alliance. Germany, once the economic powerhouse of the continent with one quarter of the EU's GDP, could well have become a drag. Until recently, according to the Economist Intelligence Unit and the IMF, Germany was the target of one third of Dutch and Swiss exports and one quarter of Danish, Belgian and French goods.

Will Germany recover? Most likely so. Will the recovery lead to a new era of prosperity? Unlikely. It is hard to contemplate painful reforms on a full stomach, regardless of how imminent the dangers. What Germans need is another crisis, a shock to wake them up from the stupor of affluence. It may well be on its way. Alas, the cost of German reawakening is likely to be paid by every single European country - except Germany.

Appendix - Impact of Minimum Wage on Germany's Economy

Interview granted to Matt Moore of Associated Press, June 14, 2007

Germany is debating the introduction of a minimum wage. The country is a special case because it is a hybrid capitalist-socialist economy and it has the Mittelstand (family-controlled small and medium enterprises). Labor mobility is limited (the labor market is not ideal or frictionless).

These may be the effects of a minimum wage on the German economy:

1. By "competing" with generous unemployment benefits, the minimum wage may create incentives to work. This will decrease the cost of various welfare programs. The surge of new entrants will, at least at first, ***INCREASE*** the unemployment figures.

2. The minimum wage may stimulate consumption

(studies show that every additional euro earned by low-wage workers is spent on consumption, not saved). This plus a general increase in the price level (to offset increased labor costs) will have inflationary effects.

3. It may enhance productivity (employers will likely insist on increased productivity to offset increased costs) and cause entrepreneurs to move out of labor-intensive and into capital-intensive industries and sectors.

4. The minimum wage may encourage technological innovation (to substitute for expensive labor inputs). This, in addition to a general reduction in demand for low-skilled, low-wage workers will again increase unemployment.

5. Finally, the minimum wage may cause German manufacturers and service providers to offshore activities and manufacturing to Central and Eastern Europe or even Asia. Anything from car manufacturing and pharmaceuticals to back office operations (credit card processing, customer relations managements, flight ticketing, insurance claims processing) can move from the hinterland of Germany to its European "colonies" or to Asia.

Also read this:

The Demise of Germany's Mittelstand

Golden Shares

In a rare accord, both the IMF and independent analysts, have cautioned Bulgaria in early 2002 that its insistence on keeping golden shares in both its tobacco and telecom monopolies even after they are privatized - will hinder its ability to attract foreign investors to these already unappealing assets. Bulgaria's $300 million arrangement with the IMF - struck in late 2001 by the new and youthful Minister of Finance in the Saxe-Coburg government - was not at risk, though.

Golden shares are usually retained by the state in infrastructure projects, utilities, natural monopolies, mining operations, defense contractors, and the space industry. They allow their holders to block business moves and counter management decisions which may be detrimental to national security, to the economy, or to the provision of public services (especially where markets fail to do so). Golden shares also enable the government to regulate the prices of certain basic goods and services - such as energy, food staples, sewage, and water.

But, in practice, golden shares serve less noble ends.

Early privatizations in Central and Eastern Europe were criticized for being crony-ridden, corrupt, and opaque. Governments were accused of giving away the family silver. Maintaining golden shares in privatized enterprises was their way of eating the privatization cake while leaving it whole, thus silencing domestic opposition effectively. The practice was started in Thatcherite Britain and Bulgaria is only the latest to adopt it.

The Bulgarian golden share in Bulgatabak is intended to shield domestic tobacco growers (most of them impoverished minority Turks) from fierce foreign competition in a glutted market. Golden shares are often used to further the interests of interest groups and isolate them from the potentially devastating effects of the global market.

The phenomenon of golden shares is not confined to economically-challenged states selling their obscure monopolies.

On December 1989, the Hungarian Post was succeeded by three firms (postal, broadcasting, and a telecom). One of the successors, MATAV, was sold to MagyarCom (currently owned by Deutsche Telekom) in stages. This has been the largest privatization in Hungary and in Central and Eastern Europe. The company's shares subsequently traded in Budapest and on NYSE simultaneously. MATAV embarked on an aggressive regional acquisitions plan, the latest of which was the Macedonian Telecom. Yet, throughout this distinctly capitalistic and shareholders-friendly record, the Hungarian government owned a golden share in MATAV.

Poland's Treasury maintains a golden share in LOT, its national carrier, and is known to have occasionally exercised it. Lithuania kept a golden share in its telecom. Even municipalities and regional authorities are emulating the centre. The city of Tallinn, for instance, owns a golden share in its water utility.

Hungary's largest firm, Hungarian Oil and Gas (MOL), was floated on the Budapest Stock Exchange (1994-1998). The state retains a "golden share" in the company which allows it to regulate retail gas prices. MOL controls c. 35% of the fuel retail market and owns virtually all the energy-related infrastructure in Hungary. It is an aggressive regional player, having recently bought Slovnaft, the Slovak oil and gas company. Theoretically, Hungary's golden share in MOL may conflict with Slovakia's golden share in Slovnaft, owned by MOL.

Contrary to popular economic thinking, golden shares do not seem to deter foreign investors. They may even create a moral hazard, causing investors to believe that they are partners with the government in an enterprise of vital importance and, thus, likely to be bailed out (i.e., an implicit state guarantee).

Moreover, golden shares are often perceived by investors and financial institutions as endowing the company with preference in government procurement and investment, privileged access to decision makers, concessionary terms of operation, and a favorable pricing structure. Golden shares are often coupled with guaranteed periods of monopoly or duopoly (i.e., periods of excess profits and rents).

The West, alas, is in no position to preach free marketry in this case. European firms are notorious for the ingenious stratagems with which they disenfranchise their shareholders. Privileged minorities often secure the majority vote by owning golden shares (this is especially egregious in the Netherlands and France).

The European Commission is investigating cases of abuse of golden shares in the UK, Spain, Portugal, Germany, France, and Belgium. The Spanish government possesses golden shares in companies it no longer has a stake in. As American portfolio investors pile in, corporate governance is changing for the better. But some countries of the former Soviet Bloc (such as Estonia) are even more advanced than the rest of the European Union.

Greek Investments (in the Balkans)

Even as Greece and Macedonia continued to wrestle with the name issue (should the young Republic monopolize the ancient name or not), the former continued its furious pace of investments in the latter.

According to the Greek newspaper, Elefteros Topos, between the years 2000-2006, Greeks invested almost 263 million USD in their nascent neighbor. That would make Greece the second largest foreign investor in Macedonia. Of the 20 most sizable investments in Macedonia's economy, 17 are financed with Greek capital. More than 20,000 people are employed in Greek-owned enterprises (c. 6% of the active workforce in this unemployment-plagued polity).

Greeks are everywhere: banking (28% of their total investment in the country); energy (25%); telecommunications (17%); industry (15%); and food (10%).

The foundations of the current presence of Greece in all Balkan countries - including EU members, Romania and Bulgaria - were laid in the decade of the 1990s.

Overview of Greek Investment Strategy in the Balkans in 1995-2000

On December 10, 2001 the Brussels-based think tank, International Crisis Group, proposed a solution to the Greek-Macedonian name dispute. It was soon commended by the State Department. The Greeks and Macedonians were more lukewarm but positive all the same.

The truth, though, is that Macedonia is in no position to effectively negotiate with Greece. The latter - through a series of controversial investments - came to virtually own the former's economy. So many Greek businessmen travel to Macedonia that Olympic Airways, the Greek national carrier began regular flights to its neighbor's capital. The visa regime was eased. Greeks need not apply for Macedonian visas, Macedonians obtain one year Schengen visas from the applicants-besieged Greek liaison office in Skopje. A new customs post was inaugurated in 2000. Greek private businesses gobbled up everything Macedonian - tobacco companies, catering cum hotel groups, mining complexes, travel agencies - at bargain basement prices, injecting much needed capital and providing access to the EU.

The sale of Macedonia's oil refinery, "Okta", to the partly privatized Greek "Hellenic Petroleum" in May 1999, was opaque and contentious. Then Prime Minister of Macedonia, Ljubco Georgievski, and then Minister of Finance, Boris Stojmenov, were accused by the opposition of corrupt dealings. Rumors abounded about three "secret annexes" to the sale agreement which cater to the alleged venality of top politicians and the parties of the ruling coalition. The deal included a pledge to construct a 230 km. $90 million oil pipeline between the port of Thessalonica and Skopje (with a possible extension to Belgrade). The Greeks would invest $80 million in the pipeline and this constitutes a part of a $182 million package deal. This was not "Hellenic Petroleum"'s only Balkan venture. It acquired distribution networks of oil products in Albania as well.

After the Austrian "Erste Bank" pulled out of the deal, "National Bank of Greece" (NBG) drove a hard bargain when it bought a controlling stake in "Stopanska Banka", Macedonia's leading banking establishment for less than $50 million in cash and in kind. With well over 60% of all banking assets and liabilities in Macedonia and with holdings in virtually all significant firms in the country, "Stopanska Banka" is synonymous with the Macedonian economy, or what's left of it. NBG bought a "clean" bank, its bad loans portfolio hived off to the state. NBG - like other Greek banks, such as Eurobank, has branches and owns brokerages in Albania, Bulgaria, and Romania. But nowhere is it as influential as in Macedonia. It was able to poach Gligor Bisev, the Deputy Governor of Macedonia's central Bank (NBM) to serve as its CEO. Another Greek bank, Alpha Bank, has bought a controlling stake in Kreditna Banka, a Macedonian bank with extensive operations in Kosovo and among NGO's.

The Greek telecom, OTE, has acquired the second mobile phone operator licence in Macedonia (Cosmofon). The winner in the public tender, Link Telekom, a Macedonian paging firm, has been disqualified, unable to produce a bank guarantee (never part of the original tender terms). The matter went to the courts.

Local businessmen predicted this outcome. They say that when "Makedonski Telekom" was sold, surprisingly, and under visible American "lobbying", to MATAV (rather than to OTE), Macedonian politicians promised to compensate the latter by awarding it the second operator licence, come what may. Whatever the truth, this acquisition enhances OTE's portfolio which includes mobile operators in Albania (CosmOTE) and Bulgaria (GloBUL).

Official Greece clearly regards Greek investments as a pillar of a Greek northern sphere of influence in the Balkan. Turkey has Central Asia, Austria and Germany have Central Europe - Greece has the Balkans. Greece officially represented the likes of Bulgaria in both NATO and the EU until their accession.

Greek is spoken in many a Balkan country and Greek businessmen are less bewildered by the transition economies in the region, having gone through a similar phase themselves in the 1950's and 1960's. Greece is a natural bridge and beachhead for Western multinationals interested in the Balkan. About 20% of Greece's trade is with the Balkan despite an enormous disparity of income per capita - Greece's being 8 times the average Balkan country's.

Exports to Balkan countries have tripled between 1992 and 2000 and Greece's trade surplus rose 10 times in the same period. Greek exports constituted 35% of all EU exports to Macedonia and 55% of all EU exports to Albania. About the only places with muted Greek presence are Bosnia and Kosovo - populated by Moslems and not by Orthodox coreligionists.

The region's instability, lawlessness, and backwardness have inflicted losses on Greek firms (for instance in 1997 in disintegrating Albania, or in 1998-9 in Kosovo and Serbia). But they kept coming back.

In the early 1990's Greece imposed an economic embargo on Macedonia and almost did the same to Albania. It disputed Macedonia's flag and constitutional name and Albania's policy towards the Greek minority within its borders. But by 1998, Greeks have committed to invest

$300 million in Macedonia - equal to 10% of its dilapidated GDP. Employing 22,000 workers, 450 Greek firms have invested $120 million in 1280 different ventures in Bulgaria. And 200 Greek businesses invested more than $50 million in the Albanian and economy, the beneficiary of a bilateral "drachma zone" since 1993. In 1998, Greece controlled 10% of the market in oil derivatives in Albania and the bulk of the market in Macedonia. Another $60 million were invested in Romania.

Nowhere was Greek presence more felt than in Yugoslavia. The two countries signed a bilateral investment accord in 1995. It opened the floodgates. Yugoslavia's law prevented Greek banks from operating in its territory. But this seems to have been the sole constraint. Mytilineos, a Greek metals group, signed two deals worth $1.5 billion with the Kosovo-based Trepca mines and other Yugoslav metal firms. The list reads like the Greek Who's Who in Business. Gener, Atemke, Attikat (construction), 3E, Delta Dairy (foodstuffs), Intracom (telecommunications), Elvo and Hyundai Hellas (motor vehicles), Evroil, BP Oil and Mamidakis (oil products).

The Milosevic regime used Greek and Cypriot banks and firms to launder money and bust the international sanctions regime. Greek firms shipped goods, oil included, up the Vardar river, through Macedonia, to Serbia. Members of the Yugoslav political elite bought properties in Greece. But this cornucopia mostly ended in 1998 with the deepening involvement of the international community in Kosovo. Only now are Greek companies venturing back hesitantly. European Tobacco has invested

$47 million in a 400 workers strong tobacco factory in Serbia opened in 2002.

Still, the 3500 investments in the Balkan between 1992-8 were only the beginning.

Despite a worsening geopolitical climate, by 2001, Greek businesses - acting through Cypriot, Luxemburg, Lichtenstein, Swiss, and even Russian subsidiaries - have invested in excess of $5 billion in the Balkan, according to the Economic Research Division of the Greek Alpha Bank. Thus, Chipita, the Greek snacks company bought Romania's Best Foods Productions through its Cyprus subsidiary, Chipita East Europe Cyprus.

The state controlled OTE alone has invested $1.5 billion in acquiring stakes in the Serb, Bulgarian, and Romanian state telecoms. This cannot be considered mere bargain hunting. OTE claims to have turned a profit on its investments in war torn Serbia, corruption riddled Romania and bureaucratic Bulgaria. Others doubt this exuberance.

Greek banks have invested $400 million in the Balkans. NBG has branches or subsidiaries in Macedonia, Bulgaria, Romania, and Albania. EFG Ergasias and Commercial Bank are active in Bulgaria, and Alpha Bank in Romania. The creation of Europe's 23rd largest bank as a result of the merger between NBG and Alpha is likely to consolidate their grip on Balkan banking.

Greek manufacturing interests have purchased stakes in breweries in Macedonia. Hellenic Bottling - formerly 3E - started off as a Coca-Cola bottler but has invested $250m on facilities in the south Balkans and in Croatia, Slovenia and Moldova. Another big investor is Delta dairy products and ice cream.

Moreover, Greece has absorbed - albeit chaotically and reluctantly - hundreds of thousands of Albanian, Macedonian, Serb, Romanian, and Bulgarian economic immigrants. In the late 1990s, Albanian expatriates remitted home well over 500 million drachmas annually. Thousands of small time cross border traders and small to medium size trading firms control distribution and retailing of Greek, European, Asian, and American origin brands (not to mention the smuggling of cigarettes, counterfeit brands, immigrants, stolen vehicles, pirated intellectual property, prostitutes, and, marginally, drugs).

As a member of the EU and an instigator of the ineffectual and bureaucratic Stability Pact, Greece has unveiled a few megabuck regional reconstruction plans. In November 1999, it proposed a $500 million five year private-public partnership to invest in infrastructure throughout the region. Next were a $1 billion oil pipeline through Bulgaria and northern Greece and an extension of a Russian gas pipeline to Albania and Macedonia. The Egnatia Highway is supposed to connect Turkey, Greece, Bulgaria, Macedonia, and Albania. Greece is a major driving force behind REM - a southeast Europe Regional Electricity trading Market declared in September 1999 in Thessalonica.

The Hellenic Observatory in the London School of Economics notes the importance of the Greek capitalist Diaspora (Antonis Kamaras, "Capitalist Diaspora: The Greeks in the Balkans"). Small, Greek, traders in well located Thessalonica provided know-how, contacts and distribution networks to established Greek businesses outside the Balkan. The latter took advantage of the vacuum created by the indifference of multinationals in the West and penetrated Balkan markets vigorously.

The Greek stratagem is evident. Greece, as a state, gets involved in transportation and energy related projects. Greek state-inspired public sector investments have been strategically placed in the telecommunications and banking sectors - the circulatory systems of any modern economy. Investments in these four sectors can be easily and immediately leveraged to gain control of domestic manufacturing and services to the benefit of the Greek private sector.

Moreover, politics is a cash guzzling business. He who controls the cash flow - controls the votes. Greece buys itself not only refineries and banks, telecoms and highways. It buys itself influence and politicians. The latter come cheap in this part of the world. Greece can easily afford them.

Gross Domestic Product (GDP)

The formula to calculate GDP is this:

GDP (Gross Domestic Product) =

Consumption + investment + government expenditure + net exports (exports minus imports) =

Wages + rents + interest + profits + non-income charges + net foreign factor income earned

But the GDP figure is vulnerable to "creative accounting":

1. The ***weight of certain items, sectors, or activities*** is reduced or increased in order to influence GDP components, such as industrial production. Developing countries often alter the way critical components of GDP like industrial production are tallied.

2. ***Goods in inventory*** are included in GDP although not yet sold. Thus, rising inventories, a telltale sign of economic ill-health, actually increases the GDP!

3. If goods produced are financed with ***credits and loans***, GDP will be artificially ***HIGH*** (inflated).

4. In some countries, ***PLANS*** and ***INTENTIONS*** to invest are counted, recorded, and booked as actual investments. This practice is frowned upon (and landed quite a few corporate managers in the gaol), but is still widespread in the shoddier and shadier corners of the globe.

5. GDP figures should be adjusted for inflation (real GDP as opposed to nominal GDP). To achieve that, the calculation of the GDP deflator is critical. But the GDP deflator is a highly subjective figure, prone, in developing countries, to reflecting the government's political needs and predilections.

6. What currency exchange rates were used? By selecting the right "points in time", GDP figures can go up and down by up to 2%!

7. Healthcare expenditures, agricultural subsidies, government aid to catastrophe-stricken areas form a part of the GDP. Thus, for instance, by increasing healthcare costs, the government can manipulate GDP figures.

8. Net exports in many developing countries are negative (in other words, they maintain a trade deficit). How can the GDP grow at all in these places? Even if consumption and investment are strongly up - government expenditures are usually down (at the behest of multilateral financial institutions) and net exports are down. It is not possible for GDP to grow vigorously in a country with a sizable and ballooning trade deficit.

9. The projections of most international, objective analysts and international economic organizations usually tend to converge on a GDP growth figure that is often lower than the government's but in line with the long-term trend. These figures are far better indicators of the true state of the economy. Statistics Bureaus in developing countries are often under the government's thumb and run by political appointees.

Growth (and Government)

It is a maxim of current economic orthodoxy that governments compete with the private sector on a limited pool of savings. It is considered equally self-evident that the private sector is better, more competent, and more efficient at allocating scarce economic resources and thus at preventing waste. It is therefore thought economically sound to reduce the size of government - i.e., minimize its tax intake and its public borrowing - in order to free resources for the private sector to allocate productively and efficiently.

Yet, both dogmas are far from being universally applicable.

The assumption underlying the first conjecture is that government obligations and corporate lending are perfect substitutes. In other words, once deprived of treasury notes, bills, and bonds - a rational investor is expected to divert her savings to buying stocks or corporate bonds.

It is further anticipated that financial intermediaries - pension funds, banks, mutual funds - will tread similarly. If unable to invest the savings of their depositors in scarce risk-free - i.e., government - securities - they will likely alter their investment preferences and buy equity and debt issued by firms.

Yet, this is expressly untrue. Bond buyers and stock investors are two distinct crowds. Their risk aversion is different. Their investment preferences are disparate. Some of them - e.g., pension funds - are constrained by law as to the composition of their investment portfolios. Once government debt has turned scarce or expensive, bond investors tend to resort to cash. That cash - not equity or corporate debt - is the veritable substitute for risk-free securities is a basic tenet of modern investment portfolio theory.

Moreover, the "perfect substitute" hypothesis assumes the existence of efficient markets and frictionless transmission mechanisms. But this is a conveniently idealized picture which has little to do with grubby reality. Switching from one kind of investment to another incurs - often prohibitive - transaction costs. In many countries, financial intermediaries are dysfunctional or corrupt or both. They are unable to efficiently convert savings to investments - or are wary of doing so.

Furthermore, very few capital and financial markets are closed, self-contained, or self-sufficient units. Governments can and do borrow from foreigners. Most rich world countries - with the exception of Japan - tap "foreign people's money" for their public borrowing needs. When the US government borrows more, it crowds out the private sector in Japan - not in the USA.

It is universally agreed that governments have at least two critical economic roles. The first is to provide a "level playing field" for all economic players. It is supposed to foster competition, enforce the rule of law and, in particular, property rights, encourage free trade, avoid distorting fiscal incentives and disincentives, and so on. Its second role is to cope with market failures and the provision of public goods. It is expected to step in when markets fail to deliver goods and services, when asset bubbles inflate, or when economic resources are blatantly misallocated.

Yet, there is a third role. In our post-Keynesian world, it is a heresy. It flies in the face of the "Washington Consensus" propagated by the Bretton-Woods institutions and by development banks the world over. It is the government's obligation to foster growth.

In most countries of the world - definitely in Africa, the Middle East, the bulk of Latin America, central and eastern Europe, and central and east Asia - savings do not translate to investments, either in the form of corporate debt or in the form of corporate equity.

In most countries of the world, institutions do not function, the rule of law and properly rights are not upheld, the banking system is dysfunctional and clogged by bad debts. Rusty monetary transmission mechanisms render monetary policy impotent.

In most countries of the world, there is no entrepreneurial and thriving private sector and the economy is at the mercy of external shocks and fickle business cycles. Only the state can counter these economically detrimental vicissitudes. Often, the sole engine of growth and the exclusive automatic stabilizer is public spending. Not all types of public expenditures have the desired effect. Witness Japan's pork barrel spending on "infrastructure projects". But development-related and consumption-enhancing spending is usually beneficial.

To say, in most countries of the world, that "public borrowing is crowding out the private sector" is wrong. It assumes the existence of a formal private sector which can tap the credit and capital markets through functioning financial intermediaries, notably banks and stock exchanges.

Yet, this mental picture is a figment of economic imagination. The bulk of the private sector in these countries is informal. In many of them, there are no credit or capital markets to speak of. The government doesn't borrow from savers through the marketplace - but internationally, often from multilaterals.

Outlandish default rates result in vertiginously high real interest rates. Inter-corporate lending, barter, and cash transactions substitute for bank credit, corporate bonds, or equity flotations. As a result, the private sector's financial leverage is minuscule. In the rich West $1 in equity generates $3-5 in debt for a total investment of $4-6. In the developing world, $1 of tax-evaded equity generates nothing. The state has to pick up the slack.

Growth and employment are public goods and developing countries are in a perpetual state of systemic and multiple market failures. Rather than lend to businesses or households - banks thrive on arbitrage. Investment horizons are limited. Should the state refrain from stepping in to fill up the gap - these countries are doomed to inexorable decline.

In times of global crisis, these observations pertain to rich and developed countries as well. Market failures signify corruption and inefficiency in the private sector. Such misconduct and misallocation of economic resources is usually thought to be the domain of the public sector, but actually it goes on eveywhere in the economy.

Wealth destruction by privately-owned firms is typical of economies with absent, lenient, or lax regulation and often exceeds anything the public administration does. Corruption, driven by avarice and fear, is common among entrepreneurs as much as among civil servants. It is a myth to believe otherwise. Wherever there is money, human psychology is in operation and with it economic malaise. Hence the need for governmental micromamangement of the private sector at all times. Self-regulation is a costly and self-deceiving urban legend.

Another engine of state involvement is provided by the thrift paradox. When the economy goes sour, rational individuals and households save more and spend less. The aggregate outcome of their newfound thrift is recessionary: decreasing consumption translates into declining corporate profitability and rising unemployment. These effects are especially pronounced when financial transmission mechanisms (banks and other financial institutions) are gummed up: frozen in fear and distrust, they do not lend money, even though deposits (and their own capital base) are ever growing.

It is true that, by diversifying risk away, via the use of derivatives and other financial instruments, asset markets no longer affect the real economy as they used to. They have become, in a sense, "gated communities", separated from Main Street by "risk barriers". But, these developments do not pertain to retail banks and when markets are illiquid and counterparty risk rampant, options and swaps are pretty useless.

The only way to effectively cancel out the this demonetization of the national economy (this "bleeding") is through enhanced government spending. Where fearful citizens save, their government should spend on infrastructure, health, education, and information technology. The state's negative savings should offset multiplying private savings. In extremis, the state should nationalize the financial sector for a limited period of times (as Israel has done in 1983 and Sweden, a decade later).

Grundig

Dutch electronics giant Philips reported yesterday a first quarter loss of $76 million with sales plunging by one seventh. It promptly blamed tottering consumer confidence, escalating pension costs, vanishing sales of television sets and a generally grim economic outlook.

The demise this week of a German competitor, Grundig, did not help.

Yet, the two succumbed to different malaises. Grundig - a 1997 Philips spin-off with plants in Germany, the United Kingdom, Portugal and Austria - was circled to its dying breath by corporate suitors, among them Taiwan's Sampo and Turkey's Beko Elektronik, one of its sub-contractors.

But both pulled out in haste when acquainted with the full picture - and especially with Grundig's $220 million in unfunded pension obligations. The biting irony of a Turkish company taking over a German one was thus avoided.

Grundig's products - increasingly regarded as commodities - were exorbitantly expensive. DVDs, TVs, video cameras, audio equipments and VCRs compete on price rather than technology. The precipitous drop in prices yielded a contraction of 3.4 percent in the global sales of consumer electronics, to $22 billion in 2001.

Belated attempts to cut costs - for instance, by outsourcing to the likes of Turkey and Hungary - were half hearted. The shedding of thousands of experienced and dedicated workers did not help.

Nor was Grundig the epitome of good governance. Its last audited financial statements are two years old and show a loss of about $160 million using the current exchange rate. This amounted to one tenth of its fast imploding sales. The company is thought to have bled another $80 million in red ink this year on $1.3 billion in turnover.

Grundig is only the last in a long list of German corporate failures: the Kirch media empire, construction company Phillip Holzmann, aircraft manufacturer Fairchild Dornier, electronics plant Schneider Technologies, engineering office Babcock Borsig, stationery maker Herlitz and airship developer Cargolifter. The Federal Statistics Office pegs the number of insolvency filings last year at 84,428.

Yet, Grundig reified the German postwar economic miracle. It was an icon of self-satisfied consumerism and the unsustainable social safety net it had spawned. Renowned for its audacious innovations and perky marketing, it flourished well into the 1970s. In 1979, it employed 38,000 laborers in 30 plants worldwide. It opened offices in France, Italy, Portugal, Spain, Sweden and Taiwan. But low-cost competitors, notably the Japanese, were already making inroads into its traditional markets. It now employs less than 4,000 people.

Grundig, like many other German companies, denied, at its peril, the painful emergence of cheaper production locales in Asia and Latin America. In the 1990s, it resisted pressures to cut costs by Philips, its holding company. Like a faded beauty, it refused to transform itself into a lean research and development or design company.

Grundig abhorred the thought of becoming the mere coordination center of overseas manufacturing and assembly facilities. It would not admit that nothing much is left of Grundig except its brand and its sales network, estimated by radio aerial and satellite dish maker Anton Kathrein, the majority shareholder since 2000, to be worth $550 million.

Ironically, even in its death throes, Grundig's products kept garnering coveted industry accolades. Last month, the Grundig Tharus 51 LCD screen has received the 2003 red dot award, bestowed annually by the Design Zentrum Nordrhein-Westfalen. It competed with 1494 products from 28 countries and was singled out for its outstanding "innovation, functionality, formal quality, ergonomic efficiency and environmental compatibility."

Still, Grundig's demise is a sign of healing. As incestuous old boy networks are crumbling under the onslaught of globalization and the financial system its strained to its limits, bank lending is being rationalized. Political meddling, though still ubiquitous, is abating. The cozy confluence of state and economic interests is waning. Grundig is a perfect example of just how pernicious these can be.

Last year, The European Commission allowed Bavaria to extend $50 million in new, 6-month, credits to the ailing manufacturer. Instead of ploughing the money into Grundig's profitable but labor-poor car radio, hotel satellite communications and office communications units - the money was misspent on its hemorrhaging TV production facilities.

But last week, according to Financial Times Deutschland, four creditor banks, including Deutsche Bank, Dresdner Bank, Bayerische Landesbank (Bavarian State Bank) and the Bavarian State Foundation for Structural Financing - refused to extend expiring credit lines and thus doomed Grundig to a timely death.

The Grundig debacle also brought into sharp relief the German postbellum invention of corporate supervisory board, composed of erstwhile chairmen of the board, deposed chief executive officers and hapless representatives of banks held hostage by previous sprees of reckless lending. These are joined by trade union or employee representatives, there to oppose job cuts and disinvestment.

Germany in inexorably pushed, kicking and screaming, to adopt the Anglo-Saxon, "heartless", model of capitalism. Its reliance on exports for growth makes it particularly vulnerable to global winds. It can no longer survive in splendid economic isolation. Gradually, it is being reduced to a mid-sized regional economic power. It is an agonizing and injurious process and Grundig is only among the first of many of its victims to come.

H

Hawala and Islamic Banking

I. OVERVIEW

In the wake of the September 11 terrorist attacks on the USA, attention was drawn to the age-old, secretive, and globe-spanning banking system developed in Asia and known as "Hawala" (to change, in Arabic). It is based on a short term, discountable, negotiable, promissory note (or bill of exchange) called "Hundi". While not limited to Moslems, it has come to be identified with "Islamic Banking".

Islamic Law (Sharia'a) regulates commerce and finance in the Fiqh Al Mua'malat, (transactions amongst people). Modern Islamic banks are overseen by the Shari'a Supervisory Board of Islamic Banks and Institutions ("The Shari'a Committee").

The Shi'a "Islamic Laws according to the Fatawa of Ayatullah al Uzama Syed Ali al-Husaini Seestani" has this to say about Hawala banking:

"2298. If a debtor directs his creditor to collect his debt from the third person, and the creditor accepts the arrangement, the third person will, on completion of all the conditions to be explained later, become the debtor. Thereafter, the creditor cannot demand his debt from the first debtor."

The prophet Muhammad (a cross border trader of goods and commodities by profession) encouraged the free movement of goods and the development of markets. Numerous Moslem scholars railed against hoarding and harmful speculation (market cornering and manipulation known as "Gharar"). Moslems were the first to use promissory notes and assignment, or transfer of debts via bills of exchange ("Hawala"). Among modern banking instruments, only floating and, therefore, uncertain, interest payments ("Riba" and "Jahala"), futures contracts, and forfeiting are frowned upon. But agile Moslem traders easily and often circumvent these religious restrictions by creating "synthetic Murabaha (contracts)" identical to Western forward and futures contracts. Actually, the only allowed transfer or trading of debts (as distinct from the underlying commodities or goods) is under the Hawala.

"Hawala" consists of transferring money (usually across borders and in order to avoid taxes or the need to bribe officials) without physical or electronic transfer of funds. Money changers ("Hawaladar") receive cash in one country, no questions asked. Correspondent hawaladars in another country dispense an identical amount (minus minimal fees and commissions) to a recipient or, less often, to a bank account. E-mail, or letter ("Hundi") carrying couriers are used to convey the necessary information (the amount of money, the date it has to be paid on) between Hawaladars. The sender provides the recipient with code words (or numbers, for instance the serial numbers of currency notes), a digital encrypted message, or agreed signals (like handshakes), to be used to retrieve the money. Big Hawaladars use a chain of middlemen in cities around the globe.

But most Hawaladars are small businesses. Their Hawala activity is a sideline or moonlighting operation. "Chits" (verbal agreements) substitute for certain written records. In bigger operations there are human "memorizers" who serve as arbiters in case of dispute. The Hawala system requires unbounded trust. Hawaladars are often members of the same family, village, clan, or ethnic group. It is a system older than the West. The ancient Chinese had their own "Hawala" - "fei qian" (or "flying money"). Arab traders used it to avoid being robbed on the Silk Road. Cheating is punished by effective ex-communication and "loss of honour" - the equivalent of an economic death sentence. Physical violence is rarer but not unheard of. Violence sometimes also erupts between money recipients and robbers who are after the huge quantities of physical cash sloshing about the system. But these, too, are rare events, as rare as bank robberies. One result of this effective social regulation is that commodity traders in Asia shift hundreds of millions of US dollars per trade based solely on trust and the verbal commitment of their counterparts.

Hawala arrangements are used to avoid customs duties, consumption taxes, and other trade-related levies. Suppliers provide importers with lower prices on their invoices, and get paid the difference via Hawala. Legitimate transactions and tax evasion constitute the bulk of Hawala operations. Modern Hawala networks emerged in the 1960's and 1970's to circumvent official bans on gold imports in Southeast Asia and to facilitate the transfer of hard earned wages of expatriates to their families ("home remittances") and their conversion at rates more favourable (often double) than the government's. Hawala provides a cheap (it costs c. 1% of the amount transferred), efficient, and frictionless alternative to morbid and corrupt domestic financial institutions. It is Western Union without the hi-tech gear and the exorbitant transfer fees.

Unfortunately, these networks have been hijacked and compromised by drug traffickers (mainly in Afganistan and Pakistan), corrupt officials, secret services, money launderers, organized crime, and terrorists. Pakistani Hawala networks alone move up to 5 billion US dollars annually according to estimates by Pakistan's Minister of Finance, Shaukut Aziz. In 1999, Institutional Investor Magazine identified 1100 money brokers in Pakistan and transactions that ran as high as 10 million US dollars apiece. As opposed to stereotypes, most Hawala networks are not controlled by Arabs, but by Indian and Pakistani expatriates and immigrants in the Gulf. The Hawala network in India has been brutally and ruthlessly demolished by Indira Ghandi (during the emergency regime imposed in 1975), but Indian nationals still play a big part in international Hawala networks. Similar networks in Sri Lanka, the Philippines, and Bangladesh have also been eradicated.

The OECD's Financial Action Task Force (FATF) says that:

"Hawala remains a significant method for large numbers of businesses of all sizes and individuals to repatriate funds and purchase gold.... It is favoured because it usually costs less than moving funds through the banking system, it operates 24 hours per day and every day of the year, it is virtually completely reliable, and there is minimal paperwork required."

(Organisation for Economic Co-Operation and Development (OECD), "Report on Money Laundering Typologies 1999-2000," Financial Action Task Force, FATF-XI, February 3, 2000, at ***http://www.oecd.org/fatf/pdf/TY2000_en.pdf*** ***)***

Hawala networks closely feed into Islamic banks throughout the world and to commodity trading in South Asia. There are more than 200 Islamic banks in the USA alone and many thousands in Europe, North and South Africa, Saudi Arabia, the Gulf states (especially in the free zone of Dubai and in Bahrain), Pakistan, Malaysia, Indonesia, and other South East Asian countries. By the end of 1998, the overt (read: tip of the iceberg) liabilities of these financial institutions amounted to 148 billion US dollars. They dabbled in equipment leasing, real estate leasing and development, corporate equity, and trade/structured trade and commodities financing (usually in consortia called "Mudaraba").

While previously confined to the Arab peninsula and to south and east Asia, this mode of traditional banking became truly international in the 1970's, following the unprecedented flow of wealth to many Moslem nations due to the oil shocks and the emergence of the Asian tigers. Islamic banks joined forces with corporations, multinationals, and banks in the West to finance oil exploration and drilling, mining, and agribusiness. Many leading law firms in the West (such as Norton Rose, Freshfields, Clyde and Co. and Clifford Chance) have "Islamic Finance" teams which are familiar with Islam-compatible commercial contracts.

II. HAWALA AND TERRORISM

Recent anti-terrorist legislation in the US and the UK allows government agencies to regularly supervise and inspect businesses that are suspected of being a front for the "Hawala" banking system, makes it a crime to smuggle more than $10,000 in cash across USA borders, and empowers the Treasury secretary (and its Financial Crimes Enforcement Network - FinCEN) to tighten record-keeping and reporting rules for banks and financial institutions based in the USA. A new inter-agency Foreign Terrorist Asset Tracking Center (FTAT) was set up. A 1993 moribund proposed law requiring US-based Halawadar to register and to report suspicious transactions may be revived. These relatively radical measures reflect the belief that the al-Qaida network of Osama bin Laden uses the Hawala system to raise and move funds across national borders. A Hawaladar in Pakistan (Dihab Shill) was identified as the financier in the attacks on the American embassies in Kenya and Tanzania in 1998.

But the USA is not the only country to face terrorism financed by Hawala networks.

In mid-2001, the Delhi police, the Indian government's Enforcement Directorate (ED), and the Military Intelligence (MI) arrested six Jammu Kashmir Islamic Front (JKIF) terrorists. The arrests led to the exposure of an enormous web of Hawala institutions in Delhi, aided and abetted, some say, by the ISI (Inter Services Intelligence, Pakistan's security services). The Hawala network was used to funnel money to terrorist groups in the disputed Kashmir Valley.

Luckily, the common perception that Hawala financing is paperless is wrong. The transfer of information regarding the funds often leaves digital (though heavily encrypted) trails. Couriers and "contract memorizers", gold dealers, commodity merchants, transporters, and moneylenders can be apprehended and interrogated. Written, physical, letters are still the favourite mode of communication among small and medium Hawaladars, who also invariably resort to extremely detailed single entry bookkeeping. And the sudden appearance and disappearance of funds in bank accounts still have to be explained. Moreover, the sheer scale of the amounts involved entails the collaboration of off shore banks and more established financial institutions in the West. Such flows of funds affect the local money markets in Asia and are instantaneously reflected in interest rates charged to frequent borrowers, such as wholesalers. Spending and consumption patterns change discernibly after such influxes. Most of the money ends up in prime world banks behind flimsy business facades. Hackers in Germany claimed (without providing proof) to have infiltrated Hawala-related bank accounts.

The problem is that banks and financial institutions - and not only in dodgy offshore havens ("black holes" in the lingo) - clam up and refuse to divulge information about their clients. Banking is largely a matter of fragile trust between bank and customer and tight secrecy. Bankers are reluctant to undermine either. Banks use mainframe computers which can rarely be hacked through cyberspace and can be compromised only physically in close co-operation with insiders. The shadier the bank - the more formidable its digital defenses. The use of numbered accounts (outlawed in Austria, for instance, only recently) and pseudonyms (still possible in Lichtenstein) complicates matters. Bin Laden's accounts are unlikely to bear his name. He has collaborators.

Hawala networks are often used to launder money, or to evade taxes. Even when employed for legitimate purposes, to diversify the risk involved in the transfer of large sums, Hawaladars apply techniques borrowed from money laundering. Deposits are fragmented and wired to hundreds of banks the world over ("starburst"). Sometimes, the money ends up in the account of origin ("boomerang").

Hence the focus on payment clearing and settlement systems. Most countries have only one such system, the repository of data regarding all banking (and most non-banking) transactions in the country. Yet, even this is a partial solution. Most national systems maintain records for 6-12 months, private settlement and clearing systems for even less.

Yet, the crux of the problem is not the Hawala or the Hawaladars. The corrupt and inept governments of Asia are to blame for not regulating their banking systems, for over-regulating everything else, for not fostering competition, for throwing public money at bad debts and at worse borrowers, for over-taxing, for robbing people of their life savings through capital controls, for tearing at the delicate fabric of trust between customer and bank (Pakistan, for instance, froze all foreign exchange accounts two years ago). Perhaps if Asia had reasonably expedient, reasonably priced, reasonably regulated, user-friendly banks - Osama bin Laden would have found it impossible to finance his mischief so invisibly.

Healthcare (in Central and Eastern Europe)

Transition has trimmed Russian life expectancy by well over a decade. People lead brutish and nasty lives only to expire in their prime, often inebriated. In the republics of former Yugoslavia, respiratory and digestive tract diseases run amok. Stress and pollution conspire to reap a grim harvest throughout the wastelands of eastern Europe. The rate of Tuberculosis in Romania exceeds that of sub-Saharan Africa.

As income deteriorated, plunging people into abject poverty, they found it increasingly difficult to maintain a healthy lifestyle. Crumbling healthcare systems, ridden by corruption and cronyism, ceased to provide even the appearance of rudimentary health services. The number of women who die at - ever rarer - childbirth skyrocketed.

Healthcare under communism was a public good, equitably provided by benevolent governments. At least in theory. Reality was drearier and drabber. Doctors often extorted bribes from hapless patients in return for accelerated or better medical treatment.

Country folk were forced to travel hundreds of miles to the nearest city to receive the most basic care. Medical degrees were - and still are - up for sale to the highest, or most well-connected, bidder. Management was venal and amateurish, as it has remained to this very day.

Hospital beds were abundant - not so preventive medicine and ambulatory care. One notable exception is Estonia where the law requires scheduled prophylactic exams and environmental assessment of health measures in the workplace.

Even before the demise of central healthcare provision, some countries in east Europe experimented with medical insurance schemes, or with universal healthcare insurance.

Others provided healthcare only through and at the workplace. But as national output and government budgets imploded, even this ceased abruptly.

Hospitals and other facilities are left to rot for lack of maintenance or shut down altogether. The much slashed government paid remuneration of over-worked medical staff was devoured by hyperinflation and stagnated ever since. Equipment falls into disrepair. Libraries stock on tattered archaic tomes.

Medicines and other substances - from cultures to vaccines to immunological markers - are no longer affordable and thus permanently in short supply. The rich monopolize the little that is left, or travel abroad in search of cure. The poor languish and die.

Healthcare provision in east Europe is irrational. In the healthcare chapter of a report prepared by IRIS Center in the University of Maryland for USAID, it says:

"In view of the fall in income and government revenue, there is a need for more accurate targeting of health care (for instance, more emphasis on preventive and primary care, rather than tertiary care), and generally more efficient use of benefits (e.g., financing spa attendance by Russian workers can be cut in favor of more widespread vaccination and public education). As the formal privatization (much is already informally privatized) of health care proceeds, and health insurance systems are developed, health care access for poverty-stricken groups and individuals needs to be provided in a more reliable and systematic way."

But this is hard to achieve when even the token salaries of healthcare workers go unpaid for months. Interfax reported on March 9 that 41 of Russia's 89 regions owe their healthcare force back wages. Unions are bereft of resources and singularly inefficacious.

The outcomes of a mere 6 percent of national level consultations in Lithuania were influenced by the health unions. Their membership fell to 20 percent of eligible workers, the same as in Poland and only a shade less than the Czech Republic (with 32 percent).

No wonder that "under the table" "facilitation fees" are common and constitute between 40 and 50 percent of the total income of medical professionals. In countries like the Czech Republic, Croatia, and chaotic Belarus, the income of doctors has diverged upwards compared to other curative vocations. It is not possible to obtain any kind of free medical care in the central Asian republics.

This officially tolerated mixture of quasi-free services and for-pay care is labeled "state-regulated corruption" by Maxim Rybakov from Central European University in his article "Shadow Cost-sharing in Russian Healthcare".

As though to defy this label, the Russian Ministry of Health is conducting - together with the Audit Chamber and the Ministry of the Interior - a criminal investigation against healthcare professionals. The Russian "Rossiiskaya Gazeta" quoted in Radio Liberty/Radio Free Europe:

"According to Shevchenko (the Russian minister of health), there are some 600,000 doctors and 3 million nurses working in Russia today; of this total around 500 medical workers are currently being investigated on suspicion of a variety of offenses such as taking bribes, using fake medical certificates, and reselling medicine at a profit. Shevchenko also stated that the State Duma will soon adopt a law on state regulation of private medical activities, which he said will put the process of commercializing medical establishments on a more legal footing."

The UN's ILO (International Labour Organization) warned, in a December 2001 press release, of a "crisis in care". According to a new survey by the ILO and Public Services International (PSI):

"The economic and social situation in several East European countries has resulted in the near collapse of some health care systems and afflicted health sector workers with high stress, poor working conditions and salaries at or below minimum wage - if and when they are paid."

Guy Standing, the ILO Director of the Socio-Economic Security Program and coordinator of the studies added:

"Rapidly increasing rates of sexually-transmitted diseases, HIV/AIDS, tuberculosis and numerous chronic diseases have created a crisis of care made all the more dramatic by diminishing public health structures, lack of training of health care professionals and general de-skilling of the workforce. All of this has surely contributed to the catastrophic fall in life expectancy rates in Russia, Ukraine and some other countries in the region."

The situation is dismal even in the more prosperous and peaceful countries of central Europe. In another survey, also conducted by the ILO ("People's Security Survey"), 82 percent of families in Hungary claimed to be unable to afford even basic care.

This is not much better than Ukraine where 88 percent of all families share this predicament. Agreements signed in the last two years between Hungarian hospitals and cash-plan insurers further removed health care from the financial reach of most Hungarians.

Healthcare workers in all surveyed countries - from the Czech Republic to Moldova - complained of earning less than the national average and of crippling wage arrears. In some countries - Armenia, Moldova, Kyrgyzstan - few bother to clock in anymore. In others - Poland and Latvia, for instance - a much abbreviated working week and temporary labor contracts are imposed on the reluctant and restive healthcare workers.

One in twenty hospitals in Poland had to close between 1998-2001. In an impolitic spat of fiscal devolution, ill-prepared local authorities throughout the region were left to administer and finance the shambolic health services within their jurisdictions.

The governments of east Europe tried to cope with this unfolding calamity in a variety of ways.

Consider Romania. Half the population claim to be "very satisfied" with its health services.

In Romania, the 1997 Health Insurance Law shifted revenue collection and provider payments to a maze-like coalition of 41 district health insurance houses (HIH) headed by a National Health Insurance House. Romanian citizens are forced to foot one third of their health bills in a country which spends a mere 3 percent of GDP on the salubrity of its citizens - the equivalent of $100 per year per capita. Only a small part of this coerced co-financing is formal and legal.

About 70 percent of the meager state budget is derived from erratic payroll health insurance fund contributions, now set at 14 percent of wages. The national budget supplements the rest. Some of the contributions are distributed among the poorest regions to narrow the inequality between urban and rural areas.

The HIH's pay health care providers, such as hospitals based on capitation, or a projected global budget. They are experimenting now with fee-for-service reimbursement methods. All these payment systems, inevitably, are open to abuse. Monitoring and auditing are poor and relations are incestuous.

The Ministry of Health still makes all major procurement decisions. Many government organs - the Ministry of the Interior, the transport system, the Army - all maintain their wastefully parallel care provision networks. Donor funds, multilateral financing, and government money have all vanished into this insatiable sink of venality.

The only rays of light are private dental and medical clinics, laboratories, and polyclinics working side by side with private pharmacies and apothecaries. These cater to the well-to-do. But the government emulated them and "privatized" the institution of the family physician (general practitioner).

GP's now receive, on a contractual basis, payment per socially-insured patient treated. They make rent-free use of clinics and equipment in their workplace. Many of these doctors now borrow small amounts from willing banks - a scarcity in Romania - to open their own practice.

In an article published on March 2000 in "Central Europe Review" and titled "Trying our Patients", Professor Pavel Pafko, Head of the Third Surgery Department, Charles University Faculty Hospital, Prague, lamented the state of Czech medicine:

"After the 1989 Velvet Revolution, there were fundamental changes in the health service: the market was opened to manufacturers of medical equipment, aids and medicines, and Parliament announced the right for everyone to choose their own doctor. In my opinion, the health service was not sufficiently prepared for these fundamental changes.

In the public's mind the idea of 'free health care' survived and continues to survive from the Communist period, as does the idea that all of us are equal as long as we are healthy. The sick man in many cases loses this equality and cannot himself pay by legal means for what the state, or rather the insurance companies, have no resources to provide."

Expenditure on health amounted in the 1990's to c. 7 percent of GDP per year (compared to 14 percent of a much larger GDP in OECD countries). But medical insurance firms cannot cope with vertiginous prices of imported medicines. Hospitals now receive insufficient lump-sum payments rather than getting reimbursed for procedures and treatments carried out. Naturally, most of these go towards staff wages. Little is left for medical care.

Poland is in no better shape. Its embattled minister of health, Mariusz Lapinski, stumbles from crisis to criticism in his doomed effort to reform a ramshackle system. The two current scandals involve heavily and unsustainably subsidized drugs and a new health bill, fiercely opposed by progressive interests, such as medical doctors and nurses. The Polish weekly, Wprost, went as far as comparing Poland's healthcare to Egypt's, Turkey's, and Mexico's.

The World Bank discovered in 1998 that 78 percent of Poles had to pay illicitly to obtain basic care. Lapinski intends to dissolve the regional state health funds and resurrect them in the form of a national edition. But state-run hospitals in Poland are insolvent. Naturally, healthcare workers have little faith in the management skills of the state.

They are calling for open competition among teams of commercial health insurance funds and health care providers. They would also like to increase health insurance contributions to allow Poland to spend on health more than the current 5.5 percent of GDP.

UPI reported recently ("Shock Therapy in Macedonian Healthcare") about a strike of medics in Macedonia as typical of the problems facing the healthcare systems of all countries in transition: privatization, the involvement of the state, and Western influence of the reform process. The transition to the western General Practitioner (GP) model is hotly debated. As far as doctors are concerned, it is a lucrative proposition. But it could exclude poorer patients from medical care altogether.

Still, the main problem is the gap between grandiose expectations and self-image - and shabby reality. East European medicine harbors fantastic pretensions to west European standards of quality and service. But it is encumbered with African financing and Vietnamese infrastructure. Someone must bridge this abyss with loads of cash. Either the government, or the consumer must cough up the funds. The sooner everyone come to terms with this stressful truth - the healthier.

Appendix - Healthcare Legislation

Healthcare legislation in countries in transition, emerging economic, and developing countries should permit - and use economic incentives to encourage - a structural reform of the sector, including its partial privatization.

Private health insurance plans - including franchises of overseas insurance plans - should be allowed, subject to rigorous procedures of inspection and to satisfying financial and governance requirements. Such competition is bound to shake the inefficient and corrupt state Health Fund and reshape it.

Procurement of medicines - should be transferred to an autonomous central purchasing agency. Both this body and its tenders will be supervised by a public committee aided by outside auditors.

The ***Approved List of Medicines*** - will be recomposed to include generic drugs whenever possible and to exclude expensive brands where generics exist. This should be a requirement in the law.

To maintain their license to practice medicine, medical stuff - from nurses to doctors - would be required to acquire ***continuing education*** and to publish in peer reviewed papers. To prevent nepotism and corruption in appointments of doctors to jobs in clinics and hospitals, all positions from ward doctor upwards will be subject to ***periodic review and open, public tenders.***

The law should ***explicitly*** allow for the following ***arrangements with the private sector*** for the provision of healthcare:

Service Contract (Dominican Republic)

The government pays private entities - including doctors - to perform specific healthcare tasks, or to provide specific healthcare services under a contract. The private service providers can make use of state-owned facilities, if they wish - or operate from their own premises.

Payments by the government are usually based on capitation (a fixed fee for a list of services to be provided to a single patient in a given period, payable even if the services were not consumed) adjusted for the patients' demographic data and reimbursement for fee-for-service items.

Management Contract (Cambodia)

The government pays private entities to manage and operate public health care facilities, like clinics, or hospitals.

Lease (Romania since 1994)

Private entities - including doctors - pay the government a lump sum or monthly fees to use specific state-owned equipment, state-employed manpower, clinics, or complete public health care facilities.

The private entity is entitled to all revenues from its operations but also bears all commercial risks, is responsible for management and operations and liable for malpractice and accidents.

The state is still responsible to make capital investments in the leased facility or equipment - but maintenance costs are borne by the private entity.

Concession and Build-Operate-Transfer (BOT) (Costa Rica)

Concession is exactly like a lease arrangement (see above) with one exception: the private entity is responsible for capital investment. In return, the contract period is extended and can be voided only with a considerable pre-advice.

In BOT (Build-Operate-Transfer) and ROT (Rehabilitate-Operate-Transfer) the capital investment involves the construction or renovation/upgrade of new healthcare facilities. The private entity uses the constructed facility to provide services. After a prescribed period of time has elapsed, ownership is transferred to the government.

Divestiture and Build-Own-Operate (BOO) (Texas, USA)

The law should permit the outright sale of state- owned health care facilities to a qualified private entity.

Another possibility is a BOO scheme, in which the private entity contractually undertakes to add facilities, improve services, purchase equipment, or all three.

Free entry

The law should allow qualified private providers to operate freely. Though regulated, these private firms will have no other relationship with the state.

Such entities would have to be licensed, certified, overseen, and accredited for expertise, safety, hygiene, maintenance, track record, liability insurance, and so on.

The state may choose to encourage such providers to locate in specific regions, to cater to poor clients, or to provide specific healthcare tasks or services by offering tax incentives, free training, access to public facilities, etc.

Franchising (Kenya, Pakistan, Philippines)

A private firm (franchisee) acquires a license from and shares profits with the franchisor (a domestic, or, more often, foreign firm). The franchisee uses the brand name, trademarks, marketing materials, management techniques, designs, media access, access to approved suppliers at bulk (discounted) prices, and training offered by the franchisor. The franchisor monitors the performance and quality of service of the franchisee.

This model works mainly in preventive care, family planning, and reproductive health.

The World Bank ("Public Policy for the Private Sector", Note number 263, dated June 2003):

"Franchisers in the health sector, often supported by international donors and nongovernmental organizations (NGOs), establish protocols, provide training for health workers, certify those who qualify, monitor the performance of franchisees, and provide bulk procurement and brand marketing."

Hospital Management

(See separate document)

The law should allow:

I. Colocation of private wing within or beside public hospital

II. Outsourcing non-clinical support services

III. Outsourcing clinical support services

IV. Outsourcing specialized clinical services

V. Private management of public hospital

VI. Private financing, construction, and leaseback of new public hospital

VII. Private financing, construction, and operation of new public hospital

VIII. Sale of public hospital as going concern

IX. Sale of public hospital for alternative use

X. Consolidation of redundant public healthcare facilities by merging them or closing down some of them

Private Sector Healthcare Monitoring and Regulatory Agency

The law should provide for the establishment of an agency to monitor and regulate private sector healthcare provision: compliance with contracts, servicing the indigent and the uninsured, imposing sanctions or "step-in" rights, and dispute resolution.

Voucher System (Nicaragua)

The law should allow for experimenting with novel payment and resource allocation techniques, such as vouchers distributed to needy populations and guaranteeing free basic service packages provided by a limited list of clinics or other healthcare facilities. Such schemes can also be managed by the private sector.

Medical Savings Accounts (Singapore)

Contributions by employers and employees accumulate over time and are used, tax-free, to pay for hospital expenses in public and private hospitals, national supplementary health insurance premiums, special procedures (including abroad), and expensive outpatient treatment and drugs for the saver and his immediate family.

Consumer Organizations

The law should encourage the formation of consumer organizations in the healthcare field (such as buyers' clubs or Health Maintenance Organizations-HMOs).

These groups will shop and tender for the best, most reasonably priced, and most efficient healthcare services for their members.

Devolution

Responsibility for the provision of some types of healthcare services and the allocation of inputs should be devolved to local authorities (municipalities).

Performance and Payments

The central authority should impose minimum performance targets in performance agreements on all healthcare facilities, both public and private. All payments - wages included - will be tied to these targets and their attainment.

Payment options should include:

Capitation - A fixed fee for a list of services to be provided to a single patient in a given period, payable even if the services were not consumed, adjusted for the patients' demographic data and reimbursement for fee-for-service items.

Diagnosis Related Group (DRG)

Resource-based Relative Value (RBRV)

Healthcare (in Germany)

The Germans, ever the pragmatic sort, call their hospitals - "houses of the sick" or "houses of those suffering". In English the word "hospital" derives from Latin and denotes hosting or hospitality. This may well be the main difference between the German health system and the Anglo-Saxon one. While the former is geared to perform a function - the latter is also concerned with the social and economic contexts of healthcare.

The German national health insurance is inordinately comprehensive. It even reimburses its clients for a few prophylactic weeks at a health spa (Kurort). Medicines - including the over the counter generic sort - are taken extremely seriously. They can be bought only in pharmacies.

This coincides with the guild-like and cartelized character of German business. But, even so, Germans find the thought of Aspirin made available in a supermarket reprehensible. Pharmacists are allowed to prescribe medicines for minor ailments, though.

There are many forms of health insurance. The Privatpatient is covered by a foreign, or German private health plan. The much lauded statutory national healthcare system - the Krankeskasse - insures the Kassenpatienten, about 90 percent of the population.

Various national health insurers - BEK, DAK, AOK - compete for the lucrative business of catering to the needs of an ageing and affluent population. Healthcare provision is even more diversified: some providers are federal, others regional, local, voluntary, or private.

In "Healthcare Reform in Germany in Comparative Perspective", Christina Altenstetter of the Graduate School and European Union Studies Center of the City University of New York, summarizes the principles that guided German healthcare since 1883:

"... Membership in the national health insurance program is mandated by law; the administration of the health insurance program is delegated to non-state bodies with representatives of the insured and employers; entitlement to benefits is linked to past contributions rather than need; benefits and contributions are related to earnings; and financing is secured through wage taxes levied on the employer and the employee."

German bureaucracies implausibly combine efficiency with red tape. The healthcare system is no exception. It has been running smoothly since Bismarck's days. The national insurers issue to their members "Krankenscheine" - booklets with coupons or vouchers. Many of them also help obtain the indispensable social security (i.e., identity) card.

Insured patients are entitled to one free consultation every 3 months. The coupon used in lieu of payment is redeemed by the insurance company which pays the doctors. Recognizing the dangers of over-visitation and over-consumption of free services and drugs, in Germany patients partly pay for everything else - from medicines to corrective contact lenses.

Hospital admittance - to both private and public facilities - is conditioned upon referral by a doctor. This apparently onerous demand served to virtually eliminate waiting lists together with the hypochondriacs, factitious disorders, and impostors that infest hospitals elsewhere.

"We have free choice of physicians, we have practically no waiting lists" - bragged Prof. Friedrich Breyer of the University of Konstanz in an interview to the BBC. He added wryly: "I wouldn't call the (British) NHS the envy of the world." Germany spends c. 8 percent of its larger GDP on public healthcare - 40 percent more than Britain. Add to this private expenditure on health and the figure balloons to 12 percent of GDP - almost twice Britain's.

British Conservatives are so impressed that they dispatched their Health Spokesman, Dr. Liam Fox, MP, on a fact-finding mission to German wonderland.

The BBC ("On the Record", December 2001) marvels that two thirds of German patients with prostate cancer survive five years after diagnosis - compared to less than one half in Britain. With leukemia, two fifths of German patients live on for five years - but only 28 percent of Britons do.

Patients can change doctors once a quarter. Within each quarter they require a referral from their original physician. This hybrid system of doctor-referral cum autonomous choice combines the best of both the General Practitioner (GP) model - and the self-referral model.

But not all is wunderbar.

Germany's healthcare market is consumer-tilted (it is called "patient orientation"). Healthcare providers are subject to rigorous quality inspections and, too often, meddlesome micromanagement. Suppliers - like medical device manufacturers - are less cosseted.

Jacoti Insights publishes "Mapping the Maze through Germany". The latest controversial healthcare reforms suppressed sales throughout the $10 billion sector in the last three years - despite a market receptive, not to say addicted, to new technology.

The reform consists of the introduction of the DRG - Diagnosis Related Group - case-based reimbursement system as of January 2004. It is only the latest in a series of panicky cost containment initiatives. Cost awareness has caused the number of hospitals in Germany to decline considerably over the last decade. Many facilities became more specialized.

According to a report by Thorsten Korner and Friedrich Wilhelm Schwartz from the Hanover medical School ("Recent Healthcare Reforms and Hospital Financing in Germany"), the country has 7 beds per 1000 people and a hospital occupancy rate of 80 percent.

This represents a massive decline from 1991 - of 15 percent in the western Lander and 25 percent in the eastern Lander. Another 2 beds per 1000 people can be found in - mostly private - preventative and rehabilitative centers. One quarter of more than 2000 hospitals - but only 7 percent of all beds - are private. Still, as the public sector shrank by one quarter - the private sector mushroomed by 60 percent.

More than a million people (in a population of just over 80 million) work in healthcare - one eighth of them physicians. These figures mask a 10 percent contraction of the private health sector workforce - compared to 5 percent in the public segment. Thus, the average staffing per bed is one of the lowest in the OECD.

The number of doctors increased by 10 percent in the last decade but all other medical professions - including nurses - suffered sharp cutbacks. Moreover, despite an increase of admissions by 9 percent in the west and 30 percent in the east - the average length of stay has dropped precipitously by 25 percent in the west and 35 percent in the east.

Many hospitals find it difficult to adjust to the new, profit and loss (deficit) orientated environment. Mini-"revolutions" such as fixed budgets, prospective payments, and the shift from in-patient to out-patient treatments as represented by ambulatory surgery, integrative care, and disease management initially met with stiff resistance.

The forthcoming transition to case-fee reimbursement, for instance, forces hospitals to invest massive amounts of resources in information technology and re-training. This led to a wave of mergers, alliances, and acquisitions.

It wasn't always this way. A 1972 law on hospital financing provided hospitals with a "full cost coverage". The state footed all investment bills while the various "sickness funds" and private patients financed all the operational costs. The resulting growth in healthcare costs was exponential.

The "Health Insurance Cost Containment Act" of 1977 tried in vain to stem the flood. Contributions by the funds were effectively frozen. When this failed, an increasingly alarmed Bundestag tried a variety of solutions in 1989, 1993, 1996, 1998, 1999, and 2000: sectoral budgets, price lists for providers, reference prices for medicines, cost limits on procurement of medical technology, restrictions on the number of physicians per geographical unit, and, finally, unpopular co-payment schemes.

While expenditures per capita stabilized - contribution rates skyrocketed by 40 percent between 1975 and 1999. As the population ages, demand for healthcare is likely to increase. As technology invades every nook and cranny of medicine, further investments are required. As costs skyrocket, budget tightening and micromanagement will increase together with a commensurate shift of power from physician to administrator.

To cap it all, Christina Altenstetter notes the possible conflict with the European Union:

"... It is difficult to predict the future role of the European Court of Justice in raising the question whether national fees schedule and benefits catalog are a violation of free trade because corporatist decision-making by German organized medicine and sickness funds is in conflict with European competition policy. If the Court were to rule on this issue against corporatism and price fixing in national practices, impressive changes can be anticipated (in the) long term."

German healthcare is comprehensive and efficient. It is also unsustainably expensive. Patients pay twice - indirectly through their heavy taxes and directly in medical fees and the cost of medicines. A guild-like, corporatist approach still stifles the competitive provision of services.

The hidden costs of such monopolistic and cartel behavior is best evident in ambulatory surgery. Only recently were hospitals allowed to provide this service - previously the preserve of the ambulatory care services. Now half of all hospitals have ambulatory surgery units and the costs of most such procedures has fallen off a cliff.

Hedging Foreign Exchange Risks (Case Study of Macedonia)

The exchange rate of the Macedonian Denar against the major hard currencies of the world has remained stable in the last few years. Because of the IMF restrictions, the local Narodna (Central) Bank does not print money and there are no physical Denars in the economy and in the local banks.

Thus, even if people want to buy Foreign Exchange in the black market, or directly from the banks - they do not have the Denars to do it with.

The total amount of Denars (M1, in professional financing lingo) in the economy is around 200,000,000 USD, according to official figures. This translates into 100 USD per capita. Thus, even if each and every citizen of Macedonia were to decide to convert ALL their Denars to Deutsch Marks - they would still be able to buy only 150 DM each, on average. These tiny amounts are not sufficient to raise the rate at which DMs are exchanged for Denars (=the price of DMs in Denars).

But will this situation last forever?

According to economic theory scarcity raises the price of the scarce commodity. If Denars are rare - their price will remain high in DM terms, i.e. they will not be devalued against the stronger currency. The longer the Central Bank does not print Denars - the longer the exchange rate will be preserved.

But a strong currency (the Denar, in this case) is not always a positive thing.

The Denar is not strong because Macedonia is rich. The country is in a problematic economic situation. The banking system is perilous and unstable. The reserves of foreign exchange are minimal - less than 30 million USD.

The currency is stable because of externally imposed constraints and an artificial manipulation of the money supply.

Moreover, a strong currency makes goods produced in Macedonia relatively expensive in outside, export markets. Thus, it is difficult for Macedonian growers and manufacturers to export. When they sell their goods in Germany, they get DM for them and when they convert these receipts into Denars - they get less then they should have if the Denar reflected the true relative strengths of the two economies: the German one and the Macedonian one.

They pay expenses (e.g.: salaries to their workers, rent, utilities) in Denars. These expenses grow all the time as true inflation grows (as opposed to the official rate of inflation which is suspiciously low) - but they keep getting the same amount of Denars for their produce and products when they convert the DMs which they got for them.

On the other hand, imports to Macedonia become relatively cheaper: it takes less Denars to buy goods in DM in Germany, for instance.

Thus, the end result is a growing preference for imports and a decline in exports. In the long term, this increases unemployment. Export is the biggest driving force in creating jobs in modern economies. In its absence, economies stagnate and dwindle and people lose their jobs.

But an unrealistic exchange rate has at least two additional adverse effects:

One - as a rule, various sectors of the economy borrow money to survive and to expand.

If they expect the local currency to be devalued - they will refrain from taking long term credits denominated in hard currencies. They will prefer credits in local currency or short term credits in hard currencies. They will be afraid of a sudden, massive devaluation (such as the one which happened in Mexico overnight).

Their lenders will also be afraid to lend them money, because these lenders cannot be sure that the borrowers will have the necessary additional Denars to pay back the credits in case of such a devaluation. Naturally, a devaluation increases the amounts of Denars needed to pay back a loan in foreign currency.

This is bad from both the macro-economic vantage point (that of the economy as a whole) - and from the micro-economic point of view (that of the single firm).

From the micro-economic point of view short term credits have to be returned long before the businesses which borrowed them have matured to the point of being able to pay them back. These short term obligations burden them, alter their financial statements for the worse and sometimes put their very viability at risk.

From the macro-economic point of view, it is always better to have longer debt maturities with less to pay every year. The longer the credits a country (single firms are part of a country) has to pay back - the better its credit standing with the financial community.

Another aspect: foreign credits are a competition to credits provided by the local banking system. If firms and individuals do not take credits from the outside because they fear a devaluation - they help to create a monopoly of the local banks. Monopolies have a way of fixing the highest possible prices (=interest rates) for their merchandise (=the money they lend).

Access to foreign credits reduces domestic interest rates through competition with the local credit providers (=banks).

It would be easy to conclude, therefore, that it is an important interest of a country to be open to foreign financial markets and to provide its firms and citizens with access to sources of foreign credits.

One important way of encouraging people (and firms are made of people) to do things - is to allay their fears. If people fear devaluation - a responsible government can never promise not to devalue its currency. Devaluation is a very important policy tool. But the government can INSURE against a devaluation.

In many countries of the West, one can buy and sell insurance contracts called forwards. They promise the buyer a given rate of exchange in a given date.

But many countries do not have access to these highly sophisticated markets.

Not all the currencies can be insured in these markets. The Macedonian Denar, for instance, is not freely convertible, because it is not liquid: there are not enough Denars to respond to the needs of a free marketplace. So, it cannot be insured using these contracts.

These less privileged countries establish special agencies which provide (mainly export) firms with insurance against changes in the exchange rates in a prescribed period of time.

Let us examine an example:

The firm MAK buys combines and tractors from Germany. It has to pay in DMs.

An international development bank offered to MAK a loan to be paid back in 7 years time in DM.

Today, MAK would be so afraid of devaluation, that it would rather pay the supplier of the equipment as soon as it has cash. This creates cash flow problems at MAK: salaries are not paid on time, raw materials cannot be bought, production stops, MAK loses its traditional markets - and all in order to avoid the risks of devaluation.

But - what if the right government agency existed?

If governmental insurance against devaluation existed - MAK would surely take the 7 year loan. It would take, let's say, 10 million DM.

MAK would apply to the governmental agency with its business.

It would pay the government agency a yearly insurance fee of 2.5% of the remaining balances of the loan (as it is amortized and reduced with each monthly payment). This would be considered a proper financing expenditure and the firm will be allowed to deduct it from its taxable income.

The government will provide MAK with an insurance policy. An exchange rate (let us say, 30 Denars to the DM) will be stated in the policy.

If - at the time that MAK had to make a payment - the rate has gone above 30 Denars to the DM - the government will pay the difference to MAK in DM. This will enable MAK to meet its obligations to its creditors.

MAK will be able to cancel this insurance at any time. If, for instance, it suddenly signs a major contract with a German buyer of its products - it will have income in DM which it will be able to use to pay the loan back. Then, the government insurance will no longer be needed.

This very simple government assistance will have the following effects:

a. It will encourage firms to obtain foreign credits.

b. It will create competition to the local banks, reduce interest rates and encourage a wider and better range of services offered to the public.

c. It will encourage foreign financial institutions to give loans to local firms once the risk of re-payment problems due to a devaluation is minimised.

d. It will place Macedonia in the ranks of the more developed and export oriented countries of the world.

e. It will facilitate activities with longer term credits (such as modernization of plants for which longer terms of payments are required).

As time goes by, the private sector may step in and supply its own insurance against devaluation.

Insurance firms the world over do it - why not in Macedonia which needs it more than many other countries?

Hospitals

Hospitals are caught in the crossfire of a worldwide debate. Should healthcare be completely privatized - or should a segment of it be left in public hands? As the debate infects countries adhering to the "social model of capitalism" (e.g., Scandinavia and France) and spreads to countries in transition in Central and Eastern Europe - it is worthwhile to study the experience of the bellwether in privatized health care: the USA.

Of the many mutations of the hospital, most people experience the Public Hospital. These are all-purpose, universal, and all-pervasive (inpatient and outpatient) institutions, which service even the indigent, criminals, illegal aliens, and members of the minorities.

Public hospitals are the descendents of almshouses, poorhouses, correction facilities, and welfare centers. Like other modern fixtures - the university, the school, the orphanage - most hospitals were originally run by the church and included a medical school.

Later on, local communities established their own hospitals. As the functions (and area) of these initially modest facilities expanded, hospitals were gradually taken over by regional authorities and state governments. Federal funding for hospitals - in the form of Medicaid and Medicare - is relatively new and dates back only to LBJ's (President Lyndon B. Johnson) Big Society in 1965.

Hospitals are now reverting to communal management. Bruce Siegel, President and CEO of Tampa General Hospital, notes in "Public Hospitals - A Prescription for Survival" that between 1978 and 1995 the number of government-owned acute care public hospitals declined by one quarter.

Most hospitals were or are being transformed into small, communal, suburban or rural facilities. In the USA, less than one third of hospitals are in inner cities and only 15%

have more than 200 beds. According to the American Hospital Association, the 100 largest hospitals averaged a mere 581 beds in 1995.

Public hospitals are in dire financial straits. Even in the USA, one third of their patients do not pay for medical services (compared to less than 5 percent in private hospitals). Medicaid barely - and belatedly - covers another third. Yet, the public hospital is legally bound to treat one and all.

In other countries, national medical insurance schemes, the equivalents of Medicare/Medicaid in the USA, (e.g., the NHS in Britain), or mixed public-private ones (e.g., Kupat Kholim or Maccabbee in Israel) provide fairly extensive coverage. Community medical insurance plans are on the rise in both the USA and Europe. Corporate plans cover the rest.

Still, uniquely in the USA, many potential patients remain exposed. More than 40 million Americans have no medical insurance of any kind. A million new disenfranchised join their ranks annually. This despite sporadic - and oft-unsuccessful - initiatives, on the state level, to extend insurance - in lieu of charity care - to the uninsured.

This kind of deprived patient often consumes less profitable or loss leading services such as trauma care, drug-related treatments, HIV therapies and obstetrical procedures. These are lengthy and costly. Private healthcare providers corner the more lucrative end of the market: hi tech and specialty services (e.g., cardiac surgery, cosmetic surgery, diagnostic imagery).

In "Our Ailing Public Hospitals - Cure them or Close Them?" published in "The New England Journal of Medicine", J.P. Kassirer mentions that public hospitals provide "culturally competent care". This fashion is the bane of public medicine. Providers are expected to deliver to their patients a politically correct package of social services and child welfare on top of the inanely expensive - and frequently unpaid for - medical treatment.

"Essential Community" hospitals are heavily dependent on public funding. State governments foot the bulk of the healthcare bill. Public and private healthcare providers pursue this money. In the USA, a majority of consumers organized themselves in Healthcare Maintenance Organizations (HMOs).

The HMO negotiates with providers (=hospitals, clinics, pharmacies) to obtain volume discounts and the best rates. Public hospitals - under-funded as they are - are not in the position to offer an attractive deal. So, they lose patients to private hospitals.

Public hospitals derive more than half their revenues from federal insurance schemes such as Medicaid. This is five times the national average for all types of hospitals. They also benefit from state and local matching funds tied to their Medicaid receipts. This addiction to dwindling - and unreliable - federal and state financing spells doom.

Medicaid Managed Care programs - intended to optimize the use of Medicaid funds - had the dual effect of reducing the coverage rate of public hospitals (i.e., their income per patient) and diverting business to ferociously competitive private ones. Public facilities are closing at a torrential pace.

In some states, one in twenty calls it a day every year. Many states (e.g., New York) and municipalities (e.g., Los Angeles) seriously considered the abolition or privatization of all public hospitals. In some states, private hospitals now enjoy almost as much Medicaid business as public ones. HMO's (Health Maintenance Organizations) have discovered Medicaid as well.

Yet, private, for profit hospitals, discriminate against publicly insured (Medicaid) patients. They prefer young, growing, families and healthier patients with Medicaid, Blue Cross/Blue Shield, or commercial medical insurance. These clients gravitate out of the public system, transforming it into an enclave of poor, chronically sick patients.

This, in turn, makes it difficult for the public system to attract human and financial capital. It is becoming more and more desolate, under-staffed, and poorly-qualified.

But public hospitals are partly to blame for this sorry state of affairs.

There are striking similarities between these decrepit institutions all over the world. Public hospitals in New York are often indistinguishable from their counterparts in Ljubljana, Moscow, Tel-Aviv, or Skopje. Their bloated management and heavily unionized staff are opaque and non-accountable. They refuse to measure up to performance targets lest their revenues and remuneration be linked to the results.

No one can tell how (in)effective and (non-)productive public hospitals are. There are no reliable statistics regarding the most basic parameters of service quality, such as wait times. Financial reporting and network development are dismal. As even governments are transformed from "dumb providers" to "smart purchasers", public hospitals must reconfigure, change ownership - privatize, lease their facilities long term - or perish.

But privatization is far from being a panacea.

It is difficult to imagine the private sector - private hospitals and HMO's - assuming the full load of patients now treated by the public sector. To start with, existing laws would have to be changed in constitutionally dubious ways. It is even more difficult to conceive of the government as a ideal and long-term "smart purchaser" of healthcare services from the private sector. Additionally, to cover all the uninsured would cost a fortune. The communities that phased out public hospitals in favor of Medicaid managed care suffered greatly according to various studies.

Siegel notes that there is no data to support the contention that public hospitals provide inferior care at a higher cost - and, indisputably, they possess unique experience in caring (both medically and socially) for low income populations. He poses the following questions:

- What are the costs and quality of public hospitals relative to their non-government peers in selected cities? These data would need to be adjusted for case mix, socioeconomic status, degree of teaching activity and other variables.

- What segment of the public hospital market has been "captured" by competing HMOs and non-government hospitals? What are the risk profiles of these segments?

- What are the legal obligations of health care providers to treat indigent patients in selected states?

- Where public services have closed or been privatized, what is the impact on access to care for the Medicaid and uninsured populations? What is the impact on remaining providers?

- What lessons can be learned from major cities and counties that lack publicly owned health care systems?

In the absence of factual answers to these questions, the arguments boil down to differences in worldview and politics. Is healthcare a fundamental human right - or a commodity? Should healthcare be left to the invisible hand and distributive justice of the market? Should prices serve as the mechanism of optimal allocation of healthcare resources - or are there other, less quantifiable, but pertinent parameters?

Whatever the philosophical predilection, healthcare should be reformed. Siegel and Altman and Brecher ("Competition and Compassion - Conflicting Roles for Public Hospitals") survey the landscape of hospital reform in the USA:

Public hospitals are increasingly governed by healthcare management experts who are likely to emphasize clinical and fiscal considerations - and not by politicians. This is coupled with the vesting of authority with hospitals, taking it back from local government.

Some hospitals are organized as (public benefit) corporations with enhanced autonomy (e.g., Memphis Regional Medical Center). Others organize themselves as Not for Profit Organizations with independent, self perpetuating boards of directors.

This is often coupled with increased transparency and accountability. Clear quantitative criteria are applied to the use of funds. Some hospitals started by revamping their compensation structures to increase both pay and financial incentives to the staff and thus attract talented people. In these reformed institutions, pay is linked to objectively measured performance and skills-related criteria. A system of bonuses, incentives, and - more rarely - penalties has been applied to senior management.

The management of many public hospitals is trained now to use rigorous financial controls, to improve customer service, to re-engineer processes and to negotiate agreements and commercial transactions. In some cases, staff is employed through employment contracts with clear severance provisions that allow the management to take commercial risks.

All this cannot be achieved without the full collaboration of the physicians employed by the hospitals. Their very profession is being revolutionized. Siegel:

"Most major public hospitals obtain a majority of their physicians through affiliations with nearby medical schools ... But the nature of these contracts and of health care has changed. Public hospitals are now under intense pressure to improve continuity of care, expand primary care capacity, reduce lengths of stay and meet a host of managed care and budgetary constraints. It will be impossible for them to do this so long as the physicians who make the bulk of the clinical decisions practice in ways that are not aligned with the imperatives of managed care and capitation. Physicians must adapt their styles of practice and accept an emphasis on absolute productivity."

Some hospitals in the USA (e.g., Cambridge Hospital in Massachusetts) formed business joint ventures with their own physicians (PHO - Physicians Hospital Organizations). They benefit together from the implementation of reforms and from increased productivity. Scheduling of patient-doctor appointments, laboratory tests, and surgeries are computerized. Obsolete information systems replaced. Long turnaround times and redundant lab tests and medical procedures eliminated.

According to various studies published in "Modern Healthcare", public hospitals have been downsizing for well over a decade now. They reduced their labour costs from more than 70 percent of their budgets 8 years ago - to less than 60 percent today. Many cut their labour force by half. Union membership is on the decline.

Public hospitals all over the world are transforming themselves into outright businesses.

They lease to their physicians - for use in their private, after-hours, practice - space (e.g., operating theatres) or time slots, or underutilized equipment. This kind of arrangement cropped up in countries as diverse as Israel and Macedonia, Russia and Germany. The lessee physician pays the hospital - either in the form of fixed fees or in the form of revenue sharing (franchise arrangement).

In some countries, the physician also commits himself to provide community-oriented, non profit or pro bono services in return for the right to use what is, essentially, community property.

Another method of using the hospital's excess capacity is to sell it, rent it, or lease it to entrepreneurs who are not members of the hospital staff: small laboratories, specialty medical services, primary care, and specialist practitioners. All these make use of the superior infrastructure of the hospital under a concession, a franchise, or a rental arrangement.

The hospital provides these professionals with a "captive market" of patients. This is very much like the relationship between an "anchor" in a shopping mall and the small retail shops surrounding it.

Hospitals - mainly in eastern Europe - also sell medical - and, sometimes, non-medical - products and services to the community on a commercial, competitive basis. Some hospitals offer for-pay medical legal services, or print jobs by the hospital's print shop. They operate the hospital's social services as a profit centre, offer medical consultancy on a fee per service basis, and even sell food from the hospital kitchen through a catering service, or data to researchers from its archives.

A hospital is a galaxy of small (to medium) size businesses operating under one organizational roof. Laundry, cleaning services, the kitchen and its attendant catering functions, the provision of television sets and telephones to patients, a business centre for the inpatient businessmen - these are all profit or loss centers.

"Internal privatization" (or intrapreneurship) transforms the hospital into a holding company. This holding company owns and operates a host of business entities. Each such entity constitutes a separate contractor which provides the hospital with a service or a product.

Thus, all laundry is done by a company which charges the hospital for its services. The same goes for the kitchen, the print shop, the legal services department and so on. These corporations employ the former staff of the hospital. This way, institutional knowledge and experience are preserved.

These corporations, owned by former employees, usually maintain a "right of first refusal" in the first five years following the transformation. They are allowed to match the best offers obtained in yearly tenders conducted by the hospital. They are also allowed to offer their services to other customers. Thus, they reduce their dependence on one client, the hospital. They become truly entrepreneurial entities, competing for profits in a market environment.

A part of the re-engineering process is to determine which of the roles of the hospital are "core competencies". All "non-core" functions are outsourced in a tender to the most competitive bidders. The hospital is likely to benefit from the transfer of these functions, in which it has no relative competitive advantage, to expert outsiders. This is somewhat akin to international (free) trade, where each nation optimizes its resources and passes the (beneficial) results to its trading partners.

To control this kind of transformation, medical information management systems need to be introduced. These improve both the quality and the quantity of data available to the management of the hospital and, as a result, the decision making process.

This makes it easier for the management to pinpoint which areas require doing what - for instance, what kind of incentives should go to which members of the staff, where could costs be cut, and where and how could productivity be improved.

Finally, a novel concept is emerging. Universities and hospitals are two important repositories of human knowledge and experience. Virtually every hospital somehow collaborates with an academic institution, or with a medical school.

But, during the last two decades, hospitals have re-cast themselves in the role of partners to the commercial exploitation of the results of research conducted within their premises or with their co-operation. Hospitals now collaborate in pharmaceutical, medical, genetic and bioengineering studies. Hospitals believe that by refraining from getting commercially involved - they give up money which really is not theirs to give up in the first place.

Large hospitals also entered the managed care market - where laws permit it. Some have established MCOs (Managed Care Organizations of patients). Others insure patients outright and market their services directly. Most hospitals now maintain their own network of suppliers. HMO's are inevitably less than thrilled with the emergence of these new competitors - but this process of disintermediation is thought to have increased both the profit margins and the absolute profits of public hospitals.

Public hospitals also pool resources to benefit from advantages of scale. They relegate services - from auditing and accounting to political lobbying - to commonly owned or merely centralized service providers. These providers also negotiate contracts with suppliers and specialists on behalf of the hospitals.

Some observers decry the apparent convergence between public hospitals and their private brethren. Such derision is misplaced. Public hospitals still treat the destitute and the immigrant. They still provide a medical safety net where no alternative exists. They are just doing it better, more rationally, and more cheaply. They should do more to open up to scrutiny. They should spin doctor. They should streamline. But one thing they should not do is regress to where they have been in the early 1990's. This is what the doctor ordered.

Human Trafficking

Human trafficking is a sterile term, used to mask the grimmest of realities. Popular culture - from Peter Robinson's police procedural "Strange Affair" to the film "Taken" - captures the more sensationalist dimensions of this vile and pernicious phenomenon: the coercion or abduction or of young girls (some of them minors) and their forced conversion into prostitutes. But there is a lot more to it than that.

Enter Vladimir Danailov, who is currently running a law office in Skopje, Macedonia.

He served as a National Legal Officer in the International Organization for Migration - Mission in the Republic of Macedonia for six years (from 2000-2006), and found himself involved in the counter trafficking capacity building projects for the local Police and Judiciary.

He spent years in analysing and researching the multifarious facets of human trafficking and his professional opinion is often sought. He is an author of books on human trafficking problems, among which is: "Handbook for Public Prosecutors regarding Prosecution of the Human Trafficking Crime" (2005), published within the training program for Public Prosecutors, Police officers, and Judges. The book actually summarizes the Case Management Training program and analysis he had performed and deals with methods for the eradication of the crime of organized human trafficking.

SV: What is human trafficking and what is the difference between it and other forms of slavery and prostitution?

VD: Human trafficking or Trafficking in Persons should be understood primarily as a serious violation of fundamental human rights and freedoms: the right not to be held in slavery or servitude, the right to liberty and security, the right to be free from cruel or inhumane treatment and the freedom of movement.
Inconsistent in the past, the description of the crime has expanded and evolved beyond its historical characterizations as the realities of the movement of, and trade in people changed. Consequently, under the term "trafficking in human beings" already used in early twentieth century treaties and conventions, a separate international legal regime has gradually emerged.

In this regard, the so called "Anti-Trafficking Protocol" as a supplementing protocol to the UN Convention Against Translational Organised Crime, (full title: *UN* ***Protocol to Prevent, Suppress and Punish Trafficking in Persons, especially Women and Children***, opened to signature in December 2000), represents a major development in international law. It was the first time a consensus definition of trafficking in human beings has been achieved within a legally binding international instrument.
In this Protocol (Also known as the Palermo Protocol), trafficking is viewed as a contemporary form of slavery, which involves a **variety of acts** (recruitment, transportation, transfer, harbouring, receipt of person), **actors** (several intermediaries are often involved in the trafficking chain), **coercive means** (threat or use of force or other forms of coercion, abduction, fraud, deception, abuse of power or position of vulnerability, etc) and **exploitative purposes** (forced labour or services, slavery or slavery-like conditions, sexual exploitation, etc). These four elements, cumulatively, describe the essence of the human trafficking crime.
This means that each of these parts has to be completed and interrelated, or linked, in order for the crime of Trafficking in Human Beings (THB) to occur. Stated another way: the *activity* must be realized by one of the *means* and both must be linked/tied to achieving the exploitative *purpose.* If any one of the three categories is absent, then the crime of trafficking has not been committed (except where minors are involved when the coercive elements are not required).
For the purposes of this Protocol: "trafficking in persons" shall mean the recruitment, transportation, transfer, harbouring or receipt of persons, by means of the threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position

of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a minimum, the exploitation of the prostitution of others or other forms of sexual exploitation, forced labour or services, slavery or practices similar to slavery, servitude or the removal of organs;
(b) The consent of a victim of trafficking in persons to the intended exploitation set forth in subparagraph (a) of this article shall be irrelevant where any of the means set forth in subparagraph (a) have been used; (c) The recruitment, transportation, transfer, harbouring or receipt of a child for the purpose of exploitation shall be considered “trafficking in persons” even if this does not involve any of the means set forth in subparagraph (a) of this article; (d) “Child” shall mean any person under eighteen years of age.
The effective prosecution of the human trafficking crime in the region or beyond requires a unified understanding of this type of very serious crime with a recognition of its constitutive elements, including all the necessary governmental measures to be adopted for its proper and effective prosecution and suppression.
With this goal in mind, the Palermo Convention (UN Convention Against Transnational Organised Crime) and its two supplementary protocols (which deal with Human Counter-trafficking and Counter-smuggling), gave rise to the intensive process of legislative harmonisation in the region. Nowadays, 8 years after this instrument was opened to signature in 2000, we may say that we have significant efforts in place to unify and harmonise the criminal recognition of the phenomenon region-wide.

As a result of this, in the Macedonian Criminal Code in January 2002, a new article on human trafficking has been introduced (Article 418-a). In spite of the enormous importance of its adoption, the new Article has commonly been understood as constituting only a partial fulfilment of the country's obligation to ensure the appropriate criminalization of THB as a separate and serious criminal offence.

A further legislative process of amending/revising Article 418-a on human trafficking tended to ensure its conformity and compliance with the existing UN definitions, providing for strengthened penalties for organising trafficking, as well as for invoking, encouraging and supporting the crime of THB, in accordance with the relevant international instruments (see footnote).

This process builds also upon previous amendments of the article, which encompassed other forms of exploitation (like forced marriages, exploitation for pornography, forced fertilization, and illegal adoption).

The last amendments of the national Criminal Code and Procedure were enacted in January 2008. A lot has been done by the Macedonian authorities and Macedonian law enforcement has at its disposal now a rather appropriate and well defined legislative tool for effectively fighting against human trafficking (and migrant smuggling) crimes.

In terms of the **difference between human trafficking and prostitution,** it is worthwhile to mention that in the period before the formal signature of this instrument (2000), there was quite a misperception of the human trafficking crime and it was confused with the phenomenon of prostitution, where victims of THB were treated as foreign prostitutes with illegal stay, and were regularly fined and expelled. This was mainly owing to the fact that the most common manifestation (form of exploitation) of the crime of human trafficking in the region was for the purpose of sexual exploitation i.e. forced prostitution. The other forms of exploitation as foreseen by the Protocol, such as forced labour, slavery, servitude, and illegal removal of human organs were rarely or never encountered.

This is why, in Macedonia's case, the amendment of the Criminal Code with the introduction of the article on human trafficking, anticipated also other possible forms of labour-related exploitation, such as forced and illegal adoption, forced fertilisation, and marriage of convenience, in order to render them more easily recognised by the law enforcement.

The main difference between the phenomenon of prostitution and the crime of human trafficking should be viewed through the status of the victim vs. that of the prostitute. The **voluntarily** act of giving one's body and the provision of sexual services for a certain material compensation is a significant characteristic in the determination of prostitution. This element can be recognized by the ability of the individual prostitute to terminate this activity more easily and at will.

In the human trafficking crime, this possibility simply does not exist for the trafficked women, i.e. victims. They have a **system of dependence imposed over them**, which, through threats and other coercive and physical enforcement methods and with the aid of additional artificially-created liabilities (debt bondage), make the victims incapable of freeing themselves from this devious circle of subordination, sexual exploitation and slavery. In this sense, there is a **strong violation** of **elementary human rights and freedoms**, which as such are inalienable, natural and inseparable, and are subject to international protection. Unlike the prostitutes, the victims of human trafficking, i.e. the trafficked women, are not able to enjoy any of these guaranteed basic human rights and freedoms

In addition, the legal treatment of prostitution is varied and ranges from complete legality, through different forms of milder criminalization, to total prohibition, i.e. a ban on prostitution. In legal terms, this means that prostitution is regarded somewhere as a crime, while elsewhere it is not a crime. In some places, its public performance is regarded as a criminal action, and, like in Macedonia, as an act against public morals and order .

It is precisely because of this need for precision that I once again emphasize that human trafficking entails the illicit engagement of the person, by kidnapping, by trafficking and moving, regardless whether it is within or out of the state boundaries. It occurs where the mediators, i.e. the human traffickers, have economic gains or other benefits through the different forms of exploitation established by using various techniques of coercion, intimidation, cheating and threats, and fostering dependence under conditions that break the basic fundamental rights and freedoms of the migrants (victims).

See the Council framework decision of 19 July 2002 on *Combating Trafficking in Human Beings*, OJ L 203, 1/08/2002, p. 0001–0004.

SV: The film "Taken" portrays Albanians as cruel human traffickers. Is the Balkans really a hub of human trafficking? Which countries and ethnicities are particularly and specifically implicated - or is it a multi-ethnic venture that knows no national boundaries?

VD: I saw the film “Taken” and I liked it very much. I consider it very important for broader message outreach when famous actors like Liam Neeson are engaged in its promotion and thus foster public awareness. The film shows one of the *modi operandi* of traffickers: recruitment by kidnapping. It also shows forcible drug addiction as a method of making victims obey orders, while they remain silent, motionless and unable to escape. One part of the movie tackles the fact that drug-related crime and human traffickers use the same routs, which is very true as far as the Balkans go. The victims' suffering is rather realistic and fully depicted, and I agree that these harrowing scenes can have a truly preventive effect on teen-audiences.

In terms of the ethnicity implicated, the Republic of Macedonia has successfully overcome a really challenging period. During the armed conflict in Macedonia in 2000-2001 between the Macedonian Police Forces and the Albanian rebels (later recognised as members of the so-called ONA -Liberation Army of the Albanians), a very negative attitude has been engendered towards the Albanians, singling them out as the main organisers and perpetuators of the human trafficking crime.

The Macedonian Police in that period was not in control of the whole territory of the country, especially the western part of Macedonia, which was predominantly Albanian. This lack of access of law enforcement allowed human trafficking to become a flourishing business in those parts, run mainly by ethnic Albanian bar-owners. In that period, there were a number of night bars, operating in the western part of the country, with an enormous number of girls kept in custody by the local bar-owners. Statistics presented by a respected local NGO “All for Fair Trials”, based on the outcomes of the cases initiated as human trafficking and prostitution offenses, show that almost all of the accused in that period were of Albanian ethnicity. Other ethnicities mainly appeared as accomplices. Such ethnic homogeneity prevailed and continued also during 2005, 2006 and 2007.

Throughout this period, a number of reports published by venerable international magazines, illustrated the expansion of the Albanian Mafia into continental Europe, gaining control over the prostitution business in Italy and with an increased control of the same in London. Czechoslovakia was mentioned on several occasions as a country where Albanians were in charge of the drug business and trafficking in stolen cars. Many of those reports describe Kosovo as drug cartel zone with all the logistics provided for drug, arm and human trafficking routs towards Europe.

These circumstances contributed to the creation of a prevailing attitude during and after the armed conflict in the country, depicting the Albanian ethnicity as especially affiliated with this type of crime in Macedonia and the human trafficking crime as something imported and the outcome of the Kosovo crises and the increased international presence in the region. It was really difficult to argue against such extreme ethnically-based figures and approaches towards the human trafficking crime which might have had a very negative effect upon the reconciliation efforts in that period and the confidence building process developed by the Ohrid Framework Agreement afterwards.

Fortunately, the latest legislative and structural reforms and the training of law enforcement agencies and institutions, as well as energetic anti-corruption measures applied countrywide, have increased the effectiveness of the overall suppression of organised crime, including human trafficking. They also exposed the involvement of other ethnicities, whether as accomplices or in the crimes of corruption, bribery, or abuse of one's official position and duty.

In this respect, the latest publications by IOM (International Organization of Migration) and the data shared by different NG (non-governmental) forums including the above mentioned and respected NGO - Coalition for Fair Trials - based on indictments and court cases analysed, confirmed a balanced and more multiethnic profile of the defendants involved in the offences related to human trafficking. For example: as far as the offences of trafficking in persons (article 418-a, Criminal Code (CC)), the smuggling of migrants (418-b, CC), organizing a criminal group (418-c, CC), and mediation in prostitution (191, CC), the ethnic structure of the defendants in the cases before the Macedonian Basic Courts is: 55% Albanian, 36% Macedonian, and 9% of the defendants belong to other ethnic groups.

In addition, most of the local clients of the sexual services of trafficked women in Macedonia are Macedonians (regardless of ethnicity) and analyses show that Macedonia has provided a sizable market for the "services" of trafficked victims even before the arrival of the international community. Consequently, it stands to reason that the regional organized criminal networks are rather multi ethnic.

This helped in regaining the desired (and recommended) attitude vis-a-vis the human trafficking crime: as a regional phenomenon and as a multi-ethnic venture that knows no national boundaries, and is merely concerned with money and profit. As mentioned in the reports from this period, trafficking to Macedonia can be traced back to the beginning of the eighties when numerous groups of "exotic dancers" from Bulgaria, the Ukraine and Russia already performed dances in the nightclubs in the national capital. These women were effectively victims of trafficking at that time as information obtained from various sources shows that they were already subject to the mechanisms that bind victims to criminal organizations, with the implementation of similar measures of coercion, intimidation, abuse and torture, typical of the criminal groups operating today.

While Macedonia has emerged as a transit and source country (and to a lesser extent, a destination country), this is rather confined to women and children trafficked for the purpose of sexual exploitation (US 2007 Trafficking in Persons Report). The problem of internal trafficking is nowadays becoming more visible.

As mentioned, the recent reports by the Macedonian Ministry of Interior detected and confirmed two prevailing tendencies of the human trafficking crime in the country:

The first is related to the growing numbers of internally trafficked persons.

The second tendency is the increased number of minors among the victims rescued or detected. According to the Ministry of Interior's statistics from this year (January-November 2008), there were 21 cases of detected and suspected traffickers involving minors! Eleven of these were recognized as the victims of trafficking, of which 10 were minors. By comparison, during the same period last year there were three registered cases and 5 victims rescued, of which 3 were minors.

SV: How involved are law enforcement officers, judges, and the state in these crimes in various countries?

DV: It is obvious that such a complex type of crime which is conducted in three disparate phases, i.e. recruitment, transportation (and harboring), and exploitation, cannot be executed solely by organized gangs without the involvement of various levels of state officials as facilitators or accomplices. Based on victim statements, obtained through standardized questionnaires while sheltered, they often point out some illicit involvement of different authorities, related to facilitation in obtaining required documents, visas, work permits, or simply an illegal entry into the territories of various countries during the transportation phase.

In the Republic of Macedonia, the issue of the involvement of the authorities could be roughly divided to two periods, although a very firm line cannot be drawn between them:

- The first period is before and immediately after the official recognition of the human trafficking crime by the national Criminal Code (2002)
- The second period is after the formal adoption and application of the Palermo criminal criteria in the Criminal Code, from 2002 to the present.

The second period is when the national law enforcements agencies and institutions started acquiring effective knowledge as to how to combat the human trafficking crime, using the the new legislative and procedural tools for adequate detection and prosecution. During this period, the national institutional response was getting much more organized: shelters were established for the rescued victims; a national referral system for the victims of trafficking; the adoption of multidisciplinary approaches to processing and assisting rescued victims; improved legislation; specialized police investigation teams; specialized case management training and courses for the police and judiciary; the new special anti organized crime prosecutorial unit was established and so were the tribunals in charge of organized crime cases; new and special investigative measures were introduced; the new Law on Witness Protection was promoted, and so on. This is the period when the prosecution of the human trafficking crime was getting more effective in general.

Of course, there were a number of procedural inconsistencies and corrupt behaviors reported during this period while processing THB caseloads. Many inconsistencies have been denounced by the general public, which provoked the Ministry of Justice to take appropriate actions. The media and the general public gave high marks to the the National Court Council decision regarding the measures taken against the local judge in the Struga Basic Court (Mr. Dimitrija Cobovski) who has dealt inappropriately (between 2000-2005) with a number of indictments against a well known trafficker (Dilaver Bojku Leku) related to human trafficking and organizing and mediating prostitution. Public opinion reacted also against the promotion of a judge (Mr Krste Sivakov) to the Appellate Court in Bitola, despite serious criticisms addressed at him for the unjustified mitigation of a jail sentence for the same accused (Dilaver Bojku), and his early release due to his "effective repentance".

Despite the success stories of effective cooperation among the media, the general public, NGOs (non-governmental organizations) and the authorities, there were a number of inconsistencies reported in dealing with and the processing of human trafficking caseload which are still left without proper attention and counteraction. It is reasonable to believe that similar unjustified "toleration, servility and receptiveness" was also demonstrated by some local judiciary officials towards defendants. Although it can not be fully proved, it is obvious that such obsequiousness and protection are results of corrupt behaviors and collusion developed among different court actors.

One of the most frequently manifested forms of "toleration" of traffickers while on trial is the "ease" with which arguments for postponing and unnecessarily prolonging court procedures are heard. In reviewing the duration and the effectiveness of court proceedings and verdicts reached in the Macedonian courts, we may say that procedural improvements and the update of the criminal provisions aside, the average duration of the procedures for the offences related to the human trafficking crime is still way too long. The postponing of hearings related to the absence of the defendant owing to the improper delivery of summons is still among the prevailing tricks. Many delay tactics used by experienced defence lawyers cause the dragging of cases and the initiation of time consuming procedural measures, compounding the presence of victim-witnesses.

According to the NGO Coalition for Fair Trials, until 2005, human trafficking trials in more than a half of the cases have been postponed for periods of more than 30 days. For example: in 2005, the average duration of the proceedings, from the initiation of the indictment in front of the basic court until the verdict reached or the last hearing completed , was around 305 days.

In addition, during the investigation phases, there were a number of attempts to approach victims-witnesses sheltered in the Transit Center for VoT (Victims of Trafficking), using mediators and sometimes corrupt local police officers with the aim of influencing (intimidating) the victims during their transportation and prior to their appearance in court.

In this regard, it is worth mentioning a situation that has not been investigated thoroughly, of a well founded suspicion for a firm link established between a former investigative police team and the case worker(s) who was working with victims rescued and sheltered. Apparently, the info gathered from the victims' testimonies was unprofessionally maintained and disclosed by the case worker to the corrupt investigators that benefited by informing the perpetrators mentioned in the victims' testimonies and, thus, obstructed the investigation.

The other aspect of the corrupt involvement of judiciary officials, typical of the beginning of this second period, is the problematic interrelations developed between local investigative judges and prosecutors especially in the ethnically mixed or predominantly Albanian (of Macedonian citizenship) areas. This may be called "ethnic corruption" or protection and toleration developed by the local investigation judges of suspects of the same ethnicity. The local investigative judges, acting upon the instructions of prosecutors, were regularly protecting the suspected or accused perpetrators, which were their "ethnic kin and kith". There were a number of cases reported internally, where the local investigative judges were obstructing investigative acts against their local neighbors, or friends. In such situations, the outcome was a prolonged, incomplete, or interrupted investigation, forged or manufactured evidence, suspects who fled "just-in-time", or the submission of very subjective and altered judicial findings.

If the suspect happened to be known as a political fundraiser or donor to any of the Albanian political parties or to former insurgents, the investigative action was usually treated as a local political and security risk.

Based on those findings, the Macedonian authorities have built up an A-team of Public Prosecutors (10 members), with a country-wide remit, to deal especially with organized crime and corruption. It was followed by a similar team of investigators (4) and trial judges (5) for the same offences and by five special courts, assigned to be in charge of the organized crime caseloads. Those measures significantly diminished the possibility of further "ethnic loyalty" and corruption involving judiciary officials on the local level.

An example of an investigation stopped against a former fighter, a member of the Albanian ethnicity, now a respected member of the Macedonian Parliament (Daut Redjepi Leka): Leka was indicted and summoned as an accomplice in a human trafficking crime, Despite the alleged evidence gathered (material evidence, identification and statements of the victim, pointing at him as the man who coerced a pregnant victim from Moldova, working in the night bar “Cafe Europe”, to get rid of her fetus by beating her, forcing her to miscarry, and helping in burying the miscarried child), the investigation has not been completed, evidence gathered is now missing, and the whole case is still a thorn in the public's side.

The other negative manifestation of the politically corrupt involvement of the authorities is the emergence of the spoils system of administration versus the state-mandated merit system (or at least a composite one). This is especially obvious and dangerous within the Ministry of Interior where usually the changes in the governing political structure cause radical shifts in staff, often sacrificing profoundly knowledgeable and already trained faces on all levels. These changes require additional periods for the training of newly assigned personnel and the wasting of donor community funding.

On the other hand, in order to survive and maintain a proper career development path, good police professionals are not immune to political pressures and affiliations. They are often ready to be attached to and be perceived as political fans of or sometime even formal members of the governing parties, securing in this way their position or further professional promotion. The undeclared administrative staff in the police is silently regarded as adherents of the opposition and therefore are marginalized or downgraded. As a result of this situation, which is never addressed openly, police professionalism, education, training and effectiveness suffer. The result of these practices is the long term polarization of police officers on all levels, shifting politically attached teams of professionals around, with professional agendas being regularly "flavored politically". It is really dangerous to predict the consequences to the rule of law if the above internal semi-political constellations within the Police, now replicated in police work in the field, were to create similar political configurations among the criminal groups.

As a result of such activities, a police officer has been arrested recently, (A.C., aged 37, from the Matejce village in the Kumanovo region) on the Macedonian – FR Yugoslav border, who “facilitated” the illegal crossing of trafficked persons and even the return of some victims - illegal migrants who were subjected to expulsion - for a certain amount of money (1500 DM on every occasion).

SV: What are the effects of the crime on its victims?

DV: The effects of the crime on the victims directly depend on the phase in which they have been rescued and processed and on the duration of the exploitation period.

Traffickers lure women and girls into their networks through false promises of decent working conditions at relatively good pay as nannies, maids, dancers, factory workers, restaurant workers, sales clerks, or models. They often transport victims from their home communities to unfamiliar destinations, including foreign countries away from family and friends, religious institutions, and other sources of protection and support, leaving the victims defenseless and vulnerable. With defective travel documents or with none, without proper visas and with an unlawful stay in a foreign country, the victims become submissive and obedient, thus creating an even greater dependence on the traffickers. Almost without exception they are forced to work to pay off their debts “created” by the organizers of the trafficking, ostensibly to cover the “very high amounts paid” for the illegal crossing of borders, for mediation services for job hunting, the issuance of papers, working permits etc. Almost all of them are coerced into “working off” these debts through forced prostitution or labor. The living conditions during “the trafficking journey” include complete isolation of the victims and their inability to communicate with the outside world, with friends, relatives, social or religious groups. The victims are often left without elementary hygienic and technical conditions in the premises used to incarcerate them.

Almost without exception, victims are reported to have been beaten, maltreated, with completely reduced mobility and communication, blackmailed, terrified, forced to engage in sex acts or slave-like labour. Such enforcement usually includes rape and other forms of sexual abuse, torture, starvation, imprisonment, forcible drug addiction, threats, psychological abuse, and coercion. Sometimes they are told that physical harm may occur to them or to others should the victim escape or attempt to escape. It is a fact that in most cases victims in trafficking are exposed to the most brutal violations of basic human rights and freedoms. Frequently, they are treated as animals and objects for trade, exposed to the highest degree of disrespect and lack of dignity and to very serious health risks including HIV and AIDS, completely devoid of any access to medical care.

As the subjects of enormous and brutal psychological and physical abuse, all the rescued victims are in desperate need of professional psychological and medical attention and treatment. Almost without exception during the recovery phase, victim suffer from repulsive affect and behavior, having been exposed for a long time to a system of firm subordination established by the traffickers. That is why the psycho-social therapy has to be individually tailored in order to be persuasive enough in countering the physical abuse suffered, and the strong and frequent flashbacks of rape, torture, maltreatment and threats with firearms, experienced. It is a fiendishly difficult job.

SV: Why do some victims, having been rescued and repatriated, allow themselves to be trafficked yet again?

DV: This issue should be analysed on two levels. One is the fact that direct assistance, protection and repatriation programs implemented in the transit countries and the final destinations have always attracted funding and preferred by the donor community. There is a variety of protection programs and schemes that have been successfully implemented in the region, assisting governments in transition to meet the required standards in these areas as part of their EU harmonisation priorities and stabilization and association programs.

The IOM program of protection and assistance and the voluntary repatriation of victims rescued in the Republic of Macedonia has been one of the more successful in the region. The capacity building components of many projects implemented here have contributed to a rather speedy, adaptive and organised institutional response by the Macedonian authorities in preventing, combating and suppressing the human trafficking crime on its territory.

Other NGOs active in this region have also regularly reported similar stories of success. But all of these projects and technical assistance programs, funds and assets spent, have been lopsided, empahsizing the countries of final destination or the transit countries, which means that all of them were (and still are) predominantly tailored to cure the negative consequences of THB. The amounts allocated by the international community through different programs reflect a rather imbalanced approach from the very conception and did not sufficiently address the roots of the human trafficking crime, i.e. the recruitment zones, the countries of origin, where trafficking journeys usually start.

Not enough attention has been given to the amelioration of the repercussions of the so called push-pull factors within the countries of origin and their environments: mainly, the all-pervasive poverty and the very limited and undeveloped absorption capacities of the local economy, resulting in scarce employment opportunities, especially for women; gender issues and equality in those societies (women's restricted access to the labour markets); restrictive visa regimes; and so on.

Addressing these root causes in the countries of origin would have had a significant preventive effect and would have made it more difficult to recruit new victims in the trafficking chain. It would have allowed those who have been repatriated to get steady jobs or perspectives preventing them from new dangerous adventures. One should not forget that the lingering debts of trafficked victims who have returned home, combined with their continuing need to support their family members, make it more likely for them to migrate again with hopes of earning easy money. Regretfully, many of them end up being re-trafficked.

The other level of analysis is the imbalance between the existing assistance and protection programs for VoT and the voluntary repatriation programs which take place in the final destination or transition countries. The post-repatriation components of most of the protection and assistance programs are still vague and have yet to be developed to be sustainably continued in certain countries of origin. Limited in funding, the post-repatriation and re-socialisation project components are usually designed strictly on a voluntary basis and rely upon the victims' will to attend or be a part of them. This pertains also to the reintegration assistance or vocational training courses organised within the victims' environment. Additionally, those societies are still stigmatising women visiting such rehabilitation and reintegration programs, which indicates their prior status as prostitutes.

Yet, the countries of origin chronically suffer form budgetary constrains and lack of sustainable funding for any local reintegration measures to be feasible. The NGO sector in these countries is not well developed, nor is it qualified and skilled in fundraising issues making it dependent of funding from abroad mainly as a component of programs or projects implemented elsewhere. Although the picture as far as funding is concerned is now slowly changing, the aforementioned observations still remain valid. The intensified process of bilateral readmission state-level arrangements (especially between countries of origin and of destination such as the one signed between Macedonia and Moldova) might make the repatriation process less expensive but cannot resolve the problem of the increased need for proper reintegration and re-socialisation of the repatriated victims.

Bearing in mind all that, it is a really challenging for the victim to find her way after the process of repatriation. Suffering from many frequent and unpleasant flashbacks and a variety of psychological disorders, and left without proper assistance by professionals, many of them cannot get reintegrated successfully and are rejected by the local community. Thus, they easily get recruited back into the trafficking chain by the local tentacles of organised crime.

According to the local IOM Mission in Skopje the following figures were reported: 19 out of 262 victims assisted in 2001 were trafficked in the past; 17 out of 214 assisted victims in 2002 and 14 out of 141 assisted victims in 2003 claimed to have been trafficked before. IOM Skopje has twice assisted 4 re-trafficked victims: two Moldavians assisted in 2003 were assisted by IOM Skopje previously and one Ukrainian assisted in 2004 was assisted previously in 2002. One victim from Belarus was assisted initially in 2000 and then again in 2001. IOM Skopje has also assisted a Romanian victim who was previously trafficked and assisted by IOM Sarajevo.

SV: What is the profile of the typical human trafficking victim? Are there children and Westerners among the victims?

DV: Generally, traffickers primarily target women and girls, who are disproportionately affected by poverty, the lack of access to education, chronic unemployment, gender discrimination, and the lack of economic opportunities in the countries of origin. Most of the victims rescued and assisted originate from the countries of Eastern Europe and especially from Moldova.

Traffickers lure women and girls into their networks through false promises of decent working conditions at a relatively good pay as nannies, maids, dancers, factory workers, restaurant workers, sales clerks, or models.

Traffickers also buy children from poor families and sell them into prostitution or into various types of forced or bonded labor.

The figures and profile of the assisted victims of trafficking rescued on the territory of Macedonia by the local IOM Mission (August 2000- Dec 2007):

YEAR	VoTs FOREIGN CITIZENS ASSISTED by IOM Skopje	VoTs MACEDONIAN CITIZENS Assisted by IOM Skopje
2000	**114**	**-**

2001	**257**	**-**
2002	**220**	**-**
2003	**135**	**1**
2004	**15**	**-**
2005	**3**	**1**
2006	**14**	**3**
2007	**13**	**2**
SUB TOTALS	**771**	**7**
TOTAL 778 victims assisted		

Nationality of the victim's assisted according to the same source

Nationality	**2000-2003**	**2004-2007**
Albania	-	3
Bosnia and Herzegovina	1	-
Bulgaria	28	3
Belarus	11	-
China	-	11
Croatia	1	1
Czech Republic	1	-
Dominican Republic	-	1
Lithuania	1	1
Moldova, Republic of	352	9
Macedonia	1	6
Romania	227	2
Russian Federation	17	1
Serbia	2	7
Ukraine	81	1
Montenegro	-	3

Kosovo	4	2
Total	727	51

Gender and age profile of the victims assisted according to the same source (IOM)

Gender vs. Age Breakdown	**2000-2003**	**2004-2007**
Female	**727**	**40**
Under 14 years	-	7
14 to 17 years	88	7
18 to 24 years	445	17
25 to 30 years	157	5
Over 30 years	37	4
Male	**0**	**11**
14 to 17 years	-	2
18 to 24 years	-	3
25 to 30 years	-	2
Over 30 years	-	4
Total	**727**	**51**

Educational Level of the victims assisted according to the same source

Educational Level	**Number**	**Percentage**
Primary School	192	24.68
Middle / Elementary School	126	16.20
High School	246	31.62
Trade / Technical / Vocational School	78	10.03
College / University	38	4.88

None	18	2.32
Other	42	5.40
N/A	38	4.88
Total	778	100.00

Economic Status- of the victims assisted in the country of origin

Family - Economics Status	Number	Percentage
Well-Off	2	0.26
Standard	119	15.17
Poor	361	46.40
Very Poor	76	9.77
N/A	220	28.29
Total	778	100.00

SV: To what extent do victims enjoy institutional protection in Macedonia?

DV: The legislative harmonization initiated by the currently binding Palermo protocols and the Palermo Convention in general, made a significant positive impact towards a more effective and proper prosecution of the human trafficking crime on the national level. The institutional response in this regard has become more organized and consolidated, along with the fulfilment of all the requirements as proclaimed in binding or related instruments.

The crucial step with regards to **proper housing and assistance** provided to the victims was taken when the former ministry of interior asylum shelter has been reconstructed and reassigned by the authorities to serve as a shelter transit centre for foreign nationals, victims of trafficking rescued on the territory of the country. This Transit Centre was formally opened on April 4, 2001. Since its establishment, the **immediate deportation** and banning of the rescued victims from the territory of Macedonia **has been prevented** as a mandatory processing of all identified victims was implemented through the Transit Centre (TC), granting them (by the new Law on Foreigners) **an extended decriminalised status and lawful stay until they are voluntarily repatriated** to their country of origin.

Within the centre and in coordination with the authorities (the Ministry of Interior and the Ministry of Labour and Social Policy), victims have now started being provided with an **adequate post-traumatic, socially re-integrative and psycho-social therapy** by experts including counselling services by specialized and trained NGOs, which fully corresponds with the standards and requirements proclaimed in the Palermo Protocol and other relevant and related instruments (see footnote).

Once accommodated in these sheltering premises, victims receive appropriate legal advice on their legal status, their rights and obligations in accordance with the existing legislation and, in case they are involved in court hearings or pre-investigative activities, they are provided with free legal counselling, assistance and representation by the team of NGO women lawyers assigned to this centre.

A big step ahead was also the establishment of the **specialised team** of senior police inspectors qualified for the timely detection and prosecution of human trafficking operations within the anti organised crime sector in the Ministry of Interior. Continuing education and training of the police officers of those units, including the new Border Police structures, have been ensured through the

specialised training curricula at the Police Academy and the Centre for Education of the Police Forces, supported by the CARDS funding mechanisms or by various project funding actions of various donors.

On the **inter-ministerial level** a special **National Commission** for Combating Trafficking in Persons and Irregular Migration has been formed on the 27th of February 2001, comprising representatives from different ministries ensuring a multidisciplinary approach to the suppression of the THB crime and its prevention on the national level. The work of the Commission has been facilitated by the establishment of the **Secretariat** as an executive body of the Commission, in 2003.

On 16th January 2002, urged by the Stability Pact, a **special sub-group** for the prevention of the trafficking in **children** started operating within the National Commisison.

Drafted by this Commisison, the Government of the Republic of Macedonia has formally adopted on March 23rd, 2006 a **National Action Plan** and a comprehensive **National Strategy** to Combat Trafficking in Persons.

In May 2005, a **Law on Witness Protection** has been adopted provididng for posibilities for additional protection of victims who serve as witnesses.

The Ministry of Labour and Social Policy established in September 2005 the **National Referral Mechanism for Victims of Trafficking** with the core objective of improving and ensuring that proper victim identification, referral and assistance are systematically carried out. The system, theoretically in place for both international and national victims of trafficking, is for the time being mainly focused on the national caseload. This referral mechanism is also involved in the procedure of appointing guardians for minors who are victims of trafficking, incorporating specially trained teams of the local Centers for Social Care in charge, operating within the Ministry of Labor and Social Policy and the national NGO sector active in this field.

With the support and collaboration of the international donor community, there were a number of campaigns to raise public awareness and of a preventive nature as well as initiatives supported by the national authorities regarding the human trafficking phenomenon, launched and implemented countrywide. Some of them were specially tailored to reach out to particularly vulnerable categories of population, which are exposed to risk.

The Academy for the Continuing Education of Judiciary Officials (judges and public prosecutors) requires an official exam at the end to qualify for election and reelection processes. The Academy's curriculum also includes instruments and best practices in the prosecution of the human trafficking crime.

See also the ***Council of Europe's Recommendation R 2000) 11 on Action against THBs for the Purpose of Sexual Exploitation*** (19 May, 2000) which calls on member states to grant victims a temporarily residence status in the country of destination in order to enable them to act as witnesses during judicial proceedings against offenders " and to provide victims with social and medical assistance

SV: Are the courts knowledgeable and efficient in processing human trafficking cases?

DV: The intensive EU association process compelled the signature and ratification by the Macedonian authorities of a number of new treaties and international conventions, which made them applicable and a part of the national legal system. In order to render national legislation in conformity with all of those instruments, the national laws has been subjected to a process of intensive harmonisation, introducing a number of changes, new articles, and modifications.

Because laws are continually being revised and amended, the process of the continuing education of judges and prosecutors is crucial to the proper functioning of the rule of law in the country.

The involvement of the judiciary, especially trial judges, in educational and training courses for police officers was mainly done on ad hoc basis which caused them to be somewhat inferior as far as the timely acknowledgement of the new treaty requirements regarding human trafficking caseloads. From 2002- 2004, there were court verdicts related to human trafficking offences that have been regarded as rather inappropriate from the punishment point of view. Although 2004 is a turning point in terms of more severe punishment for traffickers, the need for continued education of judges and prosecutors emerged as a priority.

In March 2006, a new Academy for the Training of Judges and Prosecutors was opened in the capital city (Skopje), marking the institutionalisation of an erstwhile ad hoc educational approach previously carried out by the domestic Association of Judges. The establishment of this Academy was an important step in the process of the ongoing overall judicial reform, ensuring the effectiveness and professionalism of the judiciary officials during the application and interpretation of laws and other legal provisions. .

The main purpose of the Academy is to ensure the competent, professional, independent, impartial and efficient performance of judicial and prosecution functions through the selection, organisation, and implementation of initial training for candidates for judges and prosecutors as well as the continuous professional training of judges and prosecutors.

The Academy's training curricula also includes relevant ratified instruments and conventions related to the human trafficking crime. The Academy's educational program for the new candidates and the ongoing refresher courses organized for their active colleagues is allowing the national judiciary to be knowledgeable and aware of all the relevant aspects while processing human trafficking caseloads, among others.

SV: What are the most efficacious deterrents and punishments for human traffickers: monetary fines, confiscation of property, or imprisonment?

DV: Imprisonment is being regularly imposed as the main punishment for convicted traffickers. To effectively combat this crime it is necessary to combine imprisonment with monetary fines and the confiscation of property, thus depleting the resources of organised crime. Regretfully, the last two remedies have been rather poorly applied in practise and do not fully meet expectations. Namely, the monetary fine as envisaged by the Law on Criminal Procedure has been exercised as sporadic punishment next to imprisonment. Additionally, even when imposed, it was usually in an amount that does not reflect the gravity of the crime and could not compensate the victim's claims for psychosocial damage suffered. The confiscation of property, or forfeiture of profits generated by the crime usually amount to the seizure of movable property, money, and vehicles used for the transportation of the victims at the crime scene. Although the law now foresees the confiscation of real estate, none of these remedies have been applied in human trafficking cases, yet.

In general, as observed by some local NGOs, in the period from 2002 until 2004, almost half of prison sentences in the Republic of Macedonia for human trafficking crimes were below the legal minimum (4 years). This evidences the gap between the court practice in that period and the concept of the penal policy of the country to sanction and underline the severity of the crime.

The picture has changed in 2004 when the penal policy has been made more rigorous, but still with a judicial tendency to hover around the minimum imprisonment prescribed.

SV: Victims sometimes serve as witnesses against human traffickers. Having testified, they are usually repatriated. Can you discuss these two complex problems: witness protection and repatriation? How does one make sure that the victims won't fall prey again to human trafficking or be "penalized" by the perpetrators for their testimony?

DV: Since the Article on Human Trafficking in the Criminal Code of Republic of Macedonia has been introduced and applied, the practise confirmed the fact that victims' statements were the most solid and crucial pieces of evidence that effectively led to the locking up of traffickers. Therefore, law enforcement in that period was focused on obtaining and upholding quality victim statements and charges against traffickers until the end of the criminal procedure and the court proceedings initiated. Law enforcement practise has demonstrated that once the victims are rescued and have properly recuperated while sheltered in the transit centre, it was not difficult to sustain such charges and statements, mainly due to sufficient security measures and protection afforded the intimidated witnesses as granted by the national Law on Criminal procedure.

The problems started if the initiated procedures got extended and lasted a long time, during which period the victims-witnesses got repatriated (returned to their countries of origin) even as appeals were not yet consummated and final verdicts not handed down. The principles of "*directness"* and *"contradiction*" (the ability to directly confront the witness and question her under oath) in the Macedonian Criminal Procedure constitute a legitimate right of the defendant (trafficker). They allow him to oppose, challenge, deny and argue the evidence against him brought to the court and to question and oppose witnesses. The need for the repeated and permanent presence of the victims during the whole procedure was a real problem for proper prosecution in that period especially because most of the victims, once repatriated, became part of special social reintegration programs, which regularly prevented them from anything that might lead to re-victimisation or harm the process of their of psycho-social reintegration. In the absence of a crucial testimony, the indictment against the trafficker was difficult to uphold.

On the other hand it was not always easy for Macedonian law enforcement authorities to secure the presence of the victim with the same quality of statements or testimony during the initial and other phases or instances of the trial, especially in terms of the victim's consent (to be exploited by the trafficker) which was seen and regularly interpreted as a radically mitigating circumstance for the accused. This reversal of testimony was mainly due to the fact that that the victim (regardless whether repatriated or still sheltered in the country of destination) may have received threats and got seriously intimidated (even through their families) by the tentacles of organised crime, or by the traffickers' relatives.

A positive step in overcoming the problem regarding the victim's presence was the installation of an audio-visual link between the court and the office of the prosecution in Macedonia on the one side and the corresponding institutions (or via the Embassy) in the victim's country of origin. This was made possible with a donation through a US Embassy supported project in Macedonia.

A positive legislative development with regards to witness protection on the national level was the enactment of the Law on Witness Protection which foresees also possibilities for the victims of trafficking to enter the program if they meet certain criteria and conditions. But, up to now, there hasn't been a victim of trafficking that has entered the national program of witness protection.

Perhaps the most valuable amendment to the Article on Human Trafficking in the Criminal Code was the last one, introduced in January this year (2008). It finally defined the victim's consent as irrelevant for the crime of human trafficking. This actually reinforced the principle highlighted in the Palermo Protocol and the Council Framework Decision that an investigation or prosecution of offences of trafficking in human beings will not depend on reports or accusations made by the persons subjected to the offence (see footnote).

Taken practically, this is expected to alleviate the burden of proof, currently always borne by the victim and her statements. Now law enforcement and investigations focus only on the statements of victim-witnesses as a means to verifying the existing conditions where, additionally, the victim’s abuses are photo-documented and material evidence is gathered carefully and secured independently from the victim’s statement. Furthermore, the relevance of the victim's statements is considered to be merely one instrument among others in support of the prosecution of the traffickers. Such a solution is expected to further ameliorate the pressure and intimidation of victims-witnesses, exerted by organised crime networks and the relatives of the traffickers accused.

Apart from this amendment to the law, it is worthwhile to mention the international cooperation that has developed among law enforcement agencies in the region within the SECI Initiative and its Regional Centre in Bucharest during 2002- 2004. The purpose of the SECI Initiative and the Centre was to improve regional law enforcement cooperation, through the joint activities of police and customs administrations of the different countries involved. This was accomplished by facilitating investigations, sharing experiences, establishing common operations, and continually evaluating and analyzing the crime situation in the region (Operation Mirage). The system of protection of victims as witnesses was also one of the common activities coordinated.

Council Framework Decision from 19 July 2002 on Combating THB 2002/629/JHA

SV: What is the role of NGOs (non-government organizations) in victim rehabilitation and victim interface with law enforcement authorities?

DV: The role of the NGO sector in Macedonia in effectively countering and suppressing the human trafficking crime has been underestimated in the past, when the victim identification process was a solemn right of the Macedonian Ministry of Interior (i.e., the Unit in charge of Human Trafficking, within the Organised Crime sector).

That period was characterise by major cases of rescued victims being treated as foreign nationals and an official attitude of the authorities who denied the existence of any domestic human trafficking caseload. In that period, the national police was rather sceptic and distrustful towards any attempt at joint action or cooperation with NGOs. A few cases of criminal infiltration and illicit intimidation of victims sheltered in the Transit Centre, justified for a while this kind of suspicious and protective police approach.

A deeper, trust-based cooperation and coordination has been achieved within the Transit Centre between the Police and the NGOs involved in the victims' assistance and rehabilitation programs. Under the auspices of the Ministry of Interior, National Commissions, and Secretariat a few specialised and trained NGOs have been entrusted and security-cleared to access the Transit Centre on a daily basis in order to provide regular psycho-social, medical and legal aid to the victims sheltered (in accordance with the requirements set in the Article 5 of the Palermo Protocol).
Each VoT (Victim of Trafficking) accommodated in Transit Centre C (TC) is provided with medical care, treatment and checkups by a non-government medical team, available 12 hours a day and on an on call basis, 7 days a week. With mediation and financial support from various donors, victims are provided with adequate and expert post-traumatic, socially re-integrative and psycho-social therapy and counselling by an appropriate NGO specialized and trained for this type of assistance. In the same manner, VoT accommodated in the TC are provided with free legal assistance, counselling and legal representation. Immediately following their accommodation, victims receive appropriate legal advice on their legal status, their rights and obligations in accordance with the existing legislation and, in case they are invited to a court hearing or to take part in pre-investigative activities, they are provided with free legal counselling, assistance and representation. This enables the victims to obtain - in a timely manner - all necessary advice regarding their rights and obligations as a damaged and plaintiff party; in particular their right to claim compensation, the right to an interpreter and legal defence, i.e. authorized legal representation, at the very

initial stages of the procedure, regardless of the capacity in which they are acting.

This form of coordination and cooperation has been further formalised through the internal endorsement and application of the so-called special Standard Operation Procedures (SOP), developed with aim of regulating all the procedures and internal and external duties and responsibilities of each of the players (state organs, ministries, and NGOs) involved in the referral system developed (see footnote).

The experience gleaned from this period underlined that multiple possible referral sources had no access to the victims prior to their entry into the Transit Centre. Everyone had to solely rely upon the judgment of the police, thus casting in doubt also the eligibility of persons brought to the Transit Centre.

From this perspective, local NGOs, acting on a decentralized level, as well as social centres were suggested and considered as safer and more dignified venues. The Transit Centre also became accessible to other state institutions such as Local Social Care centres who were able to provide appropriate care and social assistance to victims, especially minors in need of appointment of special guardians.

In the meantime, local NGOs reported the existence of a caseload of internal trafficking, persistently denied by the authorities.

Time was getting ripe for more comprehensive action to be undertaken on the national level by expanding the referral mechanisms to cover internal caseloads, too.

As mentioned before, in September 2005, the Ministry of Labour and Social Policy, in coordination with the NGO sector and supported by various donors, established the **National Referral Mechanism for Victims of Trafficking** for processing victims of trafficking in

Macedonia. It is characterized by an improved and multifarious victim identification process, based on secured and systematic victims referrals and assistance schemes countrywide. Although initially focused on the national caseload, this system is now operational for both international and national victims rescued.
The presentation made by the coordinative office of the National Referral System in 2008 confirmed that it is run by a permanent staff of three, together with 58 social workers from 27 social centers countrywide who are available 24 hours a day, for the purpose of timely information, detection, coordination, and direct assistance to the victims who are detected or referred by the local NGOs. This yielded an improvement in the prescreening identification system and provided the potential victims with the most appropriate referrals, sheltering and assistance. .
As was reported, from 2005 to 2008, the National Referral Mechanism succeeded to train about 525 different profiles: members of social centers expert teams, 10 representatives of different gender commissions and bodies, police counter-trafficking and border police inspectors. Twenty-one training seminars were organized for local NGOs countrywide and for 58 social workers of 27 local Centers for Social Care across the nation. The offices of 19 Centers are specifically equipped to work with victims of trafficking who are minors. They provide this class of victims with applicable reintegration and re-socialization programs. Apart from many awareness campaigns and public pool surveys conducted by the Coordinative Office of the National Referral System in conjunction with local NGOs the following figures demonstrate the practical impact of the referral activities:

From September 2005 to December 2006, there were 23 potential victims registered throughout this referral mechanism, out of which 16 were minors.

From December 2006 to December 2007, there were 30 domestic victims of trafficking identified, out of whom 5 were foreign nationals and 28 were minors. From 2005 until December 2008 there were 13 individuals that have been referred through the National Referral Mechanisms to the sheltering premises of the NGO Open Gate. Four of them underwent risk and family assessments, requisite for their safe return home. Four girls have received direct assistance and included in reconciliation and reintegration programs run by IOM (International Organization of Migration). A temporary social guardian has been appointed for seven minors within the current Transit Centre.

Generally speaking, the role of the NGO sector in the effective suppression of human trafficking is becoming crucial. It is irreplaceable due to its outreach: the best and farthest compared to other preventive and awareness messages launched. NGOs also expand the usually limited local capacities and the reintegration opportunities for victims.

On the other hand, the NGO sector should be used as a valuable and helpful resource at the disposal of the authorities in their quest to attain desired standards and practical solutions. NGOs maintain flexible international networking, cooperation, knowledge flow and transfer and the sharing of best practices in a manner accessible to all. Something that can be rather formal and time consuming as far as the state organs go, the NGO sector can easily expedite by making use of experience encountered worldwide.

In these contexts, trafficking-related issues and strategies should be anticipated and implemented within the human rights framework consistent with international conventions and instruments, especially with those that have already been subject to ratification. As mentioned in the Palermo Protocol, the signatory-country assumes the responsibility to review the possible measures for the appropriate psychological, psychophysical and sociological treatments for the healing and recovery of the victims, material help, as well as legal advice regarding their rights in a language they understand.

Legal aid is an exceptionally important precondition and a guarantee for the realization and appropriate protection of victims' rights and freedoms set forth in the Constitution and in all internationally-ratified conventions. Presenting the facts this way and with properly addressed and timed campaigns, NGOs must enlarge their preventive and educational impact on the vulnerable parts of the population: women, i.e. girls and children, alerting them to new and nefarious forms of recruitment. As part of its gender mainstreaming, the NGO Sector is actually expected to further incorporate anti-trafficking measures into its ongoing human rights and institution-building programs.

In this regard, it is worth mentioning the positive impact of the ***Council of Europe Convention on Action against Trafficking in Human Beings*** of 2005 which calls upon the treaty signatories to further adopt measures for victim protection regardless of their collaboration in the criminal prosecution of traffickers, preventing them from being repatriated in the meantime. This Convention openly prompts the authorities **to extend their cooperation with the NGO sector and with professional organizations that deal with these issues.** The treaty also prevents victims from being repatriated before all legal proceedings are completed. The other progressive feature offered in this instrument is that the problem of human trafficking has been finally decoupled from what used to be the prevalent focus on illegal migration patterns. Whereas the Palermo Protocol has now been signed by almost all European countries, only several out of 47 members of the Council of Europe have ratified the more binding Convention on Action against Trafficking in Human Beings. The Republic of Macedonia still has to finally ratify this Convention which was formally signed on 17.11.2005.

Special emphasis should be placed on training the NGOs to easily spot modern tactics and rhetoric in attracting potential victims. Non-government organizations should be aware that human traffickers are stalking their prey, concealed behind business facades that place ads in the local media, posing as legitimate enterprises, such as agencies for top-models, tourist agencies, overseas manpower recruitment firms, hired help abroad, and matchmaking. Traffickers can be organized in criminal groups but also work as individuals. They lure their victims with promises of good working conditions, usually with exceptional wages, or wealthy marriage partners. Very often the traffickers offer help in the acquiring of passports, various work permits and visas, and of course, because of the "complexity of the services", they offer transportation to the promised lands of welfare. They reach their potential clients through half-informed relatives, neighbors, acquaintances and friends, through informal and less formal reports, offers for assistance and fast solutions of certain financial and existential problems, sometimes providing even professional advice.

The NGO sector in Macedonia is under the influence of the authorities and the "spoils system" also affects them as well as the bigger international organizations operating in the country. There are numerous examples where the assignment of "turf" (local focal points for cooperation and liaison with the responsible ministries or institutions) is often granted to candidates offered by some high ranking officials (who happen to be their relatives) with the argument that such propinquity is bound to lead to better receptivity and deeper cooperation. That is one of the reasons why some of the leading international and NG organisations were or are recruiting rather young and inexperienced local staff.

In the last couple of years, a relevant counter-trafficking international organization was chaired by really unqualified persons, also bestowing on them a diplomatic status. Replete with irrelevant military training, completely insensitive to the problem of trafficking, those people got the Macedonia sinecure as a place to recover from career burn-out, or as an award for serving in other missions worldwide. Lacking in knowledge, guided by the rule of mediocrity, they get on-the-job-training. Often indulging themselves in ersatz romantic office affairs, they regularly engage in unprofessional, vicious, and malicious bullying for revenge, utilising their position and influence for self-enrichment. The nation's ability to prevent such mismanagement and behaviours committed by international staff assigned here is still unarticulated, weak and obsequious, and often compounded by eventual personal benefits.

Before the SOP was applied, pre-screening procedures and victim interviews were regularly performed according to police investigative provisions, set by the police itself, usually after a police raid and less frequently following an individual's escape or a referral via a different means. In addition, many assessments and studies in the region persistently demonstrated that the number of victims referred in the region solely by the police actually amounts to only one third of the victims that might have been immediately deported or been bereft of any protection and assistance schemes.

Hungary, Economy of

The Slovaks, perhaps a trifle prematurely, rejoiced. The Czech CTK News Agency reported from Prague that the ethnic Hungarian parties in Slovakia were cautiously unhappy. Bela Bugar, the chairman of one such party (the SMK, now in coalition) grumbled, referring to the Hungarian-Slovak basic treaty:

"If this policy of two faces were to continue, it would worsen relations at least on the level of government and the given (Hungarian) ethnic minority." The Hungarian minority in Slovakia was not even consulted before the weighty document was signed by the Socialists (MSZP) and the Union of Free Democrats (SZDSZ).

These very two parties now won the first round of the elections in Hungary, narrowly defeating the center-right coalition led by Fidesz (the Hungarian Civic Party) and the Hungarian Democratic Forum. Of the 185 seats decided, the Hungarian Socialist Party and the Free Democrats ended with 98. Another 176 seats are left to a second round. The parties then cast proportional votes to determine the composition of the remaining 25.

If they win the runoff on April 21 as well - and fervent coalition-making is currently under way - the Socialists will lead this prosperous country of 10 million people into the EU. This would not be their first taste of power, though. They ruled Hungary between 1994 and 1998.

Many Free Democrats found the experience of allying with the Socialists traumatic and believe that it tarnished the party's reputation irreversibly. Some are even pushing to team up with Fidesz rather than with the victorious Socialists. But this is unlikely. The party campaigned on an anti-Fidesz ticket.

A two-party system has emerged from these elections, in which a record 71 percent of eligible voters participated - a sign of the maturation of the Hungarian political scene. Rabid right-wingers, like the Hungarian Justice and Life party (MIEP), were trounced. This removed an obstacle from Hungary's accession to the EU. Their leader, Istvan Csurka, ordered his acolytes to vote for Orban (Fidesz), hoping to recreate the reversal of fortunes in the 1998 elections. The Socialists then also won the first round, only to lose the elections in the second.

The ruling coalition may have been punished by urbanite voters - mainly in Budapest - said the center-left daily "Nepszava". Its open contempt of intellectuals, liberals, the media, and city-dwellers has often translated into withheld or truncated budgets and bureaucratic obstructionism. Zoltan Pokorni, Fidesz's president, said the rural vote would be crucial in the second round:

"We advise our supporters in the provinces to take part in the second round. Their will should not be thwarted by Budapest."

Such was the disenchantment with Orban that the stock exchange surged almost 4% on the news. The Socialists promised less interference in the economy. And during their previous term in office, Hungary's stock market enjoyed an uninterrupted bull run. The forint - propped up by Hungary's preference for a strong currency under Fidesz - dutifully weakened.

Hungary's remarkable economic performance during Orban's reign, state interventionism notwithstanding, seems to have been utterly forgotten, though. The somewhat incredulous Socialist prime ministerial candidate, Peter Medgyessy, said, in his typical low-key manner:

"We are very happy with the confidence that has been expressed by investors. We can guarantee predictability for the economy."

But voters were after justice as well as predictability. Inequality in capitalistic Hungary grew under Orban. In post-communist societies, evenly spread poverty is often preferred to unevenly spread riches. Gnawing envy may have led to electoral retribution. Orban was accused of authoritarianism, cronyism, and patronage.

Fidesz has been denigrated as merely enjoying the long-delayed fruits of painful reforms the Socialists have instituted - for which the latter paid dearly in the last elections in 1998. The chairman of the Free Democrats, Gabor Kuncze, already cautioned against "stealth privatization" of various state assets, including many farms and a retail chain. The government, he warned, should act as a mere caretaker.

Orban's escalating rhetoric worked against him. It began to unsettle foreign investors and EU commissioners alike.

But, above all, it did not resonate with the increasingly sophisticated and cosmopolitan society that Hungary has become. Orban typecast himself as a rustic, traditionalist, anti-intellectual, nationalistic, and down to earth populist folk hero. Hungary is urban, non-conservative, intellectual, and European. It feared a possible Fidesz-MIEP rule.

Peter Medgyessy could not have been more different. He joined the Socialist party only lately and reluctantly. He worked as a besuited banker in Societe Generale in Paris. He is a technocrat. The Financial Times described his performance in a debate with the brash and arrogant Orban - "Calm and factual".

Agrarian voters may yet turn the tide. If enough Socialist voters stay home on April 21, now that MIEP is no more - Fidesz could still pull a last minute rabbit out of the hostile ballot box. But whoever wins, the right will never be the same again. It has been humbled - and warned. Be part of a liberal Europe - or cease to be altogether.

The Budapest Stock Exchange has reached its zenith for the year earlier this month, having risen by a quarter since January 1. It was buoyed by flows of foreign capital. Foreign investors disliked the outgoing government for its heavy handed interventionism and micro-management of the economy. It was also tainted by nepotism and cronyism, though not by outright and crass corruption.

Having apparently learned nothing from his biting defeat in the first round of the elections on April 7, the youthful and unrepentant prime minister, Orban, fanned the xenophobia that has become his hallmark. He cited the stock exchange's vicissitudes as proof positive of the undue and pernicious influence of "big (read: foreign) capital", likely to be running the country under the socialists.

In some ways, these elections seem to perpetuate a pattern. No government in central Europe has leveraged its first term to win a second one. Yet, in other ways, these elections are a watershed. What is decided is not the fate of politician or a party. At stake is the process of EU enlargement and the future image of a united Europe.

In a massive rally on Saturday at Kossuth ter in front of the well-lit building of parliament, Orban, flanked by pop stars and celebrity athletes, addressed the crowd, claiming to believe in the forces of "unity and love". He implored his listeners to join the train to the future. He contrasted the Bokros austerity plan of his socialist predecessors with his own business-friendly Szechenyi program. He called upon voters to "bring a friend with them to vote (for the party he chairs, Fidesz)".

Orban stands for a prouder, more affluent, Hungary. No longer the mendicant at the gates of the kingdom of Brussels, he promotes the interests of his country fearlessly and does not recoil from tough bargaining and even conflict. While unwaveringly committed to the European project, Orban, like Vaclav Klaus in the Czech Republic, is an unmistakable nationalist.

His nationalism often comes uncomfortably close to a vision of "Great Hungary". It is a non-territorial kind of expansionism and it encompasses all the Hungarians wronged by the treaty of Trianon and doomed to become minorities in neighboring countries.

By showering these expatriates with financial benefits and extra-territorial rights, Orban has engaged in economic imperialism on a minor scale. The socialists want to renegotiate the agreement with Romania, granting special privileges to Romanian temporary workers in Hungary. This was the political price Orban had to pay in order to extend these rights and more to Hungarians in Romania.

Fidesz has an informal and uneasy alliance with MIEP, the far-right, ultra-nationalist, and intermittently anti-Semitic, Hungarian Justice and Life Party. Its supporters attended the Saturday rally. Its leaders called on Fidesz to out and accept MIEP's help publicly.

Quoted in Hungarian Radio, deputy parliamentary group leader, Csaba Lentner, said that "it could have tragic consequences if the 250,000 MIEP voters will not even receive a good word from the centre-right for their unselfish sacrifice (in voting for Fidesz in the second round, as their leadership recommended)".

The nation-state may have been grafted on eastern Europe in the 20th century - but in central Europe it has always been a natural outgrowth. Yet, in both regions it derives its vitality from the land. Nationalism in the east has agrarian, rustic roots. Orban inevitably gravitated towards the village - the symbol of tradition, wholesomeness, integrity, forthrightness, honesty, deep-rooted commitment to the nation, the abode of the nuclear family - home and hearth. No wonder that the main bones of contention in the negotiations towards EU accession are farm subsidies and agricultural policy.

This mythical vision was contrasted with the no less mythical vision of the city - Budapest. Cosmopolitan, traitorous, non-productive, swarming with criminals, con-men, foreigners, and uprooted intellectuals. Orban starved Budapest by denying it access to budget funds. He clashed with its mayor publicly and gleefully. He berated urbanites and extolled the farmers. He was duly punished in the ballot box by disgruntled city-dwellers.

Europe's hinterland - the vast arable lands of Poland, Germany, Hungary, Ukraine, and Russia - is being denuded by the forces of the market. The cities swell inexorably. Urban development has become unsustainable. Infrastructure is crumbling. Crime is soaring. Orban represents the forces of reaction to these disturbing trends.

Orban may be paying the price for the success of the Hungarian economy. Capitalism is driven by inequality - and ruined by iniquity. Capitalist societies encourage people to swap their rags for riches. Capitalism seeks to foster constructive envy and the wish to emulate success stories. But a society divided among haves and haves not is, by definition, unequal and polarized. In post-communist societies, evenly spread destitution is often preferred to unevenly spread affluence. Gnawing envy may have led to electoral retribution.

Orban was also accused of authoritarianism, cronyism, and patronage. These have nothing to do with capitalism and a lot to do with nanny-state communism. Old habits die hard. State interference, the formation of a nomenclature, cronyism in privatization deals, lack of transparency, paranoia - are all leftovers from four decades of communist depredation.

In an ominous note, Peter Medgyessy, the socialist's technocratic prime ministerial candidate, vowed to honor agreements signed by the current government - if they are found to be legal. Orban, being the brash representative of a new generation, was supposed not to have been contaminated by a depraved past. But he proved to be even more socialist than any socialist before him. The markets rejoiced at the reasonable prospect of his political demise.

Where is the EU headed? Will it become a confederation of independent nation-states, as Britain would have it? Or will a Unites States of Europe emerge and subsume its components, the erstwhile nation-states?

This may well be decided in central Europe rather than in its west. Countries like France and Britain are already committed to one model or another. The swing votes - today's applicants, tomorrow's members - will, in all likelihood, determine the outcome of this debate. Hungary realizes that the greater the number of candidates it sponsors, the more clout it will possess in any future arrangement. Hence, its continued demands to commence preliminary discussions with Ukraine, Belarus, and Moldova - the EU's future neighbors following enlargement - with a view to their ultimate accession.

It was a Frenchman (Ernest Renan) who wrote:

"Nations are not eternal. They had a beginning and they will have an end. And they will probably be replaced by a European confederation."

Russian mobsters love Budapest and not only for its views and cosmopolitan atmosphere. They can easily obtain a

Hungarian passport posing as "investors" by laundering the proceeds of their illicit activities. The CIA labels Hungary a "major transshipment point for Southwest Asian heroin and cannabis and transit point for South American cocaine destined for Western Europe". It is also a "limited producer of precursor chemicals, particularly for amphetamine and methamphetamine". This is why Hungary made it into the visa regimes of many a Western country in the last few months.

The opposition Hungarian Socialist Party (MSZ) harps on Hungary's tarnished image. It accuses the government of opaqueness in tax collection and budget spending. The current legal codes threaten the rule of law, they thunder.

Two years ago, Hungary was considered less suitable to join the EU than the likes of the Czech Republic, Malta, and Slovenia. Today, its youthful and nationalistic prime minister, Viktor Orban, feels comfortable to state on Hungarian Radio: "It is not us who will join the EU - but the EU will come to us."

The abolition of borders within the EU will make Hungary a "nation of 15 million", he boasts, referring to Hungarian minorities in neighboring countries (mainly in Romania and Slovakia). Hungary is the top performer of the LEGSI index which monitors the stability of countries.

Many consider 38-year old Orban to be his country's main liability. His fiery speeches, provocative statements, and controversial policies often pit Hungary against other European countries, near and far. But this is hypocrisy. Orban's policies are typical of the countries of Central and Eastern Europe and many have emulated them.

Even his "Status Law" which grants employment, education, and social welfare benefits to minority Hungarians elsewhere - has equivalents in Germany, Russia, and Slovakia, among others. It is little known that Romanians enjoy much the same economic benefits in Hungary as their Hungarian compatriots.

As opposed to other countries in transition, Hungary did not have a single bad year since 1994. Orban's reign (from 1998) has been characterized by rapid growth (5 percent p.a.), low inflation (7 percent), and even lower unemployment (6 percent nationwide and less than 3 percent in the Budapest area). The minimum wage has doubled and real wages are up 17 percent, in line with sustained increases in labour productivity.

Taxes were cut and much deeper cuts are planned after the April 2002 elections. Employer participation in social security contributions was reduced from 33 percent to 29 percent in January.

Net external debt is half its level seven years ago - though gross external debt, at 60 percent of GDP, is high. External debt growth is currently driven by the private sector (mainly by multinationals).

This was achieved by a strange mixture of forceful government interference and the introduction of competition almost everywhere. Orban's government seems to have accomplished the impossible: micromanaging a free market economy.

Despite the presence of most multinationals, Hungary is surprisingly xenophobic. Cumulative FDI - though often offset by outflows of portfolio capital - stands at $26 billion ($2.8 billion last year alone), most of it from Germany and the Netherlands. It will likely grow considerably as accession beckons. But foreigners still find it fiendishly difficult to buy land, trade protectionism in growing, and ministers regularly denounce foreign domination and multinational encroachment upon the local economy.

Vaclav Klaus, the Czech Republic's outspoken elder statesman, warned against an emerging "Munich-Vienna-Budapest" axis of evil directed against other Central and Eastern European nations. Jewish leaders accuse Fidesz, the ruling party, of latent anti-Semitism.

In reports published by Lehman Brothers and Dresdner, Kleinwort, Wasserstein, foreign investors felt that EU accession will be retarded and new FDI discouraged should a minority government team up with the ultra rightwing Justice and Life Party (MIEP). Another concern was the loss of control over budget spending.

Hungary reneged on agreements it signed during the heyday of privatization (1993-7), when it raised more than $6 billion by selling stakes in its banking, media, and telecom sectors. The American power utility, AES, sued both the government and the Hungarian power grid for breach of contract for refusing to purchase generated power (admittedly at inflated prices). It grudgingly settled out of court last December.

The government of Canada protests the nationalization without compensation of a Canadian business running Budapest's airport terminals. The Canadians, according to "The Financial Times" accuse Hungary of appearing to "violate the obligations" of the Canadian-Hungarian investment protection agreement.

There are other worrying reversals- neatly embodied by the Szechenyi Plan for national economic development.

Hungary's budget deficit in the first two months of the year - at half a billion dollars - is four times the deficit in the corresponding period last year. Revenues are expected to deteriorate further as customs and duties are lowered - for instance on American cars.

Agricultural producer prices collapsed by one eighth in January alone, forcing the government to dole out supplementary subsidies. The western and eastern parts of Hungary - heavily dependent as they are on agriculture and basic manufacturing - do not share in the prosperity enjoyed by Budapest.

The government also decided to raise gas prices by less than inflation - all part of a new regulatory regime, replete with hidden, pre-election, subsidies. It has cancelled plans to privatize Postabank, opting instead to merge it with other state entities. It has re-nationalized a few motorways and all future motorways will be financed by the state-owned Hungarian Development Bank.

Hungary is also a greying country - 15 percent of its population are older than 65. Its workforce is contracting as its net population growth rate has turned negative. It part privatized its pensions but its un-revamped health care system masks enormous contingent obligations. Corruption is rife and the informal economy large.

Still, Hungary is flourishing.

Though its annual budget deficit and trade deficit - at $2 billion each - are c. 4 percent of GDP, its sovereign debt is the second highest rated among all the economies in transition. Government consumption is a mere 10% of GDP. Hungary is an open economy - trade constitutes two thirds of GDP.

Services make up more than 60 percent of Hungary's GDP - compared to half as much in industry. But Hungary is fast becoming an important components manufacturing and assembly zone for richer EU countries. Its industrial sector is likely to grow. Its energy monopoly, MOL, is consolidating with other oil companies in Central Europe. Its current account deficit is a mere 2 percent of a vigorous and expanding economy. More than three quarters of its exports are to EU destinations.

Interestingly, almost 40 percent of Hungary's population live in rural areas - though agriculture accounts for only 5 percent of GDP and 6 percent of the workforce. Only 16 years ago, more than a fifth of Hungary's population worked in agriculture.

Hungary's financial system is advanced and sophisticated. Interest rates are on a prolonged downward trend. The National Bank of Hungary has cut interest rates 7 times since September last year. Both gross national savings and gross domestic investment equal more than 25 percent of GDP. Less than 9 percent of the population are under the official poverty line.

Hungary has become a major supplier of car parts to the British motor industry. It is linking up to the hinterland of Eastern Europe and the Balkan by rail and road. The private sector accounts for 80 percent of GDP.

The Danube - Hungary's primary sea access - has been re-opened for traffic four months ago, for the first time since the Kosovo war. This saves Hungary tens of thousand of dollars in excess shipping costs - daily. Moreover, a Romanian-led consortium is promoting the idea of opening an alternative oil shipping lane cum pipeline through Hungary to ease the pressure on the Turkish straits.

Stratfor, the US-based strategic forecasting firm, has this to say about the re-opening of this vital transport route:

"The river's reopening will have several important effects ... It will promote trade and integration among European Union members and applicants alike ... To keep shipping costs under control, the European Union will facilitate the construction of alternate shipping infrastructure bypassing those straits.

All of these circumstances necessitate closer cooperation, both economic and political, among the EU states fast-tracked for membership and other powers in the region. Ultimately, that could help smooth the EU expansion process and aid the economies of several riparian states...

The Danube reopening comes at a fortuitous time. The European Union is accelerating expansion efforts, and all of the riparian states are either EU members or potential members. Although the EU does fund numerous infrastructure projects to promote trade, the Danube provides an instant avenue for economic integration. The EU's decision last year to shoulder most of the cost of clearing the river served as a nice political push for closer relations with applicant nations as well."

Orban's assertive comments notwithstanding, Hungary's economic future is pivotally dependent on a smooth accession to the EU, probably in 2004-5. Despite its polished, Western, image, it must invest heavily to comply with EU environmental standards and to overhaul its tax administration and legal system. Such budgetary outlays - especially in an election year - will strain Hungary's compromised fiscal discipline even further. Hungary (and the IMF) are discovering that EU accession may be incompatible with macro-economic stability.

Still, Hungary is a regular favorite of multilateral institutions.

Though often accompanied by monetary loosening due to massive capital inflows, Hungary's 15 percent band exchange rate regime (its crawling peg was abandoned in October) and inflation targeting are often lauded by the OECD.

The World Bank has committed to Hungary $2 billion in projects since 1991 - mostly for structural and institutional reforms and macro-economic support. Hungary is a recipient of Japan's Exim bank's co-financing facilities. As Hungary's transformation progressed, lending by these institutions dried up lately and Hungary owes the World Bank a meager $550 million.

By June 2001, the EBRD has invested $1.2 billion in Hungary in 64 projects worth $4.9 billion - most of them in the private sector, in telecommunication, transportation, and banking.

Hungary's elections may result in a hung parliament. If so, fiscal rectitude will be the chief victim. Hungary's monetary policy is strained to its limits. Labour shortages are likely, especially in the cities. Expect more populism, nationalistic fervor, and glitches on the path to the EU.

But Hungary was among the first communist countries to introduce a free market system in the 1960's. It became a member of the World Bank in 1982. It withdrew from the Warsaw Pact in 1956. It has always been a pioneer. "The Hungarian model" - state interventionism coupled with a thriving private sector - is working. No amount of political tinkering can bring it down.

I-J

IG Metall

A measure of IG Metall's clout is the persistent rumor that the ECB has held off on sorely needed interest rates cuts on account of the German trade union's wage demands. Moreover, though, with 2.7 million members, it is only the second largest, IG Metall serves as the benchmark and the trendsetter to less veteran or less sonorous unions in Germany.

Ver.di, the service sector's behemoth, with 3 million members, waited for IG Metall's regional wage boards to pronounce their sentence before plunging into its own negotiations with employers. Miraculously, it - and many other unions - ended up demanding the very same pay rise as did the metal-bashers. IG Metall's standing reflects the historical reverence accorded in Germany to the engineering and scientific professions.

IG Metall justified the outlandish wage increases it insists on (4-5 percent) - and the impending strike in Baden-Württemberg by 50,000 (out of 3.6 million) metalworkers on May 6 - by saying that the raises will boost domestic consumption and revive the flagging economy. Some of the extra money will be used to modernize the pay framework agreements and equate the status and the remuneration of blue collar and white collar workers doing "similar" jobs.

Warning strikes have already erupted over the last few weeks. The main employers' federation, Gesamtmetall, threatened the striking employees with lockouts.

The strike may yet be averted. Employers are offering an across the board hike of 3.3 percent over the next 15 months and a one time cash handout of $170 per worker. This is imperceptibly lower than IG Metall's target of 4 percent. IG Metall is likely to buckle down and agree to arbitration or mediation, perhaps by the embattled Schroeder, though he is reluctant to gamble his political future on the outcome as he has done two years ago. A compromise of 3.6 percent is likely, though. As IG Metall knows, many an invincible union perished through bungled strikes.

Moreover, IG Metall's previous strike was in 1995 and it cannot afford to alienate a socialist Chancellor who is in the throes of a re-election campaign. Still, it is implausibly threatening to spread the unrest from its stronghold, the southern state of Baden-Württemberg, to Berlin and Brandenburg. Ominous mutterings of a repeat of the mythical six weeks strike in the spring of 1984 abound.

This reads like a repeat of the wage negotiations in 2000. Then, as now, IG Metall demanded an increase of 5.5 percent as well as a reduction in retirement age to 60 and in the working week to 32 hours. Warning strikes petered out and the union capitulated by accepting a two year contract with modest pay rises (3 percent in 2000 and 2.1 percent in 2001).

The two previous annual wage settlements trailed inflation, expected to reach 2 percent this year. They reflected only a part of the handsome productivity gains throughout German industry. Net profits in IG Metall's sectors climbed from 1 billion DM in 1993 (a recession year) to 55 billion DM in 2000.

Real unit labour costs tumbled - but mainly due to massive layoffs. More than 1.5 million workers out of a total of 5 million in 1991 were sacked. IG Metall wants its members to recoup some of their past generosity. In a typical German euphemism, this grab is called a "redistribution component".

Admittedly, German employers abused the union's relative wage restraint during the 1990's. They did not create additional employment, nor did they invest in the retraining and re-qualification of workers made redundant. The union justly claims that wage moderation only fostered the transfer of wealth from labour to capital (i.e., from employees to shareholders).

Whatever the outcome of this industrial action, the employers will foot the bill. "Frankfurter Allgemeine" estimates that every day of the strike would translate to a whopping $2.3 billion in lost net output. Each 0.1 percent in wage increases costs the metal and electric industries c. $140 million a year. This in an industry mired in declining orders and falling production.

IG Metall's Web site is a militant affair. "Right to Strike - Away with the anti-strike paragraphs!" -it thunders. "Strike is a civil right - lockout is a misuse of power" - it preaches. It even provides practical "how-to-strike" guides, tips for strikers, and promotes a new model of "flexi-strike".

IG Metal is strict about the universal implementation of the collective agreements it painstakingly negotiates with employers. Such agreements typically tackle not only wage levels but issues like training, reduction in working time, safeguarding jobs, and equating eastern pay with western standards. The comprehensiveness and all-pervasiveness of the collective bargains is Procrustean.

"The Economist" reports the case of Viessmann, a German engineering firm. To avoid shifting the production of a new boiler to the Czech Republic, it negotiated with its workers an increase in the working week without a commensurate pay rise. IG Metall blocked the deal, though it later compromised.

This is a typical story. The collective agreements in 2000 and 2001 were an aberration and a political concession to a socialist regime in trouble. In contrast, wages rose 4.1 percent in workplaces covered by the 1999 settlement with IG Metall - most of them multinationals who exploited the agreement's egregious terms to squeeze their indigenous Mittelstand suppliers.

IG Metall is notoriously intransigent. Unlike its brethren in other industries, it refuses to link pay rises (or even annual bonuses) to profitability, for instance. It rejects the idea of implementing, by mutual consent of employees and employers, wage reductions or overtime to prevent lay-offs. It abhors profit sharing schemes, either regional, or sectoral, or even confined to the single plant level.

It would not sign two-year pay agreements based on "bad experience" in the past. Many exasperated firms resort to the profligate exercise of "opening (escape) clauses".

They renege on the collective agreements without being seen to flout the rules.

Employers ask employees to continue the working day at home after hours. Some workers clock out but continue to work all the same. Other firms - especially in the east - opt out of the employers' associations altogether, thus exempting themselves from onerous collective pay agreements.

Many attribute IG Metall's irrational exuberance to its rational fears of becoming marginalized and irrelevant. Wage increases - the union's only political leverage - are hard to negotiate in an environment of stable and low inflation, high unemployment, and ever more flexible labour markets.

The unions hitherto refrained from tackling the most pressing issues: flexible time, part time work, retirement, low wage jobs, social security reform, illegal immigrants. IG Metall spent the last 15 years negotiating an agreement to apply uniform wage criteria to blue-collar and white-collar workers.

The "Alliance for Work" pact between unions, employees, and government, proposed by its Chairman, Klaus Zwickel, in its 18th convention in 1995, went nowhere effective, though it was signed by all three parties. It included revolutionary ideas like linking pay to productivity - in return for job creation by the private sector and unemployment subsidies by the state. This was also the fate of a 1997 initiative to reduce working hours in parallel with wages in order to boost job formation.

Paradoxically, the higher the pay of its members - the less strike-prone is the union. Lay-off and strike pay doled out by the union is a function of the striking member's base wage. Add to this current expenditures - IG Metall employs more than 2000 people in its headquarters alone - and the limits of its postured belligerence become discernible.

In a major survey conducted last year in the framework of the unions' "Debate on the Future" initiative, 78 percent of German workers - union members and non-members alike - professed to being more interested in job security than in higher pay. Nine out of 10 respondents expected the unions to support secure jobs and fight unemployment.

Some workers begin to fathom the union's role in destroying employment by foisting a non-competitive wage structure upon reluctant employers. Eighty percent of employees surveyed expected IG Metall to do much more for the unemployed. Regrettably, the vast majority of the membership of IG Metall are still pugnacious and under the sway of populist activists.

Even so, IG Metall is past its heyday. It is the anachronistic outcome of numerous mergers with other fading unions in the plastics, textile, and wood industries. Despite these acquisitions and the influx of East German laborers, its membership hasn't budged since the early 1980's. In the 1990's alone it has declined by more than a million members - almost one third of the total - despite acquiring a million new members from the east.

One third of the members are retired. Less than 7 percent are under the age of 25. Women are deserting the union in droves. IG Metall represents less than 30 percent of actively employed workers in its industrial sectors.

In its "Debate on the Future" survey only 5 percent of all respondents said they would "definitely" join IG Metall. Only 3 percent imagined a long-term membership. Two thirds of the unorganized employees surveyed said they have no interest whatsoever in becoming union members.

The surges in membership that followed previous confrontations with employers seem to have abated. And 1 percent of gross wages in membership dues is a lot to pay for ill-defined and uncertain benefits. The average wage in industry - among the highest in the world - amounts to $37,000 a year, including social security contributions.

To make matters worse, in the last few significant rounds of wage negotiations, IG Metal lost its traditional bellwether role to IG BCE, the more nimble union of workers in the chemical and energy sectors. This much smaller new union signed the first collective agreements each time, thus weakening IG Metall's hand in its own negotiations.

There are cracks in IG Metall's hitherto uniform ideological facade. On March 1998 it signed an agreement with Debis - a group of car makers and metal bashing firms represented by Daimler-Benz. It agreed to let the employers decide how to flexibly implement a reduced working week of 35 hours. Five thousand companies had individual contracts with unions by the end of 1997.

Last August, bowing to political pressures by the SDP and the public outcry of its own members, IG Metall signed a plant level agreement with Volkswagen. This vitiated its insistence on exclusive industry-wide agreements. Moreover, the VW deal includes flexible work rules and pay. Five thousand workers are each to be paid 5000 DM a month to produce Volkswagen's 5000 model.

The convergence of the manufacturing and services sectors leads to mergers or collaborative efforts among competing unions. Fields like Information Technology (IT), telecommunications, pharmaceutics, and biotechnology blur the lines between knowledge and production.

Last year, for instance, IG Metall created a joint bargaining committee with the new umbrella services union, Ver.di. The committee - the indirect outcome of arbitration involving the two unions - will represent all of IBM's 26,000 workers in its German subsidiaries. Ver.di includes as one of its components one of IG Metall's most bitter rival unions, DAG.

But it would take a determined - and somewhat Thatcherite - government to face the unions down. Many German luminaries advocate a sea change in the laws pertaining to strikes, labour relations, and wage bargaining. Strikes should be allowed only after mediation fails. Employers and employees should negotiate plant-level arrangements. These seismic shifts will not transpire without a bloodied fight. Unions are monopolies and they act as cartels. Their interests are overwhelmingly vested in the status quo.

Yet, such a showdown is long overdue - and victory is within reach. Only one in five working age Germans - less than 8 million - belong to a union. Overall membership deflated by almost two fifths since unification. Even the awesome industry wide agreements cover a mere one fourth of German firms in the east - and a one half of all businesses in the western Lander.

No wonder that IG Metall has in its sights targets in east Germany and in Germany's "sphere of influence". The union owns the Otto Brenner Foundation. It is named after IG Metall's first boss and was established in 1972 "to promote the metalworkers trade union". In 1997, its dismal finances were boosted by the serendipitous liquidation of IG Metall's assets in the former East Germany.

Though claiming to engage in impartial "scientific" research, the Foundation aims to spread the union gospel among the heathen of central and eastern Europe and, especially, the eastern German Lander. The Foundation's Administrative Board is appointed by IG Metall.

Perhaps in an effort to improve its public image, IG Metall issued, in January 1999, a press release in support of compensation for forced laborers in the metal industry. It notes that the 10 million slaves that toiled and perished in German factories during the Nazi occupation of Europe constituted 40 percent of Germany's industrial workforce. More than 1000 concentration camps were "directly near or on" company property.

It took IG Metall - an ostensibly leftist organization - almost 50 years to condemn the crimes of German business and industry during the Nazi era. It is a measure of the glacial tempo of its decision making processes. Nothing seems to shake it from its well rehearsed torpor.

It, therefore, is probably doomed to share the fate of other unions - gradual but assured dissipation.

IMF (International Monetary Fund)

“IMF Kill or Cure” was the title of the cover page of the prestigious magazine, "The Economist" in its issue of 10/1/98. The more involved the IMF gets in the world economy - the more controversy surrounds it. Economies in transition, emerging economies, developing countries and, lately, even Asian Tigers all feel the brunt of the IMF recipes. All are not too happy with it, all are loudly complaining. Some economists regard this as a sign of the proper functioning of the International Monetary Fund (IMF) - others spot some justice in some of the complaints.

In his book, "A Farewell to Alms" (Princeton University Press, 2007), Gregory Clark, an economic historian at the University of California, Davis compares the World Bank and the IMF to "cult centers", "prescientific physicians who prescribed bloodletting for ailments they did not understand", as the New-York Times aptly paraphrased him.

The IMF was established in 1944 as part of the Bretton Woods agreement. Originally, it was conceived as the monetary arm of the UN, an agency. It encompassed 29 countries but excluded the losers in World War II, Germany and Japan. The exclusion of the losers in the Cold war from the WTO is reminiscent of what happened then: in both cases, the USA called the shots and dictated the composition of the membership of international organization in accordance with its predilections.

Today, the IMF numbers 182 member-countries and boasts "equity" (own financial means) of 200 billion USD (measured by Special Drawing Rights, SDR, pegged at 1.35 USD each). It employs 2600 workers from 110 countries. It is truly international.

The IMF has a few statutory purposes. They are splashed across its Statute and its official publications. The criticism relates to the implementation - not to the noble goals. It also relates to turf occupied by the IMF without any mandate to do so.

The IMF is supposed to:

1. Promote international monetary cooperation;
2. Expand international trade (a role which reverted now to the WTO);
3. Establish a multilateral system of payments;
4. Assist countries with Balance of Payments (BOP) difficulties under adequate safeguards;
5. Lessen the duration and the degree of disequilibrium in the international BOPS of member countries;
6. Promote exchange rate stability, the signing of orderly exchange agreements and the avoidance of competitive exchange depreciation.

The IMF tries to juggle all these goals in the thinning air of the global capital markets. It does so through three types of activities:

Surveillance

The IMF regularly monitors exchange rate policies, the general economic situation and other economic policies. It does so through the (to some countries, ominous) mechanism of "(with the countries' monetary and fiscal authorities). The famed (and dreaded) World consultation" Economic Outlook (WEO) report amalgamates the individual country results into a coherent picture of multilateral surveillance. Sometimes, countries which have no on-going interaction with the IMF and do not use its assistance do ask it to intervene, at least by way of grading and evaluating their economies. The last decade saw the transformation of the IMF into an unofficial (and, incidentally, non-mandated) country credit rating agency. Its stamp of approval can mean the difference between the availability of credits to a given country - or its absence. At best, a bad review by the IMF imposes financial penalties on the delinquent country in the form of higher interest rates and charges payable on its international borrowings. The Precautionary Agreement is one such rating device. It serves to boost international confidence in an economy. Another contraption is the Monitoring Agreement which sets economic benchmarks (some say, hurdles) under a shadow economic program designed by the IMF. Attaining these benchmarks confers reliability upon the economic policies of the country monitored.

Financial Assistance

Where surveillance ends, financial assistance begins. It is extended to members with BOP difficulties to support adjustment and reform policies and economic agendas. Through 31/7/97, for instance, the IMF extended 23 billion USD of such help to more than 50 countries and the outstanding credit portfolio stood at 60 billion USD. The surprising thing is that 90% of these amounts were borrowed by relatively well-off countries in the West, contrary to the image of the IMF as a lender of last resort to shabby countries in despair.

Hidden behind a jungle of acronyms, an unprecedented system of international finance evolves relentlessly. They will be reviewed in detail later.

Technical Assistance

The last type of activity of the IMF is Technical Assistance, mainly in the design and implementation of fiscal and monetary policy and in building the institutions to see them through successfully (e.g., Central Banks). The IMF also teaches the uninitiated how to handle and account for transactions that they are doing with the IMF. Another branch of this activity is the collection of statistical data - where the IMF is forced to rely on mostly inadequate and antiquated systems of data collection and analysis. Lately, the IMF stepped up its activities in the training of government and non-government (NGO) officials. This is in line with the new credo of the World Bank: without the right, functioning, less corrupt institutions - no policy will succeed, no matter how right.

From the narrow point of view of its financial mechanisms (as distinct from its policies) - the IMF is an intriguing and hitherto successful example of international collaboration and crisis prevention or amelioration (=crisis management). The principle is deceptively simple: member countries purchase the currencies of other member countries (USA, Germany, the UK, etc.). Alternatively, the draw SDRs and convert them to the aforementioned "hard" currencies. They pay for all this with their own, local and humble currencies. The catch is that they have to buy their own currencies back from the

IMF after a prescribed period of time. As with every bank, they also have to pay charges and commissions related to the withdrawal.

A country can draw up to its "Reserve Tranche Position". This is the unused part of its quota (every country has a quota which is based on its participation in the equity of the IMF and on its needs). The quota is supposed to be used only in extreme BOP distress. Credits that the country received from the IMF are not deducted from its quota (because, ostensibly, they will be paid back by it to the IMF). But the IMF holds the local currency of the country (given to it in exchange for hard currency or SDRs). These holdings are deducted from the quota because they are not credit to be repaid but the result of an exchange transaction.

A country can draw no more than 25% of its quota in the first tranche of a loan that it receives from the IMF. The first tranche is available to any country which demonstrates efforts to overcome its BOP problems. The language of this requirement is so vague that it renders virtually all the members eligible to receive the first instalment.

Other tranches are more difficult to obtain (as Russia and Zimbabwe can testify): the country must show successful compliance with agreed economic plans and meet performance criteria regarding its budget deficit and monetary gauges (for instance credit ceilings in the economy as a whole). The tranches that follow the first one are also phased. All this (welcome and indispensable) disciplining is waived in case of Emergency Assistance - BOP needs which arise due to natural disasters or as the result of an armed conflict. In such cases, the country can immediately draw up to 25% of its quota subject only to "cooperation" with the IMF - but not subject to meeting performance criteria. The IMF also does not shy away from helping countries meet their debt service obligations. Countries can draw money to retire and reduce burdening old debts or merely to service it.

It is not easy to find a path in the jungle of acronyms which sprouted in the wake of the formation of the IMF. It imposes tough guidelines on those unfortunate enough to require its help: a drastic reduction in inflation, cutting back imports and enhancing exports. The IMF is funded by the rich industrialized countries: the USA alone contributes close to 18% to its resources annually. Following the 1994-5 crisis in Mexico (in which the IMF a crucial healing role) - the USA led a round of increases in the contributions of the well-to-do members (G7) to its coffers. This became known as the Halifax-I round. Halifax-II looks all but inevitable, following the costly turmoil in Southeast Asia. The latter dilapidated the IMF's resources more than all the previous crises combined.

At first, the Stand By Arrangement (SBA) was set up. It still operates as a short term BOP assistance financing facility designed to offset temporary or cyclical BOP deficits. It is typically available for periods of between 12 to 18 months and released gradually, on a quarterly basis to the recipient member. Its availability depends heavily on the fulfilment of performance conditions and on periodic program reviews. The country must pay back (=repurchase its own currency and pay for it with hard currencies) in 3.25 to 5 years after each original purchase.

This was followed by the General Agreement to Borrow (GAB) - a framework reference for all future facilities and by the CFF (Compensatory Financing Facility). The latter was augmented by loans available to countries to defray the rising costs of basic edibles and foodstuffs (cereals). The two merged to become CCFF (Compensatory and Contingency Financing Facility) - intended to compensate members with shortfalls in export earnings attributable to circumstances beyond their control and to help them to maintain adjustment programs in the face of external shocks. It also helps them to meet the rising costs of cereal imports and other external contingencies (some of them arising from previous IMF lending!). This credit is also available for a period of 3.25 to 5 years.

1971 was an important year in the history of the world's financial markets. The Bretton Woods Agreements were cancelled but instead of pulling the carpet under the proverbial legs of the IMF - it served to strengthen its position. Under the Smithsonian Agreement, it was put in charge of maintaining the central exchange rates (though inside much wider bands). A committee of 20 members was set up to agree on a new world monetary system (known by its unfortunate acronym, CRIMS). Its recommendations led to the creation of the EFF (extended Financing Facility) which provided, for the first time, MEDIUM term assistance to members with BOP difficulties which resulted from structural or macro-economic (rather than conjectural) economic changes. It served to support medium term (3 years) programs. In other respects, it is a replica of the SBA, except that that the repayment (=the repurchase, in IMF jargon) is in 4.5-10 years.

The 70s witnessed a proliferation of multilateral assistance programs. The IMF set up the SA (Subsidy Account) which assisted members to overcome the two destructive oil price shocks. An oil facility was formed to ameliorate the reverberating economic shock waves. A Trust Fund (TF) extended BOP assistance to developing member countries, utilizing the profits from gold sales. To top all these, an SFF (Supplementary Financing Facility) was established.

During the 1980s, the IMF had a growing role in various adjustment processes and in the financing of payments imbalances. It began to use a basket of 5 major currencies. It began to borrow funds for its purposes - the contributions did not meet its expanding roles.

It got involved in the Latin American Debt Crisis - namely, in problems of debt servicing. It is to this period that we can trace the emergence of the New IMF: invigorated, powerful, omnipresent, omniscient, mildly threatening - the monetary police of the global economic scene.

The SAF (Structural Adjustment Facility) was created. Its role was to provide BOP assistance on concessional terms to low income, developing countries (Macedonia benefited from its successor, ESAF). Five years later, following the now unjustly infamous Louvre Accord which dealt with the stabilization of exchange rates), it was extended to become ESAF (Extended Structural Adjustment Facility). The idea was to support low income members which undertake a strong 3-year macroeconomic and structural program intended to improve their BOP and to foster growth - providing that they are enduring protracted BOP problems. ESAF loans finance 3 year programs with a subsidized symbolic interest rate of 0.5% per annum. The country has 5 years grace and the loan matures in 10 years. The economic assessment of the country is assessed quarterly and biannually. Macedonia is only one of 79 countries eligible to receive ESAF funds.

In 1989, the IMF started linking support for debt reduction strategies of member countries to sustained medium term adjustment programs with strong elements of structural reforms and with access to IMF resources for the express purposes of retiring old debts, reducing outstanding borrowing from foreign sources or otherwise servicing debt without resorting to rescheduling it. To these ends, the IMF created the STF (Systemic Transformation Facility - also used by Macedonia). It was a temporary outfit which expired in April 1995. It provided financial assistance to countries which faced BOP difficulties which arose from a transformation (transition) from planned economies to market ones. Only countries with what were judged by the IMF to have been severe disruptions in trade and payments arrangements benefited from it. It had to be repaid in 4.5-10 years.

In 1994, the Madrid Declaration set different goals for different varieties of economies. Industrial economies were supposed to emphasize sustained growth, reduction in unemployment and the prevention of a resurgence of by now subdued inflation. Developing countries were allocated the role of extending their growth. Countries in transition had to engage in bold stabilization and reform to win the Fund's approval. A new category was created, in the best of acronym tradition: HIPCs (Heavily Indebted Poor Countries). In 1997 New Arrangements to Borrow (NAB) were set in motion. They became the first and principal recourse in case that IMF supplementary resources were needed. No one imagined how quickly these would be exhausted and how far sighted these arrangement have proven to be. No one predicted the area either: Southeast Asia.

Despite these momentous structural changes in the ways in which the IMF extends its assistance, the details of the decision making processes have not been altered for more than half a century. The IMF has a Board of Governors. It includes 1 Governor (plus 1 Alternative Governor) from every member country (normally, the Minister of Finance or the Governor of the Central Bank of that member). They meet annually (in the autumn) and coordinate their meeting with that of the World Bank.

The Board of Governors oversees the operation of a Board of Executive Directors which looks after the mundane, daily business. It is composed of the Managing Director (Michel Camdessus from 1987) as the Chairman of the Board and 24 Executive Directors appointed or elected by big members or groups of members. There is also an Interim Committee of the International Monetary System.

The members' voting rights are determined by their quota which (as we said) is determined by their contributions and by their needs. The USA is the biggest gun, followed by Germany, Japan, France and the UK.

There is little dispute that the IMF is a big, indispensable, success. Without it the world monetary system would have entered phases of contraction much more readily. Without the assistance that it extends and the bitter medicines that it administers - many countries would have been in an even worse predicament than they are already. It imposes monetary and fiscal discipline, it forces governments to plan and think, it imposes painful adjustments and reforms. It serves as a convenient scapegoat: the politicians can blame it for the economic woes that their voters (or citizens) endure. It is very useful. Lately, it lends credibility to countries and manages crisis situations (though still not very skilfully).

This scapegoat role constitutes the basis for the first criticism. People the world over tend to hide behind the IMF leaf and blame the results of their incompetence and corruption on it. Where a market economy could have provided a swifter and more resolute adjustment - the diversion of scarce human and financial resources to negotiating with the IMF seems to prolong the agony. The abrogation of responsibility by decision makers poses a moral hazard: if successful - the credit goes to the politicians, if failing - the IMF is always to blame. Rage and other negative feeling which would have normally brought about real, transparent, corruption-free, efficient market economy are vented and deflected. The IMF money encourages corrupt and inefficient spending because it cannot really be controlled and monitored (at least not on a real time basis). Also, the more resources governments have - the more will be lost to corruption and inefficiency. Zimbabwe is a case in point: following a dispute regarding an austerity package dictated by the IMF (the government did not feel like cutting government spending to that extent) - the country was cut off from IMF funding. The results were surprising: with less financing from the IMF (and as a result - from donor countries, as well) - the government was forced to rationalize and to restrict its spending. The IMF would not have achieved these results because its control mechanisms are flawed: they rely to heavily on local, official input and they are remote (from Washington). They are also underfunded.

Despite these shortcomings, the IMF assumed two roles which were not historically identified with it. It became a country credit risk rating agency. The absence of an IMF seal of approval could - and usually does - mean financial suffocation. No banks or donor countries will extend credit to a country lacking the IMF's endorsement. On the other hand, as authority (to rate) is shifted - so does responsibility. The IMF became a super-guarantor of the debts of both the public and private sectors. This encourages irresponsible lending and investments (why worry, the IMF will bail me out in case of default). This is the "Moral Hazard": the safety net is fast being transformed into a licence to gamble. The profits accrue to the gambler - the losses to the IMF. This does not encourage prudence or discipline.

The IMF is too restricted both in its ability to operate and in its ability to conceptualize and to innovate. It is too stale: a scroll in the age of the video clip. It, therefore, resorts to prescribing the same medicine of austerity to all the country patients which are suffering from a myriad of economic diseases. No one would call a doctor who uniformly administers penicillin - a good doctor and, yet, this, exactly is what the IMF is doing. And it is doing so with utter disregard and ignorance of the local social, cultural (even economic) realities. Add to this the fact that the IMF's ability to influence the financial markets in an age of globalization is dubious (to use a gross understatement - the daily turnover in the foreign exchange markets alone is 6 times the total equity of this organization). The result is fiascos like South Korea where a 60 billion USD aid package was consumed in days without providing any discernible betterment of the economic situation. More and more, the IMF looks anachronistic (not to say archaic) and its goals untenable.

The IMF also displays the whole gamut of problems which plague every bureaucratic institution: discrimination (why help Mexico and not Bulgaria - is it because it shares no border with the USA), politicization (South Korean officials complained that the IMF officials were trying to smuggle trade concessions to the USA in an otherwise totally financial package of measures) and too much red tape. But this was to be expected of an organization this size and with so much power.

The medicine is no better than the doctor or, for that matter, than the disease that it is intended to cure.

The IMF forces governments to restrict flows of capital and goods. Reducing budget deficits belongs to the former - reducing balance of payments deficits, to the latter. Consequently, government find themselves between the hard rock of not complying with the IMF performance demands (and criteria) - and the hammer of needing its assistance more and more often, getting hooked on it.

The crusader-economist Michel Chossudowski wrote once that the IMF's adjustment policies "trigger the destruction of whole economies". With all due respect (Chossudowski conducted research in 100 countries regarding this issue), this looks a trifle overblown. Overall, the IMF has beneficial accounts which cannot be discounted so off-handedly. But the process that he describes is, to some extent, true:

Devaluation (forced on the country by the IMF in order to encourage its exports and to stabilize its currency) leads to an increase in the general price level (also known as inflation). In other words: immediately after a devaluation, the prices go up (this happened in Macedonia and led to a doubling of the inflation which persisted before the 16% devaluation in July 1997). High prices burden businesses and increase their default rates. The banks increase their interest rates to compensate for the higher risk (=higher default rate) and to claw back part of the inflation (=to maintain the same REAL interest rates as before the increase in inflation). Wages are never fully indexed. The salaries lag after the cost of living and the purchasing power of households is eroded. Taxes fall as a result of a decrease in wages and the collapse of many businesses and either the budget is cruelly cut (austerity and scaling back of social services) or the budget deficit increases (because the government spends more than it collects in taxes). Another bad option (though rarely used) is to raise taxes or improve the collection mechanisms. Rising manufacturing costs (fuel and freight are denominated in foreign currencies and so do many of the tradable inputs) lead to pricing out of many of the local firms (their prices become too high for the local markets to afford). A flood of cheaper imports ensues and the comparative advantages of the country suffer. Finally, the creditors take over the national economic policy (which is reminiscent of darker, colonial times).

And if this sounds familiar it is because this is exactly what is happening in Macedonia today. Communism to some extent was replaced by IMF-ism. In an age of the death of ideologies, this is a poor - and dangerous - choice. The country spends 500 million USD annually on totally unnecessary consumption (cars, jam, detergents). It gets this money from the IMF and from donor countries but an awful price: the loss of its hard earned autonomy and freedom. No country is independent if the strings of its purse are held by others.

In an interview he granted on April 14, 2005 to the Washington File, produced by the Bureau of International Information Programs, U.S. Department of State, John Taylor, outgoing Under Secretary of the Treasury outlined the Bush administration's vision for the International Monetary Fund (IMF).

The IMF, he said, ***"assess the economic policies of countries that do not need the fund's resources ... (This) would allow the IMF to signal its approval or disapproval of, and provide markets with a clearer view of a country's economic policies ... (Other reforms would be) the inclusion of collective action clauses in sovereign bond issues and 100 percent debt forgiveness for the most impoverished countries ..."***

I. The Organization

A typical week at the IMF in June 2002.

Franek Rozwadowki, the new Chief of Mission for Macedonia implored the government to "implement prudent fiscal and monetary policies, particularly on wages (which impact) the budget, employment, and growth." The government - facing elections in September that year - and the IMF failed to conclude a standby agreement for 2002-2003.

In another fragile corner of the globe, the Senate of Argentina, at the behest of the IMF, scrapped the 1974 Law of Economic Subversion often applied to foreign investors by the military junta and, more recently, by the courts. It was one of numerous conditions posed by the IMF in its negotiations with the embattled government.

Later, Argentina defaulted on its obligations to the IMF and to other creditors and bondholders.

The Malawian authorities accused the IMF of "encouraging" the country to sell its strategic maize reserves at a 50 percent loss on the eve of crippling and famine-inducing crop shortages. The proceeds were to be used to pay off foreign commercial debts - claimed the Minister of Agriculture. The IMF denied any involvement and pointed the finger at both a food expert of the European Union - and the Malawi government.

In Uruguay - the hapless victim of Argentina's meltdown - the Fund supported a tripling of an existing loan to $2.2 billion. The IMF praised the government's unpopular hiking of taxes on salaries and pensions in the midst of a severe recession. It was the only way Uruguay could comply with its fiscal targets, it said.

The IMF was founded in 1944 by the nearly victorious allies. It reflects the lessons derived from the global depression that preceded and precipitated the conflagration. Its limited and crystal clear charter reads:

"The IMF was created to promote international monetary co-operation ; to facilitate the expansion and balanced growth of international trade; to promote exchange stability; to assist in the establishment of a multilateral system of payments; to make its general resources temporarily available to its members experiencing balance of payments difficulties under adequate safeguards; and to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members."

Like other Cold War structures - the IMF is an organization in search of a mission. It is more powerful, more controversial, more intrusive, more paternal, more coercive, more ubiquitous and more integrated with the US administration and other multilateral agencies and institutions than it has ever been. It has "invaded" the turf of other agencies and NGO's and appropriated some private sector functions as well.

In the process, it has exceeded its charter and its mandate by far and has transformed itself into a combination gigantic research institute, consultancy house, technical training facility, university, rating agency, supervisory authority, development bank, investment bank, and executive with sharply increased powers. Many resent this mission creep or feel threatened by it.

Others question the wisdom of such functional imperialism and its impact on the IMF and on its "clients" and shareholders - the nation-states. Doubts are voiced: is the IMF, this Byzantine bureaucracy, truly necessary? Can't the private sector take over many of its roles? The IMF's lack of transparency and accountability do not help.

It had to pass a special "transparency decision" in January 2001, calling for more thorough disclosure of its deliberations with member countries. Responding to the indignant outcry of NGO's and the private sector - the IMF has formed in 2002 an Internal Evaluation Unit. Yet, its inner processes, its finances, the inflated wages, perks and perquisites of its much feted and bloated bureaucracy - all remain alarmingly opaque.

As an example of the IMF's unexpected mutation, consider, for instance, its growing role in the regulation and surveillance of capital and financial markets throughout the world.

in May 2002, at the First Annual Forum of APEC's Finance and Development Program held in Beijing, the IMF's affable Deputy Managing Director, Shigemitsu Sugisaki, summed up the current philosophy of the lending agency:

"Our main priorities at the IMF have been on strengthening surveillance and crisis prevention. We cannot expect to eliminate all future crises, nor can we expect to be able to fully anticipate them. However, we can do a better job of reducing the risks of crises by promoting sound policies and the development of strong institutions by our member countries, as well as better risk assessments and investment decisions by market participants."

A new International Capital Markets Department keeps track of private capital flows, collaborates with other departments on assessment of vulnerabilities, on the monitoring of markets, forecasting, and the development of early warning systems. Sugisaki is unabashed about the IMF's role in providing investors with "a stronger basis to make judgments about the allocation of private capital" - hitherto the reserve of private sector rating agencies and global investment banks.

The IMF regularly issues Reports on the Observance of Standards and Codes (ROSC's) which cover "institutional issues, in particular on data dissemination, fiscal transparency, monetary and financial policy transparency, and financial sector issues". The IMF is collaborating with the OECD's FATF (Financial Action Task Force) on an anti-money laundering module.

This is only one of the Fund's institutional reform initiatives - hitherto tackled by the World Bank, NGO's, multilateral organizations (such as the UN), and bilaterally, between governments.

The Fund - jointly with the World Bank and other multilateral institutions - provides its members with a "Financial Sector Assessment Program" (FSAP) - a review of financial institutions, legislation, regulation, and supervision coupled with prescriptive measures to counter detected vulnerabilities. This review process covers also off shore money centers.

But the IMF is now competing head on not only with rating agencies and investment bankers - but also with regional development lenders and with its Bretton-Woods twin, the World Bank. IMF officials, rendered cynical by decades of friction with crime gangs thinly disguised as governments - consistently disparaged and mocked the feely-touchy, less than rigorous approach to lending of their World Bank counterparts.

To the citizens of many impoverished countries, who bear the brunt of its dogmatic austerity measures, the IMF is a repository of privileged and confidential information about their countries. It is unelected, unsupervised, misunderstood - yet, seemingly omnipotent and forever encroaching on often hard-earned sovereignty, like some sinister Medieval order.

In a dialog with Tom Rodwell, an Australian journalist, I wrote:

"The IMF has yet to adopt the "client-orientated" approach. It harbors deep (and oft-justified) distrust of the willingness of governments to blindly follow its dictates. It is a paranoid organization, based on authoritarian techniques of 'negotiations' and 'agreement'. Euphemisms rule. Normally, the IMF holds 'consultations' with the host governments. These are rather one-sided affairs. The governments are needy and impoverished ones. They lack the cadre of educated people needed in order to truly engage the IMF in constructive discourse. They are intimidated by the bullying tactics of the IMF and of its emissaries. The tone is imperial and impatient."

I was, therefore, startled to learn that the IMF's hallowed Executive Board has approved, on May 10, 2002 the Africa Capacity Building Initiative "in response to the urgent call by African leaders ... to strengthen economic governance and domestic capacity ... to carry out sound economic poverty-reducing policies."

Though presented as part of the IMF's ongoing technical assistance program - it is clearly and closely linked to political initiatives in Africa by the American administration - and to the New Partnership for Africa's Development, South Africa's pet project.

The World Bank and assorted donors - as well as the atrociously run African Development Bank - are supposed to act as equal partners. Still, the Initiative is clearly "owned" by the IMF. Its resident experts are slated to do the bulk of the arduous work. The IMF has, thus, firmly established itself in the hitherto excluded bureaucratic turf of development financing.

The argument against the IMF often revolves around two axes:

That it is a neo-colonialist institution, out to perpetuate the hegemony of rich countries over poorer ones - and that it is an impregnable fortress of outdated, inappropriate, even detrimental economic policies, collectively known as "The Washington Consensus".

The IMF is undoubtedly under undue political influence by the USA - which underwrites a quarter of its budget and hosts its headquarters. The recent spate of lending to Turkey and past excesses in Yeltsin's venal and mismanaged Russia are attributable to such American arm-twisting. The appointment, in early 2005, of a neo-conservative stalwart, Paul Wolfowitz, to head the IMF, is likely to exacerbate this incestuous relationship.

It is also true that the IMF is greatly concerned with its members' ability to service their external debt and, therefore, with the debt's size, sustainability, and sensitivity to fiscal and monetary policies. In this sense, the IMF is, indeed, the guardian of foreign creditors and their representative and enforcer. It so happens that most creditors are rich countries or banks and investors from the West.

But it would be nothing short of paranoid to postulate some kind of conspiracy, or colonial-mercantilist designs, or to claim, as the Canadian Prof. Michel Chussodowski does, that the IMF is a willing and cognizant instrument in the destruction of certain nations (e.g., Yugoslavia), or, generally, accuse it of other geopolitical machinations.

Few of the IMF's vocal anti-globalization opponents know that it deals as regularly and as strictly with its richer members - even those which do not require its assistance, advice, or intervention. On May 8, 2002, for instance, it concluded the mandatory Article IV consultation with Denmark.

The IMF explains Article IV thus:

"Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities."

The IMF sounded these cautionary notes about Denmark's generally much-praised economic policies:

"It will be important to avoid public spending overruns while allowing for the operation of automatic stabilizers ... Some wage moderation is needed to stem losses in market shares in continental Europe ... Improving public expenditure discipline, particularly at the lower levels of the government, should be a priority ... (We) encourage the authorities to pursue intentions to strengthen public management and outsource services where appropriate ... recommend that the long-term viability of the present welfare system should be kept

under close review by the Danish authorities." And so on.

A recent (April 2005) report castigated America's profligacy and the globally destabilizing effects of its alarming and ever-mushrooming twin (the trade and the budget) deficits.

While the conspiracy theories can be safely and off-handedly discarded - it is a lot more difficult to defend the IMF's policies. These consist of a universally-applied prescription of fiscal and monetary discipline, balanced budgets, a sustainable public debt, avoidance of moral hazard, restrained wage and expenditure policies, preference for the private sector, enhancement of the financial sector, structural reform, and exchange rate stability.

The IMF still sticks to the doctrine of a "nominal anchor": if not the exchange rate - than inflation targeting. The IMF concedes that the consensus is shifting towards more flexible exchange rate regimes in countries exposed to the global capital markets - but this is not supported by its policy advice.

The IMF's Deputy Managing Director, Shigemitsu Sugisaki hastened to stamp out this heresy in his address to the First Annual Forum of APEC's Finance and Development Program held in Beijing on May 26, 2002:

"Of course, this is not to say that, for certain economies, a pegged exchange rate regime, buttressed by the requisite supporting policies and institutions, cannot be a viable alternative. For such economies, in general, the harder and more rigid the peg, the better ... (Floating

exchange rate regimes) do not imply a policy of benign neglect toward the exchange rate."

"For emerging market countries, with their high degree of involvement with global trade and finance, movements in exchange rates have important economic consequences, and economic policies, including monetary policy and exchange market intervention, need to take account of these movements." This is the oxymoron of "managed float".

The principles are commendable - their blind and doctrinarian implementation in the form of micromanaged conditionality - are not. The IMF - aware of its fast eroding public and political support, especially in the USA - has recently conjured up "country ownership" of agreed economic programs and "poverty reduction and growth facilities" - both intended to soothe jangling nerves. But these public relations exercises are auxiliary to its main thrust: fiscal rectitude, solvency, debt repayments.

Alas, many of these policies are ill-suited to the needs of failed or mismanaged states and the kleptocracies that rule them - the IMF's main clientele. While in "normal" countries macroeconomic stability is the prerequisite to long-term economic growth - this is not necessarily the case in the developing, emerging, and transition economies of sub-Saharan Africa, the Middle East, South Asia, East Europe, Central Asia, Latin America, or the Balkan.

Actually, too much stability may, in these benighted corners of the Earth, spell stagnation. Stability cannot translate to growth in the absence of functioning institutions, the rule of law, and properly rights. A dysfunctional banking system and rusted or clogged monetary transmission mechanisms render any monetary policy impotent.

A venal bureaucracy and graft-prone political class are likely to squander and misappropriate loans and grants - no matter how well intentioned and closely supervised. Finally, in the absence of a formal, entrepreneurial, and thriving private sector - only the state can provide a counter-cyclical impetus and the sole engine of growth is development-related and consumption-enhancing public spending. Public expenditures are the only functioning automatic stabilizer.

In this context, the classic argument of "public borrowing crowding out the private sector" is misplaced. Most of the private sector in these countries is informal. It does not compete in the credit markets with public borrowing - simply because there are no credit or capital markets to speak of. Interest rates are onerously high due to outlandish default rates - so, businesses borrow from each other, barter, and work in cash. Banks refuse to lend to businesses or households and thrive on arbitrage. Investment horizons are limited.

The IMF is obsessed with "exchange rate (and other nominal) anchors". It erroneously believes that - where all else is ominously fluid - only a predictable exchange rate (or inflation target) can guarantee stability. But this forces the government to adhere to constant policies of Procrustean fiscal contraction and thus exacerbate the anyhow depressed state of the economy. The alternative - fiscal expansion - would lead to pressure on the exchange rate peg and result in devaluation.

Yet, a pegged exchange rate in inflation-prone economies is tantamount to appreciation of the domestic currency - another form of instability. An overvalued currency coupled with deficient structural reforms and low productivity - adversely affect the country's terms of trade (i.e., its competitiveness in export markets).

This declining competitiveness, in turn, leads to trade deficits and a deteriorating balance of payment. Hence another IMF-inspired source of instability. Thus, a regime of pegged exchange rates exacerbates both the duration and the degree of disequilibrium in the international balance of payments of the IMF's members.

The current account of a country that runs a gigantic balance of payments deficit but is not permitted by the IMF to devalue its currency - is only likely to deteriorate. Often, to protect the currency, the whole system is drained of liquidity (demonetized), interest rates are kept debilitatingly high, and the balance of payments deficit skyrockets, until the inevitable collapse.

Moreover, exchange (rate) stability inhibits the expansion and balanced growth of international trade - an explicit role of the IMF. Trade is based on dynamic exchange rate disparities which reflect the relative advantages of the countries involved. In a world of artificially fixed exchange rates - trade stagnates and price signals are distorted.

The IMF was never mandated to rate the creditworthiness of its members and shareholders. In providing clean or soiled bills of financial health it is manifestly acting ultra vires. Its ability to strangle a country financially if it does not comply with its programs - no matter what the social or economic costs are - is very worrying.

The IMF refuses to acknowledge that, far from being an exact science, economics is a branch of mass psychology and a form of social engineering. Not unlike previous central planning agencies, it neglects the social, political, and environmental costs of its policies. Yet, these sometimes outweigh the purely economic outcomes.

High interest rates stifle growth. An unrealistic exchange rate dampens exports. These effects are accounted for in the IMF's models. But there are other pernicious policy outcomes which the IMF consistently ignores - at the peril of the member countries:

Persistent unemployment breeds crime. Poverty results in civil strife. Taxes drive a growing part of the economy underground. Low wages in the public sector lead to venality and graft. Growing income inequalities foster discontent and brain drain. Different cultures possess different priorities, preferences, and values.

The IMF is indispensable. It imposes monetary and fiscal discipline on unruly governments, forces them to plan ahead, and introduces painful adjustments and reforms as well as better governance. It serves as a convenient scapegoat: politicians blame it for their own shortcomings and misguided policies and claim that negotiations with the IMF and follow-up consume the bulk of their management time to little effect.

Finally, there is the Damocles sword of moral hazard. IMF lending of last resort is a safety net made available to countries "too big or too important to fail". It encourages politicians, creditors, and investors to assume risks they would not have otherwise, convinced of an ultimate bailout in case of failure. This certainty has been dented when the IMF refused to salvage Russia in 1998 and Argentina four years later - but it is still largely intact.

But there is a second type of moral hazard. When IMF-mandated policies succeed, local politicians hasten to take credit. When they fail - the IMF is universally derided. Thus, stakeholders - decision makers, reckless lenders, loss-prone investors, friendly governments, the citizenry - conveniently shift to Washington the blame for their own misdeeds and misbehavior.

This kind of buck passing is known in psychology as "alloplastic defenses" and is considered an integral part of some pathologies. Here, too, increased transparency and accessibility can help. The IMF needs to assertively point the finger and allocate blame when wrongly accused.

The IMF is lucky to be attacked either by anti-market fundamentalists, or by anti-IMF fanatics. Passionate emotions frequently produce ill-thought and unfounded arguments. Consider this exchange:

In a press briefing on May 16, 2002, Thomas Dawson, the Fund's Director of External Relations Department was asked by one of the journalists:

"I'd like to get your reaction to a prominent Nobel prize-winning economist (Joseph Stiglitz), who laid out an opinion last weekend, saying that the IMF's insistence on fiscal tightening in Argentina made things worse, and that the high rates of interest in Argentina were largely a function of external factors, such as the Asian

financial crisis, and that the IMF's approach and the approach of others have amounted to blaming the victim."

He responded, thrashing the poor arguments of the distinguished - but biased - critic:

"With regard to the fiscal tightening point ... in the course of the year 2001 when the authorities, without consulting with us, instituted the zero-deficit law ... We indicated to them that we thought this was excessive fiscal tightening ... He (Stiglitz) ... focuses on federal spending levels, barely mentioning provincial levels. As the authorities themselves indicate in the April 24th 14-point agreement, having an arrangement on the provincial level is very, very important ..."

"He also indicates that corruption is not much of a problem. The authorities ... indicate that corruption issues are very important. He also, I think, fails to understand or recognize the sovereignty of the Argentine people. The Currency Board was adopted by the Argentine Government in the early 1990s, enjoyed for a number of years a great deal of popular support, and it seems as if Professor Stiglitz is trying to say that what we should have done is gone to the Argentines and dictate to them to change their currency regime. That's what we are usually accused of by Professor Stiglitz, but he seems to be taking that sort of approach himself. So, I have to say I am rather under whelmed with his arguments."

II. The Policies

Indonesia's Minister of Development Planning called in May-June 2002 on his country to sever its ties with the "colonial power", the IMF, come November 2002, when its agreement with the lending agency expires. He blamed its coercive policies for the country's alleged near insolvency and civil disorder. Local bigwigs hastened to concur.

Lenders and donors often condition credits, debt reduction, and aid upon the IMF's seal of approval, in the form of a standby arrangement. Despite protestations to the contrary, cross-conditionality - including World Bank conditions in IMF programs and vice versa - is still rife.

Thus, inadvertently, the IMF has assumed in the last two decades the dual - and intimately related - roles of a sovereign credit risk rating agency and a lender of last resort - hitherto not among its core few and well-defined competencies.

Because other, non-IMF, financing is premised on its endorsement, the IMF carries disproportionate weight with governments and often leverages this stature to non-economic ends. From Moldova to Russia, the IMF has not been above meddling in domestic politics, though in the guise of "impartial advice" or "loan conditions to be met".

The IMF lends funds to countries in distress - e.g., to ameliorate a balance of payment or a capital account crisis (for instance, in Thailand in 1997), or a meltdown of the financial system (in Turkey last year). Such lending is predicated on a program ostensibly negotiated with the authorities - but, in practice, dictated by the IMF. The program provides detailed policy guidelines and performance evaluation benchmarks.

Yet, how reliable and realistic are these programs? Often produced in the throes of civil strife (Macedonia), currency collapse (Brazil), implosion of the banking system (Argentina), or natural and man-made disasters (Africa) - they tend to reflect mere wishful thinking and bureaucratic wrangles.

They are based on partial or fake figures provided by the kleptocracies that rule many of the IMF's most needy clients. Though mainly forward-looking (prospective) - IMF programs imply a modicum of certainty where there is none and are, thus, grossly misleading documents.

Rarely does the IMF admit that it is as much at a loss as its client government. In 2001 - as Albanians fought Macedonians in the outskirts of the capital, Skopje - The IMF suspended a previous program and placed Macedonia on "staff monitoring" - a euphemism for "let's wait and see how things turn out".

But these criticisms aside - the IMF is an important global center of scholarship and policy advice. It has made some contributions to the overhaul of the international financial architecture in train since 1998 - and is advocating controversial innovations such as national bankruptcy proceedings. Yet, is its advice sound and are its policies efficacious?

The IMF's prescriptive - and universally applied - policy mix displayed remarkable resilience in the face of global financial crises in the past decade. It includes: austerity measures, fiscal and monetary discipline, decreased inflation, balanced budgets, a sustainable public debt, avoidance of moral hazard, restrained wage and expenditure policies, preference for the private sector, the strengthening of the financial system, and structural reform.

In its recent past, the IMF advocated crippling competitive devaluations. This policy "recommendation" has now been replaced by either a pegged exchange rate - or a free floating rate coupled with an inflation target. These are known as "nominal anchors" and are supposed to guarantee economic stability and its inevitable outcome: economic growth.

The World Bank summarized the ten commandments of the Washington Consensus in its year 2000 Poverty Report thus:

1. Fiscal discipline;
2. Redirection of public expenditure toward education, health and infrastructure investment;
3. Tax reform - broadening the tax base and cutting marginal tax rates;
4. Interest rates that are market determined and positive (but moderate) in real terms;
5. Competitive exchange rates;
6. Trade liberalization - replacement of quantitative restrictions with low and uniform tariffs;
7. Openness to foreign direct investment;
8. Privatization of state enterprises;
9. Deregulation - abolition of regulations that impede entry or restrict competition, except or those justified on safety, environmental and consumer protection grounds, and prudential oversight of financial institutions;

10. Legal security for property rights.

The IMF is fairly dogmatic and ideological. It never praises - or learns from - countries - no matter how economically successful - if they diverged from its doctrines. Two prime examples are: Malaysia which introduced capital controls following the 1998 Asian crisis - and Ireland which pursued expansionary fiscal policies despite a decade of searing-hot economy. Both acted contrary to every vestige of IMF wisdom - and both prospered.

The IMF deviates from its catechism only when instructed to do so by its paymaster, the USA. Thus, Stratfor, the American strategic forecasting firm, noted the schizophrenic behaviour of the IMF. Under fairly similar circumstances, it chose to lend to Turkey, a crucial US ally - but not to Argentina. The IMF's new African poverty reduction initiative carries the fingerprints of the American administration as well.

Most strikingly, in line with the much proclaimed US positions, and contrary to everything the IMF has ever preached, it encourages Japan to slash its taxes even further while increasing its public spending, and, by implication, its crushing and unsustainable public debt and gaping budget deficit.

But these are aberrations. Moreover, even the orthodoxy of the "Washington Consensus" is not all wrong. The faults of the IMF's policies run deeper and can be traced to its modus operandi and raison d'etre.

First, though much reduced, some IMF "crisis" lending is concessionary - soft loans, at subsidized interest rates, with sizable grace periods. This fosters moral hazard and encourages imprudent behavior. Walter Bagehot, the legendary 19th editor of "The Economist", advised lenders of last resort to lend freely but at a penalty rate and against collateral.

Charles Calomiris and Allan Meltzer follow this sound advice in their Summer 1999 article published in "National Affairs" and titled "Fixing the IMF":

"A penalty rate encourages the borrower to negotiate with private creditors to seek (lower) market rates. The IMF would lend only when there is a liquidity crisis-that is, when private lenders are unwilling to lend. That is precisely the responsibility that a lender of last resort should fulfill."

The second fundamental problem is that IMF programs exclusively tackle national "balance sheets" - budget deficits, inflation, and public debt. The implicit assumption is that the smaller and more thrifty the state - the better off its citizenry. This principle invariably holds true in rich and well-governed countries.

Not so in developing, emerging, and transition economies. Here, the better the national accounts - the worst off the inhabitants. Unemployment, social tensions, and poverty grow as macroeconomic parameters "improve". Income and wealth inequalities soar and the middle class evaporates to the detriment of the country's political stability.

This inversion is due to arthritic monetary transmission mechanisms - and to the absence of a private sector. The economic engine in such destitute countries is the state.

Public spending takes the place of capital formation and generates consumption. The savings level is largely immaterial because financial intermediaries fail to transform it into investments. Thus, the curbing of the state's involvement in the economy has an adverse and prolonged recessionary impact.

The third perverse trend is the crowding-out of private sector or bilateral capital flows by multilateral debt. The share of IMF and World Bank lending in the total public debt of developing countries has quintupled in the last two decades. The money is mostly used to repay creditors - multilateral, bilateral, and private sector (i.e., banks). Thus, the increase in the total indebtedness of borrowing countries serves to bail out stranded lenders - but does little to foster economic growth and development.

The IMF's biggest problem by far may be that it strayed way out of its - ostensible - competency. It is reasonably qualified to deal with fiscal matters, the financial system, and monetary issues with emphasis on the exchange rate regime. It is an absolute dilettante when it comes to reform - structural or otherwise.

"The Reality of Aid 2002", a report produced by a coalition of NGO's, charges that:

"Far from abandoning aid conditionality, international financial institutions and bilateral donors are collaborating in an unprecedented consensus to retool the aid regime under the rubric of 'ownership' and aid effectiveness."

The IMF itself admits, in its February 2001 report, "Structural Adjustment Conditionality in Fund-Supported

Programs", to an average of 41 conditions per agreement concluded between 1995-2000. Independent scholars, such as Nancy Alexander, found 114 conditions in a typical program in sub-Saharan Africa in 1999.

The International Confederation of Free Trade Unions (ICFTU) cites the example of Romania's November 2001 standby arrangement with the IMF. It included conditions pertaining to the liberalization of domestic energy prices, privatization, and the restructuring of state-owned enterprises. Macedonia was required by the IMF to sell or shut down its loss-making state enterprises as a condition for any agreement with the Fund.

This control freakery coupled with micromanagement of the minutest details of both the economic and social policies of recipient-countries is counter-productive. The IMF personnel are poorly qualified to dole out policy advice on these issues. They compensate for insecurity with haughtiness. As a result, the IMF's clients are alienated and angered by its conduct.

They regard the Fund's programs as external and sinister impositions and at best ignore parts of it. The dual concepts of "ownership" and "aid effectiveness" are rendered shams by this overweening attitude. What could have been a partnership between indigenous reformists and well-meaning, knowledgeable, foreigners - is frequently transformed into a xenophobic tug of war.

The tenets of the Washington Consensus are no longer confined to arcane provisos in IMF and World Bank programs. They are now the pillars of a new regime of international law. They are embedded in the charter of the World Trade Organization, for instance - a quasi-judiciary body as well as a regulator of international trade and much more besides.

In many respects, therefore, the IMF survived the 1997-8 crisis to prosper and become more potent than ever. Hence, perhaps, the backlash by well-meaning but often ignorant and impractical anti-globalizers and assorted self-appointed NGO's. To its credit, the IMF is not ignoring them. It is trying to maintain a meaningful dialog. But its survival is not premised on the success of such a discourse - as it was once thought to be.

Footnote - Ann Kruger's SDRM plan

The IMF is, in a way, a lender of last resort. When a country seeks IMF financing, its balance of payments is already ominously stretched, its debt shunned by investors, and its currency under pressure. Put differently, the IMF's active clients are effectively illiquid (though never insolvent in the strict sense of the word). Anne Krueger's November 2001 proposal to allow countries to go bankrupt makes, therefore, eminent sense.

Today, sovereign debt defaults result in years of haggling among bankers and bondholders. It is a costly process, injurious to the distressed country's future ability to borrow. The terms agreed are often onerous and, in many cases, lead to a second event of default. The experiences of Argentina, Ukraine, and Ecuador are instructive. Russia - another serial debt restructurer - would have been in a far worse pickle were it not for the serendipitous surge in oil prices.

A carefully thought-out international sovereign bankruptcy procedure is likely to yield two important results:

I. It will relegate to the marketplace many tricky issues now tackled by a politically-compromised and bloated IMF.
II. It will eliminate the ability of a single creditor to blackmail all the others - and the debtor - into an awkward deal (the "last man syndrome).

By streamlining and clarifying the outcomes of financial crises, an international bankruptcy court, or arbitration mechanism, will, probably, enhance the willingness of veteran creditors to lend to developing countries and even attract new funding. It is the murkiness and arm-twisting of the current non-system that deter capital flows to emerging economies.

Still, the analogy is partly misleading. What if a developing country abuses the bankruptcy procedures? As "The Economist" noted correctly "an international arbiter can hardly threaten to strip a country of its assets, or forcibly change its 'management'".

Yet, this is precisely where market discipline comes in. A rogue debtor can get away with legal shenanigans once - but it is likely to be shunned by lenders henceforth. Good macroeconomic policies are bound to be part and parcel of any package of debt rescheduling and restructuring in the framework of a sovereign bankruptcy process.

Immigration (and Labor)

Jean-Marie Le Pen - France's dark horse presidential contender - is clearly emotional about the issue of immigration and, according to him, its correlates, crime and unemployment. His logic is dodgy at best and his paranoid xenophobia ill-disguised. But Le Pen and his ilk - from Carinthia to Copenhagen - succeeded to force upon European mainstream discourse topics considered hitherto taboos. For decades, the European far right has been asking all the right questions and proffering all the far answers.

Consider the sacred cow of immigration and its emaciated twin, labour scarcity, or labour shortage.

Immigrants can't be choosy. They do the dirty and dangerous menial chores spurned by the native population. At the other extreme, highly skilled and richly educated foreigners substitute for the dwindling, unmotivated, and incompetent output of crumbling indigenous education systems in the West. As sated and effete white populations decline and age, immigrants gush forth like invigorated blood into a sclerotic system.

According to the United Nations Population Division, the EU would need to import 1.6 million migrant workers annually to maintain its current level of working age population. But it would need to absorb almost 14 million new, working age, immigrants per year just to preserve a stable ratio of workers to pensioners.

Similarly hysterical predictions of labour shortages and worker scarcity abounded in each of the previous three historic economic revolutions.

As agriculture developed and required increasingly more advanced skills, the extended family was brutally thrust from self-sufficiency to insufficiency. Many of its functions - from shoemaking to education - were farmed out to specialists. But such experts were in very short supply. To overcome the perceived workforce deficiency, slave labour was introduced and wars were fought to maintain precious sources of "hands", skilled and unskilled alike.

Labour panics engulfed Britain - and later other industrialized nations such as Germany - during the 19th century and the beginning of the twentieth.

At first, industrialization seemed to be undermining the livelihood of the people and the production of "real" (read: agricultural) goods. There was fear of over-population and colonial immigration coupled with mercantilism was considered to be the solution.

Yet, skill shortages erupted in the metropolitan areas, even as villages were deserted in an accelerated process of mass urbanization and overseas migration. A nascent education system tried to upgrade the skills of the newcomers and to match labour supply with demand. Later, automation usurped the place of the more expensive and fickle laborer. But for a short while scarce labour was so strong as to be able to unionize and dictate employment terms to employers the world over.

The services and knowledge revolutions seemed to demonstrate the indispensability of immigration as an efficient market-orientated answer to shortages of skilled labour. Foreign scientists were lured and imported to form the backbone of the computer and Internet industries in countries such as the USA. Desperate German politicians cried "Kinder, not Inder" (children, not Indians) when chancellor Schroeder allowed a miserly 20,000 foreigners to emigrate to Germany on computer-related work visas.

Sporadic, skill-specific scarcities notwithstanding - all previous apocalyptic Jeremiads regarding the economic implosion of rich countries brought on by their own demographic erosion - have proven spectacularly false.

Some prophets of doom fell prey to Malthusian fallacies. According to these scenarios of ruination, state pension and health obligations grow exponentially as the population grays. The number of active taxpayers - those who underwrite these obligations - declines as more people retire and others migrate. At a certain point in time, the graphs diverge, leaving in their wake disgruntled and cheated pensioners and rebellious workers who refuse to shoulder the inane burden much longer. The only fix is to import taxable workers from the outside.

Other doomsayers gorge on "lumping fallacies". These postulate that the quantities of all economic goods are fixed and conserved. There are immutable amounts of labour (known as the "lump of labour fallacy"), of pension benefits, and of taxpayers who support the increasingly insupportable and tenuous system. Thus, any deviation from an infinitesimally fine equilibrium threatens the very foundations of the economy.

To maintain this equilibrium, certain replacement ratios are crucial. The ratio of active workers to pensioners, for instance, must not fall below 2 to 1. To maintain this ratio, many European countries (and Japan) need to import millions of fresh tax-paying (i.e., legal) immigrants per year.

Either way, according to these sages, immigration is both inevitable and desirable. This squares nicely with politically correct - yet vague - liberal ideals and so everyone in academe is content. A conventional wisdom was born.

Yet, both ideas are wrong. These are fallacies because economics deals in non-deterministic and open systems. At least nine forces countermand the gloomy prognoses aforementioned and vitiate the alleged need for immigration:

I. Labour Replacement

Labour is constantly being replaced by technology and automation. Even very high skilled jobs are partially supplanted by artificial intelligence, expert systems, smart agents, software authoring applications, remotely manipulated devices, and the like. The need for labour inputs is not constant. It decreases as technological sophistication and penetration increases. Technology also influences the composition of the work force and the profile of skills in demand.

As productivity grows, fewer workers produce more. American agriculture is a fine example. Less than 3 percent of the population are now engaged in agriculture in the USA. Yet, they produce many times the output produced a century ago by 30 percent of the population. Per capita the rise in productivity is even more impressive.

II. Chaotic Behaviour

All the Malthusian and Lumping models assume that pension and health benefits adhere to some linear function with a few well-known, actuarial, variables. This is not so. The actual benefits payable are very sensitive to the assumptions and threshold conditions incorporated in the predictive mathematical models used. Even a tiny change in one of the assumptions can yield a huge difference in the quantitative forecasts.

III. Incentive Structure

The doomsayers often assume a static and entropic social and economic environment. That is rarely true, if ever. Governments invariably influence economic outcomes by providing incentives and disincentives and thus distorting the "ideal" and "efficient" market. The size of unemployment benefits influences the size of the workforce. A higher or lower pension age coupled with specific tax incentives or disincentives can render the most rigorous mathematical model obsolete.

IV. Labour Force Participation

At a labour force participation rate of merely 60% (compared to the USA's 70%) - Europe still has an enormous reservoir of manpower to draw on. Add the unemployed - another 8% of the workforce - to these gargantuan numbers - and Europe has no shortage of labour to talk of. These workers are reluctant to work because the incentive structure is titled against low-skilled, low-pay, work. But this is a matter of policy. It can be changed. When push comes to shove, Europe will respond by adapting, not by perishing, or by flooding itself with 150 million foreigners.

V. International Trade

The role of international trade - now a pervasive phenomenon - is oft-neglected. Trade allows rich countries to purchase the fruits of foreign labour - without importing the laborers themselves. Moreover, according to economic theory, trade is preferable to immigration because it embodies the comparative advantages of the trading parties. These reflect local endowments.

VI. Virtual Space

Modern economies are comprised 70% of services and are sustained by vast networks of telecommunications and transport. Advances in computing allow to incorporate skilled foreign workers in local economic activities - from afar. Distributed manufacturing, virtual teams (e.g., of designers or engineers or lawyers or medical doctors), multinationals - are all part of this growing trend. Many Indian programmers are employed by American firms without ever having crossed the ocean or making it into the immigration statistics.

VII. Punctuated Demographic Equilibria

Demographic trends are not linear. They resemble the pattern, borrowed from evolutionary biology, and known as "punctuated equilibrium". It is a fits and starts affair. Baby booms follow wars or baby busts. Demographic tendencies interact with economic realities, political developments, and the environment.

VIII. Emergent Social Trends

Social trends are even more important than demographic ones. Yet, because they are hard to identify, let alone quantify, they are scarcely to be found in the models used by the assorted Cassandras and pundits of international development agencies. Arguably, the emergence of second and third careers, second families, part time work, flextime, work-from-home, telecommuting, and unisex professions have had a more decisive effect on our economic landscape than any single demographic shift, however pronounced.

IX. The Dismal Science

Immigration may contribute to growing mutual tolerance, pluralism, multiculturalism, and peace. But there is no definitive body of evidence that links it to economic growth. It is easy to point at immigration-free periods of unparalleled prosperity in the history of nations - or, conversely, at recessionary times coupled with a flood of immigrants.

So, is Le Pen right?

Only in stating the obvious: Europe can survive and thrive without mass immigration. The EU may cope with its labour shortages by simply increasing labour force participation. Or it may coerce its unemployed (and women) into low-paid and 3-d (dirty, dangerous, and difficult) jobs. Or it may prolong working life by postponing retirement. Or it may do all the above - or none. But surely to present immigration as a panacea to Europe's economic ills is as grotesque a caricature as Le Pen has ever conjured.

Indices

The quality of Wall Street research has suffered grievous blows these last two years. Yet, publishers of political and economic indices largely escaped unscathed. Though their indicators often influence the pecuniary fate of developing countries, they are open to little scrutiny and criticism.

The Heritage Foundation and the Wall Street Journal are the joint publishers of the 2002 edition of the much-vaunted "Index of Economic Freedom". The annual publication purports to measure and compare the level of economic freedoms in 155 countries.

According to its Web site, the Index takes into account these factors:

- Corruption in the judiciary, customs service, and government bureaucracy;
- Non-tariff barriers to trade, such as import bans and quotas as well as strict labeling and licensing requirements;
- The fiscal burden of government, which encompasses income tax rates, corporate tax rates, and government expenditures as a percent of output;
- The rule of law, efficiency within the judiciary, and the ability to enforce contracts;
- Regulatory burdens on business, including health, safety, and environmental regulation;
- Restrictions on banks regarding financial services, such as selling securities and insurance;
- Labor market regulations, such as established work weeks and mandatory separation pay; and

- Black market activities, including smuggling, piracy of intellectual property rights, and the underground provision of labor and other services.

The Heritage Foundation's boasts of using the "most recent data" available on September 2001. I downloaded the chapter about Macedonia and studied it at length, starting with the most basic, numerical, "facts". I then compared them to figures released by the Macedonian Bureau of Statistics, the IMF, the World Bank, the European Bank for Reconstruction and Development, the United Nations Development agency, and the European Investment Bank.

Macedonia's GDP is $3.4 billion and not $2.7 billion as the report states. Macedonia's GDP exceeded $3 billion in the last 4 years. Nor has GDP grown by 2.7 percent last year or the year before. In 2001, it has actually declined by 4.3 percent and is likely to decline again or rise a little this year. As a result, GDP per capita is wrongly computed. The trade deficit is not $300 million - but double that. It has been above $500 for the last few years. Net foreign direct investment has been closer to $100 million for two years now - rather than the paltry $29 million the report misreports.

The report makes "rice" one of Macedonia's "major" agricultural products. It is, actually, first on its list. Alas, little rice is grown in Macedonia nowadays, though it did use to be a weighty European rice grower decades ago. Nor does the country produce noticeable quantities of citrus, or grains, as the report would have us believe.

The authoritative-sounding introduction to the chapter informs us that Macedonia maintains a budget surplus "from the sale of state-owned telecommunications". In its decade of existence, Macedonia enjoyed a budget surplus only in 2000 and it had nothing to do with the sale of its telecom to the German-Hungarian MATAV. The proceeds of this privatization were kept in a separate bank account. Only a small part was used for budgetary and balance of payment purposes.

The outgoing prime minister would be pleasantly astounded to learn that he "privatized approximately 90 percent of (the country's) state-owned firms". These were actually privatized by the opposition when it was in power until 1998. It is true that major assets, such as Macedonia's refinery and its leading bank, were privatized in the last 4 years. It is also true that the bulk of state-owned loss making enterprises were either sold or shut. But these constitute less than 15 percent of the number of companies the state owned in 1992.

The fiscal burden of Macedonia is 34 percent of GDP - not 23 percent as is the impression that section provides. It has surpassed 30 percent of GDP long ago. Moreover, in the sub-chapter titled "Fiscal Burden of the Government" the authors contend that "government expenditures equaled 23.3 percent of GDP". A mere three lines later fiscal rectitude sets in and "the government consumes 19 percent of GDP". Which is it?

The "monetary policy" segment is a misleading one-liner: "Between 1993 and 2000, Macedonia's weighted annual average rate of inflation was 7.15 percent." The term "weighted annual average rate of inflation" is not explained anywhere in the tome. Whatever it is, this average masks the hyperinflation of Macedonia's first half decade and the near deflation of the last few years. The straight average in this period was 56 percent, not 7 percent.

The report says that "the country's political instability has had a debilitating effect on foreign investment". It sounds logical but does not stand up to scrutiny. Investment flows actually increased in the conflict year as bargain hunters from Greece, Slovenia, Germany, and other countries converged on Macedonia.

And so it continues.

Macedonia is a tiny and unimportant country. Clearly, scarce research resources are better allocated to Russia or Indonesia. But many of the erroneous data quoted in the report would have required a single surfing session to amend. Sloppy editing, internal contradictions, and outdated information regarding one country, regardless of how inconsequential it is, render the entire opus suspicious.

Unfortunately, indices such as these affect both portfolio and direct investment flows, the country's rating, its image in the international media, and the government's standing domestically. The golden rule with such a responsibility is "handle with care". Regrettably, few do.

Inefficiency (Market)

Even the most devout proponents of free marketry and hidden hand theories acknowledge the existence of market failures, market imperfections and inefficiencies in the allocation of economic resources. Some of these are the results of structural problems, others of an accumulation of historical liabilities. But, strikingly, some of the inefficiencies are the direct outcomes of the activities of "non bona fide" market participants. These "players" (individuals, corporations, even larger economic bodies, such as states) act either irrationally or egotistically (too rationally).

What characterizes all those "market impeders" is that they are value subtractors rather than value adders. Their activities generate a reduction, rather than an increase, in the total benefits (utilities) of all the other market players (themselves included). Some of them do it because they are after a self interest which is not economic (or, more strictly, financial). They sacrifice some economic benefits in order to satisfy that self interest (or, else, they could never have attained these benefits, in the first place). Others refuse to accept the self interest of other players as their limit. They try to maximize their benefits at any cost, as long as it is a cost to others. Some do so legally and some adopt shadier varieties of behaviour. And there is a group of parasites – participants in the market who feed off its very inefficiencies and imperfections and, by their very actions, enhance them. A vicious cycle ensues: the body economic gives rise to parasitic agents who thrive on its imperfections and lead to the amplification of the very impurities that they prosper on.

We can distinguish six classes of market impeders:

1. ***Crooks and other illegal operators.*** These take advantage of ignorance, superstition, greed, avarice, emotional states of mind of their victims – to strike. They re-allocate resources from (potentially or actually) productive agents to themselves. Because they reduce the level of trust in the marketplace – they create negative

added value. (See: "The Shadowy World of International Finance" and "The Fabric of Economic Trust")

2. ***Illegitimate operators*** include those treading the thin line between legally permissible and ethically inadmissible. They engage in petty cheating through misrepresentations, half-truths, semi-rumours and the like. They are full of pretensions to the point of becoming impostors. They are wheeler-dealers, sharp-cookies, Daymon Ranyon characters, lurking in the shadows cast by the sun of the market. Their impact is to slow down the economic process through disinformation and the resulting misallocation of resources. They are the sand in the wheels of the economic machine.

3. The ***"not serious" operators***. These are people too hesitant, or phobic to commit themselves to the assumption of any kind of risk. Risk is the coal in the various locomotives of the economy, whether local, national, or global. Risk is being assumed, traded, diversified out of, avoided, insured against. It gives rise to visions and hopes and it is the most efficient "economic natural selection" mechanism. To be a market participant one must assume risk, it in an inseparable part of economic activity. Without it the wheels of commerce and finance, investments and technological innovation will immediately grind to a halt. But many operators are so risk averse that, in effect, they increase the inefficiency of the market in order to avoid it. They act as though they are resolute, risk assuming operators. They make all the right moves, utter all the right sentences and emit the perfect noises. But when push comes to shove – they recoil, retreat,

defeated before staging a fight. Thus, they waste the collective resources of all that the operators that they get involved with. They are known to endlessly review projects, often change their minds, act in fits and starts, have the wrong priorities (for an efficient economic functioning, that is), behave in a self defeating manner, be horrified by any hint of risk, saddled and surrounded by every conceivable consultant, glutted by information. They are the stick in the spinning wheel of the modern marketplace.

4. The former kind of operators obviously has a character problem. Yet, there is a more problematic species: those suffering from ***serious psychological problems***, personality disorders, clinical phobias, psychoneuroses and the like. This human aspect of the economic realm has, to the best of my knowledge, been neglected before. Enormous amounts of time, efforts, money and energy are expended by the more "normal" – because of the "less normal" and the "eccentric". These operators are likely to regard the maintaining of their internal emotional balance as paramount, far over-riding economic considerations. They will sacrifice economic advantages and benefits and adversely affect their utility outcome in the name of principles, to quell psychological tensions and pressures, as part of obsessive-compulsive rituals, to maintain a false grandiose image, to go on living in a land of fantasy, to resolve a psychodynamic conflict and, generally, to cope with personal problems which have nothing to do with the idealized rational economic player of the theories. If quantified, the

amounts of resources wasted in these coping manoeuvres is, probably, mind numbing. Many deals clinched are revoked, many businesses started end, many detrimental policy decisions adopted and many potentially beneficial situations avoided because of these personal upheavals.

5. ***Speculators and middlemen*** are yet another species of parasites. In a theoretically totally efficient marketplace – there would have been no niche for them. They both thrive on information failures. The first kind engages in arbitrage (differences in pricing in two markets of an identical good – the result of inefficient dissemination of information) and in gambling. These are important and blessed functions in an imperfect world because they make it more perfect. The speculative activity equates prices and, therefore, sends the right signals to market operators as to how and where to most efficiently allocate their resources. But this is the passive speculator. The "active" speculator is really a market rigger. He corners the market by the dubious virtue of his reputation and size. He influences the market (even creates it) rather than merely exploit its imperfections. Soros and Buffet have such an influence though their effect is likely to be considered beneficial by unbiased observers. Middlemen are a different story because most of them belong to the active subcategory. This means that they, on purpose, generate market inconsistencies, inefficiencies and problems – only to solve them later at a cost extracted and paid to them, the perpetrators of the problem. Leaving ethical questions aside, this is a highly wasteful

process. Middlemen use privileged information and access – whereas speculators use information of a more public nature. Speculators normally work within closely monitored, full disclosure, transparent markets. Middlemen thrive of disinformation, misinformation and lack of information. Middlemen monopolize their information – speculators share it, willingly or not. The more information becomes available to more users – the greater the deterioration in the resources consumed by brokers of information. The same process will likely apply to middlemen of goods and services. We are likely to witness the death of the car dealer, the classical retail outlet, the music records shop. For that matter, inventions like the internet is likely to short-circuit the whole distribution process in a matter of a few years.

6. The last type of market impeders is well known and is the only one to have been tackled – with varying degrees of success by governments and by legislators worldwide. These are the ***trade restricting arrangements***: monopolies, cartels, trusts and other illegal organizations. Rivers of inks were spilled over forests of paper to explain the pernicious effects of these anti-competitive practices (see: "Competition Laws"). The short and the long of it is that competition enhances and increases efficiency and that, therefore, anything that restricts competition, weakens and lessens efficiency.

What could anyone do about these inefficiencies? The world goes in circles of increasing and decreasing free marketry. The globe was a more open, competitive and, in certain respects, efficient place at the beginning of the 20th century than it is now. Capital flowed more freely and so did labour. Foreign Direct Investment was bigger. The more efficient, "friction free" the dissemination of information (the ultimate resource) – the less waste and the smaller the lebensraum for parasites. The more adherence to market, price driven, open auction based, meritocratic mechanisms – the less middlemen, speculators, bribers, monopolies, cartels and trusts. The less political involvement in the workings of the market and, in general, in what consenting adults conspire to do that is not harmful to others – the more efficient and flowing the economic ambience is likely to become.

This picture of "laissez faire, laissez aller" should be complimented by even stricter legislation coupled with effective and draconian law enforcement agents and measures. The illegal and the illegitimate should be stamped out, cruelly. Freedom to all – is also freedom from being conned or hassled. Only when the righteous freely prosper and the less righteous excessively suffer – only then will we have entered the efficient kingdom of the free market.

This still does not deal with the "not serious" and the "personality disordered". What about the inefficient havoc that they wreak? This, after all, is part of what is known, in legal parlance as: "force majeure".

Note

There is a raging debate between the "rational expectations" theory and the "prospect theory". The former - the cornerstone of rational economics - assumes that economic (human) players are rational and out to maximize their utility (see: "The Happiness of Others", "The Egotistic Friend" and "The Distributive Justice of the Market"). Even ignoring the fuzzy logic behind the ill-defined philosophical term "utility" - rational economics has very little to do with real human being and a lot to do with sterile (though mildly useful) abstractions. Prospect theory builds on behavioural research in modern psychology which demonstrates that people are more loss averse than gain seekers (utility maximizers). Other economists have succeeded to demonstrate irrational behaviours of economic actors (heuristics, dissonances, biases, magical thinking and so on).

The apparent chasm between the rational theories (efficient markets, hidden hands and so on) and behavioural economics is the result of two philosophical fallacies which, in turn, are based on the misapplication and misinterpretation of philosophical terms.

The first fallacy is to assume that all forms of utility are reducible to one another or to money terms. Thus, the values attached to all utilities are expressed in monetary terms. This is wrong. Some people prefer leisure, or freedom, or predictability to expected money. This is the very essence of risk aversion: a trade off between the utility of predictability (absence or minimization of risk) and the expected utility of money. In other words, people have many utility functions running simultaneously - or, at best, one utility function with many variables and coefficients. This is why taxi drivers in New York cease working in a busy day, having reached a pre-determined income target: the utility function of their money equals the utility function of their leisure.

How can these coefficients (and the values of these variables) be determined? Only by engaging in extensive empirical research. There is no way for any theory or "explanation" to predict these values. We have yet to reach the stage of being able to quantify, measure and numerically predict human behaviour and personality (=the set of adaptive traits and their interactions with changing circumstances). That economics is a branch of psychology is becoming more evident by the day. It would do well to lose its mathematical pretensions and adopt the statistical methods of its humbler relative.

The second fallacy is the assumption underlying both rational and behavioural economics that human nature is an "object" to be analysed and "studied", that it is static and unchanged. But, of course, humans change inexorably. This is the only fixed feature of being human: change. Some changes are unpredictable, even in deterministic principle. Other changes are well documented. An example of the latter class of changes in the learning curve. Humans learn and the more they learn the more they alter their behaviour. So, to obtain any meaningful data, one has to observe behaviour in time, to obtain a sequence of reactions and actions. To isolate, observe and manipulate environmental variables and study human interactions. No snapshot can approximate a video sequence where humans are concerned.

Inflation

Introduction

In a series of speeches designed to defend his record, Alan Greenspan, until recently an icon of both the new economy and stock exchange effervescence, reiterated the orthodoxy of central banking everywhere. His job, he repeated disingenuously, was confined to taming prices and ensuring monetary stability. He could not and, indeed, would not second guess the market. He consistently sidestepped the thorny issues of just how destabilizing to the economy the bursting of asset bubbles is and how his policies may have contributed to the froth.

Greenspan and his ilk seem to be fighting yesteryear's war against a long-slain monster. The obsession with price stability led to policy excesses and disinflation gave way to deflation - arguably an economic ill far more pernicious than inflation. Deflation coupled with negative savings and monstrous debt burdens can lead to prolonged periods of zero or negative growth. Moreover, in the zealous crusade waged globally against fiscal and monetary expansion - the merits and benefits of inflation have often been overlooked.

As economists are wont to point out time and again, inflation is not the inevitable outcome of growth. It merely reflects the output gap between actual and potential GDP. As long as the gap is negative - i.e., whilst the economy is drowning in spare capacity - inflation lies dormant. The gap widens if growth is anemic and below the economy's potential. Thus, growth can actually be accompanied by deflation.

Indeed, it is arguable whether inflation was subdued - in America as elsewhere - by the farsighted policies of central bankers. A better explanation might be overcapacity - both domestic and global - wrought by decades of inflation which distorted investment decisions. Excess capacity coupled with increasing competition, globalization, privatization, and deregulation - led to ferocious price wars and to consistently declining prices.

Quoted by "The Economist", Dresdner Kleinwort Wasserstein noted that America's industry is already in the throes of deflation. The implicit price deflator of the non-financial business sector has been -0.6 percent in the year to the end of the second quarter of 2002. Germany faces the same predicament. As oil prices surge, their inflationary shock will give way to a deflationary and recessionary aftershock.

Depending on one's point of view, this is a self-reinforcing virtuous - or vicious cycle. Consumers learn to expect lower prices - i.e., inflationary expectations fall and, with them, inflation itself. The intervention of central banks only hastened the process and now it threatens to render benign structural disinflation - malignantly deflationary.

Should the USA reflate its way out of either an impending double dip recession or deflationary anodyne growth?

It is universally accepted that inflation leads to the misallocation of economic resources by distorting the price signal. Confronted with a general rise in prices, people get confused. They are not sure whether to attribute the surging prices to a real spurt in demand, to speculation, inflation, or what. They often make the wrong decisions.

They postpone investments - or over-invest and embark on preemptive buying sprees. As Erica Groshen and Mark Schweitzer have demonstrated in an NBER working paper titled "Identifying inflation's grease and sand effects in the labour market", employers - unable to predict tomorrow's wages - hire less.

Still, the late preeminent economist James Tobin went as far as calling inflation "the grease on the wheels of the economy". What rate of inflation is desirable? The answer is: it depends on whom you ask. The European Central Bank maintains an annual target of 2 percent. Other central banks - the Bank of England, for instance - proffer an "inflation band" of between 1.5 and 2.5 percent. The Fed has been known to tolerate inflation rates of 3-4 percent.

These disparities among essentially similar economies reflect pervasive disagreements over what is being quantified by the rate of inflation and when and how it should be managed.

The sin committed by most central banks is their lack of symmetry. They signal visceral aversion to inflation - but ignore the risk of deflation altogether. As inflation subsides, disinflation seamlessly fades into deflation. People - accustomed to the deflationary bias of central banks - expect prices to continue to fall. They defer consumption. This leads to inextricable and all-pervasive recessions.

The Measurement of Inflation

Inflation rates - as measured by price indices - fail to capture important economic realities. As the Boskin commission revealed in 1996, some products are transformed by innovative technology even as their prices decline or remain stable. Such upheavals are not encapsulated by the rigid categories of the questionnaires used by bureaus of statistics the world over to compile price data. Cellular phones, for instance, were not part of the consumption basket underlying the CPI in America as late as 1998. The consumer price index in the USA may be overstated by one percentage point year in and year out, was the startling conclusion in the commission's report.

Current inflation measures neglect to take into account whole classes of prices - for instance, tradable securities. Wages - the price of labor - are left out. The price of money - interest rates - is excluded. Even if these were to be included, the way inflation is defined and measured today, they would have been grossly misrepresented.

Consider a deflationary environment in which stagnant wages and zero interest rates can still have a - negative or positive - inflationary effect. In real terms, in deflation, both wages and interest rates increase relentlessly even if they stay put. Yet it is hard to incorporate this "downward stickiness" in present-day inflation measures.

The methodology of computing inflation obscures many of the "quantum effects" in the borderline between inflation and deflation. Thus, as pointed out by George Akerloff, William Dickens, and George Perry in "The Macroeconomics of Low Inflation" (Brookings Papers on Economic Activity, 1996), inflation allows employers to cut real wages.

Workers may agree to a 2 percent pay rise in an economy with 3 percent inflation. They are unlikely to accept a pay cut even when inflation is zero or less. This is called the "money illusion". Admittedly, it is less pronounced when compensation is linked to performance. Thus, according to "The Economist", Japanese wages - with a backdrop of rampant deflation - shrank 5.6 percent in the year to July as company bonuses were brutally slashed.

Friction Inflation

Economists in a November 2000 conference organized by the ECB argued that a continent-wide inflation rate of 0-2 percent would increase structural unemployment in Europe's arthritic labour markets by a staggering 2-4 percentage points. Akerloff-Dickens-Perry concurred in the aforementioned paper. At zero inflation, unemployment in America would go up, in the long run, by 2.6 percentage points. This adverse effect can, of course, be offset by productivity gains, as has been the case in the USA throughout the 1990's.

The new consensus is that the price for a substantial decrease in unemployment need not be a sizable rise in inflation. The level of employment at which inflation does not accelerate - the non-accelerating inflation rate of unemployment or NAIRU - is susceptible to government policies.

Vanishingly low inflation - bordering on deflation - also results in a "liquidity trap". The nominal interest rate cannot go below zero. But what matters are real - inflation adjusted - interest rates. If inflation is naught or less - the authorities are unable to stimulate the economy by reducing interest rates below the level of inflation.

This has been the case in Japan in the last few years and is now emerging as a problem in the USA. The Fed - having cut rates 11 times in the past 14 months and unless it is willing to expand the money supply aggressively - may be at the end of its monetary tether. The Bank of Japan has recently resorted to unvarnished and assertive monetary expansion in line with what Paul Krugman calls "credible promise to be irresponsible".

This may have led to the sharp devaluation of the yen in recent months. Inflation is exported through the domestic currency's depreciation and the lower prices of export goods and services. Inflation thus indirectly enhances exports and helps close yawning gaps in the current account. The USA with its unsustainable trade deficit and resurgent budget deficit could use some of this medicine.

But the upshots of inflation are fiscal, not merely monetary. In countries devoid of inflation accounting, nominal gains are fully taxed - though they reflect the rise in the general price level rather than any growth in income. Even where inflation accounting is introduced, inflationary profits are taxed.

Thus inflation increases the state's revenues while eroding the real value of its debts, obligations, and expenditures denominated in local currency. Inflation acts as a tax and is fiscally corrective - but without the recessionary and deflationary effects of a "real" tax.

The outcomes of inflation, ironically, resemble the economic recipe of the "Washington consensus" propagated by the likes of the rabidly anti-inflationary IMF. As a long term policy, inflation is unsustainable and would lead to cataclysmic effects. But, in the short run, as a "shock absorber" and "automatic stabilizer", low inflation may be a valuable counter-cyclical instrument.

Inflation also improves the lot of corporate - and individual - borrowers by increasing their earnings and marginally eroding the value of their debts (and savings). It constitutes a disincentive to save and an incentive to borrow, to consume, and, alas, to speculate. "The Economist" called it "a splendid way to transfer wealth from savers to borrowers."

The connection between inflation and asset bubbles is unclear. On the one hand, some of the greatest fizz in history occurred during periods of disinflation. One is reminded of the global boom in technology shares and real estate in the 1990's. On the other hand, soaring inflation forces people to resort to hedges such as gold and realty, inflating their prices in the process. Inflation - coupled with low or negative interest rates - also tends to exacerbate perilous imbalances by encouraging excess borrowing, for instance.

Still, the absolute level of inflation may be less important than its volatility. Inflation targeting - the latest fad among central bankers - aims to curb inflationary expectations by implementing a consistent and credible anti-inflationary as well as anti-deflationary policy administered by a trusted and impartial institution, the central bank.

Miscalculating Inflation

The most accurate yardstick of inflation is the GDP deflator (which includes the prices of capital goods and export and import prices). Regrettably, it is rarely used or mentioned in public.

The Consumer Price Index is not the same as the Living Expenditures Index.

The Living Expenditures Index measures the changes in the prices of the SAME products in a given period of time.

The Consumer Price Index measures the changes in the prices of products bought during a period of time, even if they are NOT the same products (in other words, even with changed consumption habits).

In other words:

The Consumer Price Index reflects the purchasing habits of the households which participate in the surveys.

This means that the measured level of inflation can be manipulated for political reasons by:

1. Changing the composition of the consumption "basket" (deciding the prices of which products and services will be included and what will be omitted)

2. Altering the weights (weight coefficients) of the various products and services within the consumption basket.

3. There is no agreed methodology on how to properly measure the service component in the economy (including government and public goods, rents, and barter or countertrade transactions). Choosing the "right" methodology can have a negative or positive effect on the level of measured inflation.

4. Including or excluding certain retail and shopping venues (such as e-commerce, catalog sales, open air markets, garage sales, and so on).

5. Constructing a non-representative sample of households for the survey by overemphasizing certain locales (e.g., urban, or West vs. east, North vs. South), certain socio-economic classes (e.g., the middle-class), or certain demographics (e.g., minimizing the roles of seniors and teenagers).

6. Exaggerating or minimizing the role of the informal (grey or black) economy.

Measures to Contain Inflation and the Trade Deficit

Countries around the world - from Vietnam to Kazakhstan - have adopted these measures to reduce their burgeoning inflation and trade deficit:

Hedging (fixing the future prices of foodstuffs, oil, and commodities by purchasing forward contracts in the global markets)

Removal of import duties, excise taxes, VAT, and other taxes and fees on all energy products and foodstuffs

Subsidizing the consumption of the poorest 10% of the population

Introducing price controls and freezing the prices of essential products

Banning the export of foodstuffs (or introducing customs duties and quotas on such exports)

Raising interest rates and reserve requirements in the banking system to prevent new credit formation

Forcing banks to purchase government bonds to reduce liquidity in the market

Administratively capping credit growth and tightening lending to consumers and for real-estate transactions

Freezing, reducing or waiving public sector fees and charges

Releasing commodities, oil, and minerals from strategic reserves

Capping interest rates on deposits (to prevent credit formation using money from new deposits)

Reclaiming agricultural lands and modernizing farms and agriculture (long-term measures)

Declaring a World Trade Organization (WTO) emergency and introducing import quotas and duties on non-essentials and luxury goods

Introducing an inflation target

Allowing for a gradual devaluation of the currency, within a band or range or as a crawling peg. A strong currency has anti-inflationary effects, so any devaluation must be minimal, slow, and subject to market forces.

Informal Economy (also: Black or Gray Economy)

Some call it the "unofficial" or "informal" economy, others call it the "grey economy" but the old name fits it best: the "black economy". In the USA "black" means "profitable, healthy" and this is what the black economy is. Macedonia should count its blessings for having had a black economy so strong and thriving to see it through the transition. If Macedonia had to rely only on its official economy it would have gone bankrupt long ago.

The black economy is made up of two constituent activities:

1. Legal activities that are not reported to the tax authorities and the income from which goes untaxed and unreported. For instance: it is not illegal to clean someone's house, to feed people or to drive them. It is, however, illegal to hide the income generated by these activities and not to pay tax on it. In most countries of the world, this is a criminal offence, punishable by years in prison.

2. Illegal activities which, needless to say, are also not reported to the state (and, therefore, not taxed).

These two types of activities together are thought to comprise between 15% (USA, Germany) to 60% (Russia) of the economic activity (as measured by the GDP), depending on the country. It would probably be an underestimate to say that 40% of the GDP in Macedonia is "black". This equals 1.2 billion USD per annum. The money generated by these activities is largely held in foreign exchange outside the banking system or smuggled abroad (even through the local banking system). Experience in other countries shows that circa 15% of the money "floats" in the recipient country and is used to finance consumption. This should translate to 1 billion free floating dollars in the hands of the 2 million citizens of Macedonia. Billions are transferred to the outside world (mostly to finance additional transactions, some of it to be saved in foreign banks away from the long hand of the state). A trickle of money comes back and is "laundered" through the opening of small legal businesses.

These are excellent news for Macedonia. It means that when the macro-economic, geopolitical and (especially) the micro-economic climates will change – billions of USD will flow back to Macedonia. People will bring their money back to open businesses, to support family members and just to consume it. It all depends on the mood and on the atmosphere and on how much these people feel that they can rely on the political stability and rational management. Such enormous flows of capital happened before: in Argentina after the Generals and their corrupt regime were ousted by civilians, in Israel when the peace process started and in Mexico following the signature of NAFTA, to mention but three cases. These reserves can be lured back and transform the economy.

But the black economy has many more important functions.

The black economy is a cash economy. It is liquid and fast. It increases the velocity of money. It injects much needed foreign exchange to the economy and inadvertently increases the effective money supply and the resulting money aggregates. In this sense, it defies the dictates of "we know better" institutions such as the IMF. It fosters economic activity and employs people. It encourages labour mobility and international trade. Black economy, in short, is very positive. With the exception of illegal activities, it does everything that the official economy does – and, usually, more efficiently.

So, what is morally wrong with the black economy? The answer, in brief: it is exploitative. Other parts of the economy, which are not hidden (though would have liked to be), are penalized for their visibility. They pay taxes. Workers in a factory owned by the state or in the government service cannot avoid paying taxes. The money that the state collects from them is invested, for instance, in infrastructure (roads, phones, electricity) or used to pay for public services (education, defence, policing). The operators of the black economy enjoy these services without paying for them, without bearing the costs and worse: while others bear the costs. These encourages them, in theory to use these resources less efficiently.

And all this might be true in a highly efficient, almost ideal market economy. The emphasis is on the word "market". Unfortunately, we all live in societies which are regulated by bureaucracies which are controlled (in theory, rarely in practice) by politicians. These elites have a tendency to misuse and to abuse resources and to allocate them in an inefficient manner. Even economic theory admits that any dollar left in the hands of the private sector is much more efficiently used than the same dollar in the hands of the most honest and well meaning and well planning civil servant. Governments all over the world distort economic decisions and misallocate scarce economic resources.

Thus, if the goals are to encourage employment and economic growth – the black economy should be welcomed. This is precisely what it does and, by definition, it does so more efficiently than the government. The less tax dollars a government has – the less damage it does. This is an opinion shares by most economists in the world today. Lower tax rates are an admission of this fact and a legalization of parts of the black economy.

The black economy is especially important in times of economic hardships. Countries in transition are a private case of emerging economies which are a private case of developing countries which used to be called (in less politically correct times) "Third World Countries". They suffer from all manner of acute economic illnesses. They lost their export markets, they are technologically backward, their unemployment skyrockets, their plant and machinery are dilapidated, their infrastructure decrepit and dysfunctional, they are lethally illiquid, they become immoral societies (obligations not honoured, crime flourishes), their trade deficits and budget deficits balloon and they are conditioned to be dependent on handouts and dictates from various international financial institutions and donor countries.

Read this list again: isn't the black economy a perfect solution until the dust settles?

It enhances exports (and competitiveness through imports), it encourages technology transfers, it employs people, it invests in legitimate businesses (or is practised by them), it adds to the wealth of the nation (black marketeers are big spenders, good consumers and build real estate), it injects liquidity to an otherwise dehydrated market. Mercifully, the black economy is out of the reach of zealous missionaries such as the IMF. It goes its own way, unnoticed, unreported, unbeknownst, untamed. It doesn't pay attention to money supply targets (it is much bigger than the official money supply figure), or to macroeconomic stability goals. It plods on: doing business and helping the country to survive the double scourges of transition and Western piousness and patronizing. As long as it is there, Macedonia has a real safety net. The government is advised to turn a blind eye to it for it is a blessing in disguise.

There is one sure medicine: eliminate the population and both unemployment and inflation will be eliminated. Without the black economy, the population of Macedonia would not have survived. This lesson must be remembered as the government prepares to crack down on the only sector of the economy which is still alive and kicking.

Operational Recommendations

The implementation of these recommendations and reforms should be obliged to be GRADUAL. The informal economy is an important pressure valve for the release of social pressures, it ameliorates the social costs inherent to the period of transition and it constitutes an important part of the private sector.

As we said in the body of our report, these are the reasons for the existence of an informal economy and they should be obliged to all be tackled:

- High taxation level (in Macedonia, high payroll taxes);
- Onerous labour market regulations;
- Red tape and bureaucracy (which often leads to corruption);
- Complexity and unpredictability of the tax system.

Reporting Requirements and Transparency

- All banks should be obliged to report foreign exchange transactions of more than 10,000 DM (whether in one transaction or cumulatively by the same legal entity). The daily report should be submitted to the Central Bank. In extreme cases, the transactions should be investigated.

- All the ZPP account numbers of all the firms in Macedonia should be publicly available through the Internet and in printed form.

- Firms should be obliged by law to make a list of all their bank accounts available to the ZPP, to the courts and to plaintiffs in lawsuits.

- All citizens should be obliged to file annual, personal tax returns (universal tax returns, like in the USA). This way, discrepancies between personal tax returns and other information can lead to investigations and discoveries of tax evasion and criminal activities.

- All citizens should be obliged to file bi-annual declarations of personal wealth and assets (including real estate, vehicles, movables, inventory of business owned or controlled by the individual, financial assets, income from all sources, shares in companies, etc.).

- All retail outlets and places of business should be required to install – over a period of 3 years – cash registers with "fiscal brains". These are cash registers with an embedded chip. The chips are built to save a trail (detailed list) of all the transactions in the place of business. Tax inspectors can pick the chip at random, download its contents to the tax computers and use it to issue tax assessments. The information thus gathered can also be crossed with and compared to information from other sources (see: "Databases and Information Gathering"). This can be done only after the full implementation of the recommendations in the section titled "Databases and Information Gathering". I do not regard it as an effective measure. While it increases business costs – it is not likely to prevent cash or otherwise unreported transactions.

- All taxis should be equipped with taximeters, which include a printer. This should be a licencing condition.

- Industrial norms (for instance, the amount of sugar needed to manufacture a weight unit of chocolate, or juice) should be revamped. Norms should NOT be determined according to statements provided by the factory - but by a panel of experts. Each norm should be signed by three people, of which at least one is an expert engineer or another expert in the relevant field. Thought should be dedicated to the possibility of employing independent laboratories to determine norms and supervise them.

- Payments in wholesale markets should be done through a ZPP counter or branch in the wholesale market itself. Release of the goods and exiting the physical location of the wholesale market should be allowed only against presentation of a ZPP payment slip.

Reduction of Cash Transactions

- Cash transactions are the lifeblood of the informal economy. Their reduction and minimization is absolutely essential in the effort to contain it. One way of doing it is by issuing ZPP payment (debit) cards to businesses, firm and professionals. Use of the payment cards should be mandatory in certain business-to-business transactions.

- All exchange offices should be obliged to issue receipt for every cash transaction above 100 DM and to report to the Central Bank all transactions above 1000 DM. Suspicious transactions (for instance, transactions which exceed the financial wherewithal of the client involved) should be duly investigated.

- The government can reduce payroll taxes if the salary is not paid in cash (for instance, by a transfer to the bank account of the employee). The difference between payroll taxes collected on cash salaries and lower payroll taxes collected on noncash salaries – should be recovered by imposing a levy on all cash withdrawals from banks. The banks can withhold the tax and transfer it to the state monthly.

- Currently, checks issued to account-holders by banks are virtually guaranteed by the issuing banks. This transforms checks into a kind of cash and checks are used as cash in the economy. To prevent this situation, it is recommended that all checks will be payable to the beneficiary only. The account-holder will be obliged to furnish the bank with a monthly list of checks he or she issued and their details (to whom, date, etc.). Checks should be valid for 5 working days only.

- An obligation can be imposed to oblige businesses to effect payments only through their accounts (from account to account) or using their debit cards. Cash withdrawals should be subject to a withholding tax deducted by the bank. The same withholding tax should be applied to credits given against cash balances or to savings houses (stedilnicas). Alternatively, stedilnicas should also be obliged to deduct, collect and transfer the cash withdrawal withholding tax.

- In the extreme and if all other measures fail after a reasonable period of time, all foreign trade related payments should be conducted through the Central Bank. But this is really a highly irregular, emergency measure, which I do not recommend at this stage.

- The interest paid on cash balances and savings accounts in the banks should be increased (starting with bank reserves and deposits in the central bank).

- The issuance of checkbook should be made easy and convenient. Every branch should issue checkbooks. All the banks and the post office should respect and accept each other's checks.

- A Real Time Gross Settlement System should be established to minimize float and facilitate interbank transfers.

Government Tenders

- Firms competing for government tenders should be obliged to acquire a certificate from the tax authorities that they owe no back-taxes. Otherwise, they should be barred from bidding in government tenders and RFPs (Requests for Proposals).

Databases and Information Gathering

- Estimating the informal economy should be a priority objective of the Bureau of Statistics, which should devote considerable resources to this effort. In doing so, the Bureau of Statistics should coordinate closely with a wide variety of relevant ministries and committees that oversee various sectors of the economy.

- All registrars should be computerized: land, real estate, motor vehicles, share ownership, companies registration, tax filings, import and export related documentation (customs), VAT, permits and licences, records of flights abroad, ownership of mobile phones and so on. The tax authorities and the Public Revenue Office (PRO) should have unrestricted access to ALL the registers of all the registrars. Thus, they should be able to find tax evasion easily (ask for sources of wealth- how did you build this house and buy a new car if you are earning 500 DM monthly according to your tax return?).

- The PRO should have complete access to the computers of the ZPP and to all its computerized and non-computerized records.

- The computer system should constantly compare VAT records and records and statements related to other taxes in order to find discrepancies between them.

- Gradually, submissions of financial statements, tax returns and wealth declarations should be computerized and done even on a monthly basis (for instance, VAT statements).

- A system of informants and informant rewards should be established, including anonymous phone calls. Up to 10% of the intake or seizure value related to the information provided by the informant should go to the informant.

Law Enforcement

- Tax inspectors and customs officials should receive police powers and much higher salaries (including a percentage of tax revenues). The salaries of all tax inspectors – regardless of their original place of employment – should be equalized (of course, taking into consideration tenure, education, rank, etc.).

- Judges should be trained and educated in matters pertaining to the informal economy. Special courts for taxes, for instance, are a good idea (see recommendation below). Judges have to be trained in tax laws and the state tax authorities should provide BINDING opinions to entrepreneurs, businessmen and investors regarding the tax implications of their decisions and actions.

- It is recommended to assign tax inspectors to the public prosecutors' office to work as teams on complex or big cases.

- To establish an independent Financial and Tax Police with representatives from all relevant ministries but under the exclusive jurisdiction of the PRO. The remit of this Police should include all matters financial (including foreign exchange transactions, property and real estate transactions, payroll issues, etc.).

- Hiring and firing procedures in all the branches of the tax administration should be simplified. The number of administrative posts should be reduced and the number of tax inspectors and field agents increased.

- Tax arrears and especially the interest accruing thereof should be the first priority of the ZPP, before all other payments.

- All manufacturers and sellers of food products (including soft drinks, sweetmeats and candy, meat products, snacks) should purchase a licence from the state and be subjected to periodic and rigorous inspections.

- All contracts between firms should be registered in the courts and stamped to become valid. Contracts thus evidenced should be accompanied by the registration documents (registrar extract) of the contracting parties. Many "firms" doing business in Macedonia are not even legally registered.

Reforms and Amnesty

- A special inter-ministerial committee with MINISTER-MEMBERS and headed by the PM should be established. Its roles: to reduce bureaucracy, to suggest appropriate new legislation and to investigate corruption.

- Bureaucracy should be pared down drastically. The more permits, licences, tolls, fees and documents needed – the more corruption. Less power to state officials means less corruption. The One Stop Shop concept should be implemented everywhere.

- A general amnesty should be declared. Citizens declaring their illegal wealth should be pardoned BY LAW and either not taxed or taxed at a low rate once and forever on the hitherto undeclared wealth.

The Tax Code

- To impose a VAT system. VAT is one the best instruments against the informal economy because it tracks the production process throughout a chain of value added suppliers and manufacturers.

- The Tax code needs to be simplified. Emphasis should be placed on VAT, consumption taxes, customs and excise taxes, fees and duties. To restore progressivity, the government should directly compensate the poor for the excess relative burden.

- After revising the tax code in a major way, the government should declare a moratorium on any further changes for at least four years.

- The self-employed and people whose main employment is directorship in companies should be given the choice between paying a fixed % of the market value of their assets (including financial assets) or income tax.

- All property rental contracts should be registered with the courts. Lack of registration in the courts and payment of a stamp tax should render the contract invalid. The courts should be allowed to evidence and stamp a contract only after it carries the stamp of the Public Revenue Office (PRO). The PRO should register the contract and issue an immediate tax assessment. Contracts, which are for less than 75% of the market prices, should be subject to tax assessment at market prices. Market prices should be determined as the moving average of the last 100 rental contracts from the same region registered by the PRO.

- Filing of tax returns – including for the self-employed – should be only with the PRO and not with any other body (such as the ZPP).

Legal Issues

- The burden of proof in tax court cases should shift from the tax authorities to the person or firm assessed.

- Special tax courts should be established within the existing courts. They should be staffed by specifically trained judges. Their decisions should be appealed to the Supreme Court. They should render their decisions within 180 days. All other juridical and appeal instances should be cancelled – except for an appeal instance within the PRO. Thus, the process of tax collection should be greatly simplified. A tax assessment should be issued by the tax authorities, appealed internally (within the PRO), taken to a tax court session (by a plaintiff) and, finally, appealed to the Supreme Court (in very rare cases).

- The law should allow for greater fines, prison terms and for the speedier and longer closure of delinquent businesses.

- Seizure and sale procedures should be specified in all the tax laws and not merely by way of reference to the Income Tax Law. Enforcement provisions should be incorporated in all the tax laws.

- To amend the Law on Tax Administration, the Law on Personal Income Tax and the Law on Profits Tax as per the recommendations of the IRS experts (1997-9).

Customs and Duties

- Ideally, the customs service should be put under foreign contract managers. If this is politically too sensitive, the customs personnel should be entitled to receive a percentage of customs and duties revenues, on a departmental incentive basis. In any case, the customs should be subjected to outside inspection by expert inspectors who should be rewarded with a percentage of the corruption and lost revenues that they expose.

- In the case of imports or payments abroad, invoices, which include a price of more than 5% above the list price of a product, should be rejected and assessment for the purposes of paying customs duties and other taxes should be issued at the list price.

- In the case of exports or payments from abroad, invoices which include a discount of more than 25% on the list price of a product should be rejected and assessment for the purposes of paying customs duties and other taxes should be issued at the list price.

- The numbers of tax inspectors should be substantially increased and their pay considerably enhanced. A departmental incentive system should be instituted involving a percentage of the intake (monetary fines levied, goods confiscated, etc.).

- The computerized database system (see "Databases and Information Gathering") should be used to compare imports of raw materials for the purposes of re-export and actual exports (using invoices and customs declarations). Where there are disparities and discrepancies, severe and immediate penal actions should be taken. Anti-dumping levies and measures, fines and criminal charges should be adopted against exporters colluding with importers in hiding imported goods or reducing their value.

- Often final products are imported and declared to the customs as raw materials (to minimize customs duties paid). Later these raw materials are either sold outright in the domestic or international markets or bartered for finished products (for example: paints and lacquers against furniture or sugar against chocolate). This should be a major focus of the fight against the informal economy. I follow with an analysis of two products, which are often abused in this manner.

- I study two examples (white sugar and cooking oil) though virtually all raw materials and foods are subject to the aforementioned abuse.

- White Sugar is often imported as brown sugar. One way to prevent this is to place sugar on the list of LB (import licence required) list, to limit the effective period of each licence issued, to connect each transaction of imported brown sugar to a transaction of export, to apply the world price of sugar to customs duties, to demand payment of customs duties in the first customs terminal, to demand a forwarder's as well as an importer's guarantee and to require a certificate of origin. The same goes for Cooking Oil (which – when it is imported packaged – is often declared as some other goods).

- All payments to the customs should be made only through the ZPP. Customs and tax inspectors should inspect these receipts periodically.

- All goods should be kept in the customs terminal until full payment of the customs duties, as evidenced by a ZPP receipt, is effected.

Public Campaign

- The government should embark on a massive Public Relations and Information campaign. The citizens should be made to understand what is a budget, how the taxes are collected, how they are used. They should begin to view tax evaders as criminals. "He who does not pay his taxes – is stealing from you and from your children", "Why should YOU pay for HIM?" "If we all did not pay taxes- there would be no roads, bridges, schools, or hospitals" (using video to show disappearing roads, bridges, suffering patients and students without classes), "Our country is a partnership – and the tax-evader is stealing from the till (kasa)" and so on.

- The phrase "Gray Economy" should be replaced by the more accurate phrases "Black Economy" or "Criminal Economy".

Infrastructure

In the past, if you were to mention the word "infrastructure", the only mental association would have been: "physical". Infrastructure comprised roads, telephone lines, ports, airports and other very tangible country spanning things. Many items were added to this category as time went by, but they all preserved the "tangibility requirement" - even electricity and means of communication were measured by their physical manifestations: lines, poles, distances.

Today, we recognize three additional categories of infrastructure which would have come as a surprise to our forefathers:

Social infrastructure - laws, social institutions and agencies, social stratification, demographic elements and other social structures, formal and informal.

It is amazing to think that previously no one thought of the legal code as infrastructure. It has all the hallmarks of infrastructure: it spans the entire country, it dynamically evolves and is multi-layered, without it no goal-orientated human activity (such as the conduct of business) is possible. A foreign investor is likely to be more interested to know whether his property rights are protected under the law than what are the availability and accessibility of electricity lines.

An investor can always buy a generator and produce his own electricity - but he can never enact laws unilaterally. The country's denizens are bound to encounter the law (or resort to it) sometime in their lives, even if they never travel on a road or use a telephone.

The second category of infrastructure is the ***human infrastructure***. What is the mentality of the people? Are they lazy, industrious, submissive, used to improvise, team-spirited, individualistic, rebellious, inventive and so on? Are they conservative, open-minded, xenophobic, ethnically radicalized, likely to use brute force to settle disputes? Are they ignorant, educated, technologically literate, seek information or reject it, trustful and trustworthy or suspicious and resentful?

An educated workforce is as much part of a country's infrastructure as are its phone line.

The last category of infrastructure is the ***information infrastructure***. It is all the infrastructure which tackles the manipulation of symbols of all kinds : the accumulation of data, its processing and its dissemination. Words are symbols and so are money and computer bytes. So banks, computers, Internet linkups, WANs and LANs (Wide and local area computer networks), standardized accounting, other standards for goods and services - all these are examples of the information infrastructure.

The development of all these types of infrastructure is intimately linked. They usually evolve almost concurrently. They form feedback loops. The slow or hindered development of one of them prevents the flourishing of all the others.

This is really quite reasonable. If the workforce is not educated, it will not be keen or qualified to manipulate data and symbols. It will buy less computers, use the Internet less, bank less and so on. This, in turn, will reduce the need for phone lines, office buildings and so forth. There seems to be an "infrastructure multiplier" at work here.

This multiplier is a two way street: an increase or decrease in each type of infrastructure adversely or positively influences the others.

The West itself is in dire need of infrastructure. Its current infrastructure is crumbling, either owing to advanced age or to over-usage. Roads in large parts of the USA are in poorer condition than they are in some countries of Africa. In 1997, America-On-Line, a major Internet provider, was unable to provide services to its customers for weeks on end because communication lines in the USA were totally jammed. Certain places in Israel could receive television signals only in the last few years, as infrastructure reached them. Infrastructure is a universal problem.

The West invests in the infrastructure of developing countries through two venues:

Through international finance organizations (such as the World Bank and the European Bank for Reconstruction and Development). The terms and conditions of this kind of financing are very lenient. Those are really grants more than credits.

The implementation of these infrastructural projects is awarded to contractors via international tenders, with bids submitted from the world over. Rarely does a local firm outbids its better financed, better equipped and better motivated first world rivals.

Alternatively, multinational firms get involved in local projects directly. But this kind of financing comes with a lot of strings attached. The multinationals expect to recoup both their investment and a reasonable return on it. They come heavily subsidized by the governments of their countries. Their contribution to the local economy, during the construction of the infrastructure, is fleeting, at best.

They prefer to employ their own crews and equipment. They do not trust the locals too much or too often.

But whichever way the infrastructure is created, problems arise at the host country.

Consider international, multilateral, finance organizations. Inevitably, think and plan on a global scale. They invest in infrastructure only if and when it services - or has the potential to service in the larger scheme of things - a cluster of neighboring countries.

Clear regional benefits have to be unequivocally demonstrated in order for multilateral organizations to get involved. They neglect, overlook, or outright reject investments in much needed local infrastructure.

Such financial institutions always prefer to invest in a cross-border highway rather than in a cross-country road, for instance. The benefit to the domestic economy of the aforementioned local road could be appreciatively more sizeable. Still, the international fund would encourage the cross border highway. This is its charter - to promote multilateral investments - and this is what it does best. The interests of the host country are a secondary consideration.

On the other hand, the private sector invests only in countries with well developed infrastructure in all the aforementioned categories. But this is a conundrum: if the infrastructure is already developed, investments by the private sector are less beneficial. The result is that straightforward investments by the private sector - not subsidized, not partial, not co-funded by international institutions - mainly flow to the developed, industrial world.

Studies unearthed four disadvantages of countries with under-developed infrastructure:

Such countries suffer from interminable bottlenecks in all the levels of economic activity, especially in the production and distributions phases (principally in the transportation of raw materials to factories and of finished products from industry and field to the marketplace).

This adversely affects the availability of the country's domestic produce in both local and foreign markets. Agricultural produce is most affected but, to a lesser extent, so are industrial goods. If the communications infrastructure is decrepit, the service sector is similarly impacted.

A second issue is the distortion of the price mechanism. Prices increase owing to the wastage of resources when trying to overcome problems in infrastructure. Prices are supposed to reflect inputs and values and thus to assist the markets to optimally allocate resources. If the prices reflect other, unrelated, issues, then they are distorted and, in turn, distort economic activity.

The third problem is that one country's disadvantage is another's advantage. Other countries, with better infrastructure benefit : they attract more foreign investment, they conduct more business, they export more, they have lower inflation (cheaper prices) and their economy is not distorted by irrelevant, ulterior, non business considerations.

The fourth - and maybe largest and longest term - handicap is when the country's image is affected. Infrastructure is much easier to fix than a country's image. If the country acquires a reputation of a mere transit area, an underdeveloped, inefficient, non productive, hopeless case, it suffers greatly until these impressions change. The image problem has the gravest possible consequences: repelled investors, reluctant financiers, frightened bankers, disgruntled foreign investors.

There are eight known solution to the problems of a country with underdeveloped infrastructure:

It can privatize its infrastructure (commencing with its energy and telecommunications sectors, which are the most attractive to foreign and domestic private investors alike).

Then, it can allow the business sector to operate parts of the national infrastructure. The usual arrangement is that firms invest in creating infrastructure and then collect fees for operating and maintaining it. The fees collected are large enough to cover both the investment and the maintenance costs and to return a pre-determined profit. The most famous example are toll roads, often constructed by the private sector.

Another way is to commercialize the infrastructure (to collect fees for using the telephony network, or the highways) and to plough back the proceeds exclusively into projects of infrastructure. Thus, all the income generated by cars passing on a highway can be dedicated to the construction of additional highways and not funneled into the general budget.

The fourth method is to adapt the prices of using the infrastructure to the real costs of constructing and of operating it. In most developing countries, consumers pay only a fraction of these real costs. Prices are heavily subsidized and the infrastructure is left to decay and rot away. This, obviously, is a political decision to be taken by the political echelons. In many countries, such readjustment of prices to reflect real costs frequently creates social unrest and has severe political ramifications.

The country could condition investments in multilateral infrastructure projects upon investments in its own, local infrastructure. A multinational firm which wishes to invest in a highway (and thus reap considerable rewards), can be required to invest a portion of its future profits in local roads and other forms of infrastructure. A multinational fund interested to invest in a telecommunications project which involves three countries can be asked to commit itself to a "local investment" clause, a "local content purchase" clause, or an "offset" arrangement (the purchase of local goods against any import of goods connected to the project to the country).

The country must open its markets to domestic and foreign competition by de-regulating. It must dismantle trade barriers : tariffs, quotas, restrictions, anti-investment regulations, restrictive standardization and so on. Competition both lowers the costs of infrastructure and improves its quality, as rival firms strive to supply more value at a lower price.

An important condition is that the country does not prefer one kind of infrastructure to another. All categories of infrastructure should be simultaneously and similarly stimulated. This will carry favor with the international business community and is bound to alter the image of the country for the better. It will also create a positive feedback loop whereby an improvement in one category of infrastructure yields improvements in all the others.

Last - but far from least - the country must promote international agreements which facilitate reductions in the costs of cross-boundary transport of goods, services and information. Less documentation, less one sided fees, less bureaucracy will reduce the costs of doing businesses (transaction costs) and the total damage to the national economy. The less encumbered by red tape, the more a country tends to prosper.

Innovation

On 18 June business people across the UK took part in Living Innovation 2002. The extravaganza included a national broadcast linkup from the Eden Project in Cornwall and satellite-televised interviews with successful innovators.

Innovation occurs even in the most backward societies and in the hardest of times. It is thus, too often, taken for granted. But the intensity, extent, and practicality of innovation can be fine-tuned. Appropriate policies, the right environment, incentives, functional and risk seeking capital markets, or a skillful and committed Diaspora - can all enhance and channel innovation.

The wrong cultural context, discouraging social mores, xenophobia, a paranoid set of mind, isolation from international trade and FDI, lack of fiscal incentives, a small domestic or regional market, a conservative ethos, risk aversion, or a well-ingrained fear of disgracing failure - all tend to stifle innovation.

Product Development Units in banks, insurers, brokerage houses, and other financial intermediaries churn out groundbreaking financial instruments regularly. Governments - from the United Kingdom to New Zealand - set up "innovation teams or units" to foster innovation and support it. Canada's is more than two decades old.

The European Commission has floated a new program dubbed INNOVATION and aimed at the promotion of innovation and encouragement of SME participation. Its goals are:

- "(The) promotion of an environment favourable to innovation and the absorption of new technologies by enterprises;
- Stimulation of a European open area for the diffusion of technologies and knowledge;
- Supply of this area with appropriate technologies."

But all these worthy efforts ignore what James O'Toole called in "Leading Change" - "the ideology of comfort and the tyranny of custom." The much quoted Austrian economist, Joseph Schumpeter coined the phrase "creative destruction". Together with its twin - "disruptive technologies" - it came to be the mantra of the now defunct "New Economy".

Schumpeter seemed to have captured the unsettling nature of innovation - unpredictable, unknown, unruly, troublesome, and ominous. Innovation often changes the inner dynamics of organizations and their internal power structure. It poses new demands on scarce resources. It provokes resistance and unrest. If mismanaged - it can spell doom rather than boom.

Satkar Gidda, Sales and Marketing Director for SiebertHead, a large UK packaging design house, was quoted in "The Financial Times" last week as saying:

"Every new product or pack concept is researched to death nowadays - and many great ideas are thrown out simply because a group of consumers is suspicious of anything that sounds new ... Conservatism among the buying public, twinned with a generation of marketing directors who won't take a chance on something that breaks new ground, is leading to super-markets and car showrooms full of me-too products, line extensions and minor product tweaks."

Yet, the truth is that no one knows why people innovate. The process of innovation has never been studied thoroughly - nor are the effects of innovation fully understood.

In a new tome titled "The Free-Market Innovation Machine", William Baumol of Princeton University claims that only capitalism guarantees growth through a steady flow of innovation:

"... Innovative activity-which in other types of economy is fortuitous and optional-becomes mandatory, a life-and-death matter for the firm."

Capitalism makes sure that innovators are rewarded for their time and skills. Property rights are enshrined in enforceable contracts. In non-capitalist societies, people are busy inventing ways to survive or circumvent the system, create monopolies, or engage in crime.

But Baumol fails to sufficiently account for the different levels of innovation in capitalistic countries. Why are inventors in America more productive than their French or British counterparts - at least judging by the number of patents they get issued?

Perhaps because oligopolies are more common in the US than they are elsewhere. Baumol suggests that oligopolies use their excess rent - i.e., profits which exceed perfect competition takings - to innovate and thus to differentiate their products. Still, oligopolistic behavior does not sit well with another of Baumol's observations: that innovators tend to maximize their returns by sharing their technology and licensing it to more efficient and profitable manufacturers. Nor can one square this propensity to share with the ever more stringent and expansive intellectual property laws that afflict many rich countries nowadays.

Very few inventions have forced "established companies from their dominant market positions" as the "The Economist" put it recently. Moreover, most novelties are spawned by established companies. The single, tortured, and misunderstood inventor working on a shoestring budget in his garage - is a mythical relic of 18th century Romanticism.

More often, innovation is systematically and methodically pursued by teams of scientists and researchers in the labs of mega-corporations and endowed academic institutions. Governments - and, more particularly the defense establishment - finance most of this brainstorming. the

Internet was invented by DARPA - a Department of Defense agency - and not by libertarian intellectuals.

A recent report compiled by PricewaterhouseCoopers from interviews with 800 CEO's in the UK, France, Germany, Spain, Australia, Japan and the US and titled "Innovation and Growth: A Global Perspective" included the following findings:

"High-performing companies - those that generate annual total shareholder returns in excess of 37 percent and have seen consistent revenue growth over the last five years - average 61 percent of their turnover from new products and services. For low performers, only 26 percent of turnover comes from new products and services."

Most of the respondents attributed the need to innovate to increasing pressures to brand and differentiate exerted by the advent of e-business and globalization. Yet a full three quarters admitted to being entirely unprepared for the new challenges.

Two good places to study routine innovation are the design studio and the financial markets.

Tom Kelly, brother of founder David Kelly, studies, in "The Art of Innovation", the history of some of the greater inventions to have been incubated in IDEO, a prominent California-based design firm dubbed "Innovation U." by Fortune Magazine. These include the computer mouse, the instant camera, and the PDA. The secret of success seems to consist of keenly observing what people miss most when they work and play.

Robert Morris, an Amazon reviewer, sums up IDEO's creative process:

- Understand the market, the client, the technology, and the perceived constraints on the given problem;
- Observe real people in real-life situations;
- Literally visualize new-to-the- world concepts AND the customers who will use them;
- Evaluate and refine the prototypes in a series of quick iterations;
- And finally, implement the new concept for commercialization.

This methodology is a hybrid between the lone-inventor and the faceless corporate R&D team. An entirely different process of innovation characterizes the financial markets. Jacob Goldenberg and David Mazursky postulated the existence of Creativity Templates. Once systematically applied to existing products, these lead to innovation.

Financial innovation is methodical and product-centric. The resulting trade in pioneering products, such as all manner of derivatives, has expanded 20-fold between 1986 and 1999, when annual trading volume exceeded 13 trillion dollar.

Swiss Re Economic Research and Consulting had this to say in its study, Sigma 3/2001:

"Three types of factors drive financial innovation: demand, supply, and taxes and regulation. Demand driven innovation occurs in response to the desire of companies to protect themselves from market risks ... Supply side factors ... include improvements in technology and heightened competition among financial service firms. Other financial innovation occurs as a rational response to taxes and regulation, as firms seek to minimize the cost that these impose."

Financial innovation is closely related to breakthroughs in information technology. Both markets are founded on the manipulation of symbols and coded concepts. The dynamic of these markets is self-reinforcing. Faster computers with more massive storage, speedier data transfer ("pipeline"), and networking capabilities - give rise to all forms of advances - from math-rich derivatives contracts to distributed computing. These, in turn, drive software companies, creators of content, financial engineers, scientists, and inventors to a heightened complexity of thinking. It is a virtuous cycle in which innovation generates the very tools that facilitate further innovation.

The eminent American economist Robert Merton - quoted in Sigma 3/2001 - described in the Winter 1992 issue of the "Journal of Applied Corporate Finance" the various phases of the market-buttressed spiral of financial innovation thus:

1. "In the first stage ... there is a proliferation of standardised securities such as futures. These securities make possible the creation of custom-designed financial products ...
2. In the second stage, volume in the new market expands as financial intermediaries trade to hedge their market exposures.
3. The increased trading volume in turn reduces financial transaction costs and thereby makes

further implementation of new products and trading strategies possible, which leads to still more volume.

4. The success of these trading markets then encourages investments in creating additional markets, and the financial system spirals towards the theoretical limit of zero transaction costs and dynamically complete markets."

Financial innovation is not adjuvant. Innovation is useless without finance - whether in the form of equity or debt. Schumpeter himself gave equal weight to new forms of "credit creation" which invariably accompanied each technological "paradigm shift". In the absence of stock options and venture capital - there would have been no Microsoft or Intel.

It would seem that both management gurus and ivory tower academics agree that innovation - technological and financial - is an inseparable part of competition. Tom Peters put it succinctly in "The Circle of Innovation" when he wrote: "Innovate or die". James Morse, a management consultant, rendered, in the same tome, the same lesson more verbosely: "The only sustainable competitive advantage comes from out-innovating the competition."

The OECD has just published a study titled "Productivity and Innovation". It summarizes the orthodoxy, first formulated by Nobel prizewinner Robert Solow from MIT almost five decades ago:

"A substantial part of economic growth cannot be explained by increased utilisation of capital and labour. This part of growth, commonly labelled 'multi-factor productivity', represents improvements in the efficiency of production. It is usually seen as the result of innovation by best-practice firms, technological catch-up by other firms, and reallocation of resources across firms and industries."

The study analyzed the entire OECD area. It concluded, unsurprisingly, that easing regulatory restrictions enhances productivity and that policies that favor competition spur innovation. They do so by making it easier to adjust the factors of production and by facilitating the entrance of new firms - mainly in rapidly evolving industries.

Pro-competition policies stimulate increases in efficiency and product diversification. They help shift output to innovative industries. More unconventionally, as the report diplomatically put it: "The effects on innovation of easing job protection are complex" and "Excessive intellectual property rights protection may hinder the development of new processes and products."

As expected, the study found that productivity performance varies across countries reflecting their ability to reach and then shift the technological frontier - a direct outcome of aggregate innovative effort.

Yet, innovation may be curbed by even more all-pervasive and pernicious problems. "The Economist" posed a question to its readers in the December 2001'issue of its Technology Quarterly:

Was "technology losing its knack of being able to invent a host of solutions for any given problem ... (and) as a corollary, (was) innovation ... running out of new ideas to exploit."

These worrying trends were attributed to "the soaring cost of developing high-tech products ... as only one of the reasons why technological choice is on the wane, as one or two firms emerge as the sole suppliers. The trend towards globalisation-of markets as much as manufacturing-was seen as another cause of this loss of engineering diversity ... (as was the) the widespread use of safety standards that emphasise detailed design specifications instead of setting minimum performance requirements for designers to achieve any way they wish.

Then there was the commoditisation of technology brought on largely by the cross-licensing and patent-trading between rival firms, which more or less guarantees that many of their products are essentially the same ... (Another innovation-inhibiting problem is that) increasing knowledge was leading to increasing specialisation - with little or no cross- communication between experts in different fields ...

... Maturing technology can quickly become de-skilled as automated tools get developed so designers can harness the technology's power without having to understand its inner workings. The more that happens, the more engineers closest to the technology become incapable of contributing improvements to it. And without such user input, a technology can quickly ossify."

The readers overwhelmingly rejected these contentions. The rate of innovation, they asserted, has actually accelerated with wider spread education and more efficient weeding-out of unfit solutions by the marketplace. "... Technology in the 21st century is going to be less about discovering new phenomena and more about putting known things together with greater imagination and efficiency."

Many cited the S-curve to illuminate the current respite. Innovation is followed by selection, improvement of the surviving models, shake-out among competing suppliers, and convergence on a single solution. Information technology has matured - but new S-curves are nascent: nanotechnology, quantum computing, proteomics, neuro-silicates, and machine intelligence.

Recent innovations have spawned two crucial ethical debates, though with accentuated pragmatic aspects. The first is "open source-free access" versus proprietary technology and the second revolves around the role of technological progress in re-defining relationships between stakeholders.

Both issues are related to the inadvertent re-engineering of the corporation. Modern technology helped streamline firms by removing layers of paper-shuffling management. It placed great power in the hands of the end-user, be it an executive, a household, or an individual. It reversed the trends of centralization and hierarchical stratification wrought by the Industrial Revolution. From microprocessor to micropower - an enormous centrifugal shift is underway. Power percolates back to the people.

Thus, the relationships between user and supplier, customer and company, shareholder and manager, medium and consumer - are being radically reshaped. In an intriguing spin on this theme, Michael Cox and Richard Alm argue in their book "Myths of Rich and Poor

- Why We are Better off than We Think" that income inequality actually engenders innovation. The rich and corporate clients pay exorbitant prices for prototypes and new products, thus cross-subsidising development costs for the poorer majority.

Yet the poor are malcontented. They want equal access to new products. One way of securing it is by having the poor develop the products and then disseminate them free of charge. The development effort is done collectively, by volunteers. The Linux operating system is an example as is the Open Directory Project which competes with the commercial Yahoo!

The UNDP's Human Development Report 2001 titled "Making new technologies work for human development" is unequivocal. Innovation and access to technologies are the keys to poverty-reduction through sustained growth. Technology helps reduce mortality rates, disease, and hunger among the destitute.

"The Economist" carried last December the story of the agricultural technologist Richard Jefferson who helps "local
plant breeders and growers develop the foods they think best ... CAMBIA (the institute he founded) has resisted the lure of exclusive licences and shareholder investment, because it wants its work to be freely available and widely used". This may well foretell the shape of things to come.

Intellectual Property, Future of

In 1997, I published a book of short stories in Israel. The publishing house belongs to Israel's leading (and exceedingly wealthy) newspaper. I signed a contract which stated that I am entitled to receive 8% of the income from the sales of the book after commissions payable to distributors, shops, etc. A few months later, I won the coveted Prize of the Ministry of Education (for short prose). The prize money (a few thousand euros) was snatched by the publishing house on the legal grounds that all the money generated by the book belongs to them because they own the copyright.

In the mythology generated by capitalism to pacify the masses, the myth of intellectual property stands out. It goes like this: if the rights to intellectual property were not defined and enforced, commercial entrepreneurs would not have taken on the risks associated with publishing books, recording records, and preparing multimedia products. As a result, creative people will have suffered because they will have found no way to make their works accessible to the public. Ultimately, it is the public which pays the price of piracy, goes the refrain.

But this is factually untrue. In the USA there is a very limited group of authors who actually live by their pen. Only select musicians eke out a living from their noisy vocation (most of them rock stars who own their labels - George Michael had to fight Sony to do just that) and very few actors come close to deriving subsistence level income from their profession. All these can no longer be thought of as mostly creative people. Forced to defend their intellectual property rights and the interests of Big Money, Madonna, Michael Jackson, Schwarzenegger and Grisham are businessmen at least as much as they are artists.

Economically and rationally, we should expect that the costlier a work of art is to produce and the narrower its market - the more emphasized its intellectual property rights.

Consider a publishing house.

A book which costs 20,000 euros to produce with a potential audience of 1000 purchasers (certain academic texts are like this) - would have to be priced at a a minimum of 50 euros to recoup only the direct costs. If illegally copied (thereby shrinking the potential market as some people will prefer to buy the cheaper illegal copies) - its price would have to go up prohibitively to recoup costs, thus driving out potential buyers. The story is different if a book costs 5,000 euros to produce and is priced at 10 euros a copy with a potential readership of 1,000,000 readers. Piracy (illegal copying) should in this case be more readily tolerated as a marginal phenomenon.

This is the theory. But the facts are tellingly different. The less the cost of production (brought down by digital technologies) - the fiercer the battle against piracy. The bigger the market - the more pressure is applied to clamp down on samizdat entrepreneurs.

Governments, from China to Macedonia, are introducing intellectual property laws (under pressure from rich world countries) and enforcing them belatedly. But where one factory is closed on shore (as has been the case in mainland China) - two sprout off shore (as is the case in Hong Kong and in Bulgaria).

But this defies logic: the market today is global, the costs of production are lower (with the exception of the music and film industries), the marketing channels more numerous (half of the income of movie studios emanates from video cassette sales), the speedy recouping of the investment virtually guaranteed. Moreover, piracy thrives in very poor markets in which the population would anyhow not have paid the legal price. The illegal product is inferior to the legal copy (it comes with no literature, warranties or support). So why should the big manufacturers, publishing houses, record companies, software companies and fashion houses worry?

The answer lurks in history. Intellectual property is a relatively new notion. In the near past, no one considered knowledge or the fruits of creativity (art, design) as "patentable", or as someone's "property". The artist was but a mere channel through which divine grace flowed. Texts, discoveries, inventions, works of art and music, designs - all belonged to the community and could be replicated freely. True, the chosen ones, the conduits, were honoured but were rarely financially rewarded. They were commissioned to produce their works of art and were salaried, in most cases. Only with the advent of the Industrial Revolution were the embryonic precursors of intellectual property introduced but they were still limited to industrial designs and processes, mainly as embedded in machinery. The patent was born. The more massive the market, the more sophisticated the sales and marketing techniques, the bigger the financial stakes - the larger loomed the issue of intellectual property. It spread from machinery to designs, processes, books, newspapers, any printed matter, works of art and music, films (which, at their beginning were not considered art), software, software embedded in hardware, processes, business methods, and even unto genetic material.

Intellectual property rights - despite their noble title - are less about the intellect and more about property. This is

Big Money: the markets in intellectual property outweigh the total industrial production in the world. The aim is to secure a monopoly on a specific work. This is an especially grave matter in academic publishing where small- circulation magazines do not allow their content to be quoted or published even for non-commercial purposes. The monopolists of knowledge and intellectual products cannot allow competition anywhere in the world - because theirs is a world market. A pirate in Skopje is in direct competition with Bill Gates. When he sells a pirated Microsoft product - he is depriving Microsoft not only of its income, but of a client (=future income), of its monopolistic status (cheap copies can be smuggled into other markets), and of its competition-deterring image (a major monopoly preserving asset). This is a threat which Microsoft cannot tolerate. Hence its efforts to eradicate piracy - successful in China and an utter failure in legally-relaxed Russia.

But what Microsoft fails to understand is that the problem lies with its pricing policy - not with the pirates. When faced with a global marketplace, a company can adopt one of two policies: either to adjust the price of its products to a world average of purchasing power - or to use discretionary differential pricing (as pharmaceutical companies were forced to do in Brazil and South Africa). A Macedonian with an average monthly income of 160 USD clearly cannot afford to buy the Encyclopaedia Encarta Deluxe. In America, 50 USD is the income generated in 4 hours of an average job. In Macedonian terms, therefore, the Encarta is 20 times more expensive. Either the price should be lowered in the Macedonian market - or an average world price should be fixed which will reflect an average global purchasing power.

Something must be done about it not only from the economic point of view. Intellectual products are very price sensitive and highly elastic. Lower prices will be more than compensated for by a much higher sales volume. There is no other way to explain the pirate industries: evidently, at the right price a lot of people are willing to buy these products. High prices are an implicit trade-off favouring small, elite, select, rich world clientele. This raises a moral issue: are the children of Macedonia less worthy of education and access to the latest in human knowledge and creation?

Two developments threaten the future of intellectual property rights. One is the Internet. Academics, fed up with the monopolistic practices of professional publications - already publish on the web in big numbers. I published a few book on the Internet and they can be freely downloaded by anyone who has a computer or a modem. The full text of electronic magazines, trade journals, billboards, professional publications, and thousands of books is available online. Hackers even made sites available from which it is possible to download whole software and multimedia products. It is very easy and cheap to publish on the Internet, the barriers to entry are virtually nil. Web pages are hosted free of charge, and authoring and publishing software tools are incorporated in most word processors and browser applications. As the Internet acquires more impressive sound and video capabilities it will proceed to threaten the monopoly of the record companies, the movie studios and so on.

The second development is also technological. The oft-vindicated Moore's law predicts the doubling of computer memory capacity every 18 months. But memory is only one aspect of computing power. Another is the rapid simultaneous advance on all technological fronts. Miniaturization and concurrent empowerment by software tools have made it possible for individuals to emulate much larger scale organizations successfully. A single person, sitting at home with 5000 USD worth of equipment can fully compete with the best products of the best printing houses anywhere. CD-ROMs can be written on, stamped and copied in house. A complete music studio with the latest in digital technology has been condensed to the dimensions of a single chip. This will lead to personal publishing, personal music recording, and the to the digitization of plastic art. But this is only one side of the story.

The relative advantage of the intellectual property corporation does not consist exclusively in its technological prowess. Rather it lies in its vast pool of capital, its marketing clout, market positioning, sales organization, and distribution network.

Nowadays, anyone can print a visually impressive book, using the above-mentioned cheap equipment. But in an age of information glut, it is the marketing, the media campaign, the distribution, and the sales that determine the economic outcome.

This advantage, however, is also being eroded.

First, there is a psychological shift, a reaction to the commercialization of intellect and spirit. Creative people are repelled by what they regard as an oligarchic establishment of institutionalized, lowest common denominator art and they are fighting back.

Secondly, the Internet is a huge (200 million people), truly cosmopolitan market, with its own marketing channels freely available to all. Even by default, with a minimum investment, the likelihood of being seen by surprisingly large numbers of consumers is high.

I published one book the traditional way - and another on the Internet. In 50 months, I have received 6500 written responses regarding my electronic book. Well over 500,000 people read it (my Link Exchange meter registered c. 2,000,000 impressions since November 1998). It is a textbook (in psychopathology) - and 500,000 readers is a lot for this kind of publication. I am so satisfied that I am not sure that I will ever consider a traditional publisher again. Indeed, my last book was published in the very same way.

The demise of intellectual property has lately become abundantly clear. The old intellectual property industries are fighting tooth and nail to preserve their monopolies (patents, trademarks, copyright) and their cost advantages in manufacturing and marketing.

But they are faced with three inexorable processes which are likely to render their efforts vain:

The Newspaper Packaging

Print newspapers offer package deals of cheap content subsidized by advertising. In other words, the advertisers pay for content formation and generation and the reader has no choice but be exposed to commercial messages as he or she studies the content.

This model - adopted earlier by radio and television - rules the internet now and will rule the wireless internet in the future. Content will be made available free of all pecuniary charges. The consumer will pay by providing his personal data (demographic data, consumption patterns and preferences and so on) and by being exposed to advertising. Subscription based models are bound to fail.

Thus, content creators will benefit only by sharing in the advertising cake. They will find it increasingly difficult to implement the old models of royalties paid for access or of ownership of intellectual property.

Disintermediation

A lot of ink has been spilt regarding this important trend. The removal of layers of brokering and intermediation - mainly on the manufacturing and marketing levels - is a historic development (though the continuation of a long term trend).

Consider music for instance. Streaming audio on the internet or downloadable MP3 files will render the CD obsolete. The internet also provides a venue for the marketing of niche products and reduces the barriers to entry previously imposed by the need to engage in costly marketing ("branding") campaigns and manufacturing activities.

This trend is also likely to restore the balance between artist and the commercial exploiters of his product. The very definition of "artist" will expand to include all creative people. One will seek to distinguish oneself, to "brand" oneself and to auction off one's services, ideas, products, designs, experience, etc. This is a return to pre-industrial times when artisans ruled the economic scene. Work stability will vanish and work mobility will increase in a landscape of shifting allegiances, head hunting, remote collaboration and similar labour market trends.

Market Fragmentation

In a fragmented market with a myriad of mutually exclusive market niches, consumer preferences and marketing and sales channels - economies of scale in manufacturing and distribution are meaningless. Narrowcasting replaces broadcasting, mass customization replaces mass production, a network of shifting affiliations replaces the rigid owned-branch system. The decentralized, intrapreneurship-based corporation is a late response to these trends. The mega-corporation of the future is more likely to act as a collective of start-ups than as a homogeneous, uniform (and, to conspiracy theorists, sinister) juggernaut it once was.

Intellectual Property (in Countries in Transition)

The jury in the trial of ElcomSoft in a federal court in San Jose, California, are continuing their deliberations today. They are asked to determine whether the Russian software development firm has knowingly and intentionally violated the much decried 1998 Digital Millennium Copyright Act (DMCA). They have heard testimonies from Dmitry Sklyarov, the Russian programmer whose arrest last year at the DefCon hackers' conference in Las Vegas led to the proceedings and from Vladimir Katalov, ElcomSoft's general director.

The firm is accused of having sold a software application to circumvent the flawed copy protection provided by Adobe. Copyright holders often define what can and cannot be done with their work using such "rights management" systems. Bypassing a weak protection means that the intellectual property - e-books in this case - can be freely copied and disseminated without compensation, a practice known as "piracy".

At Adobe's behest, Sklyarov was incarcerated for more than 3 weeks and spent four additional months on bail in the United States. He then struck a deal with the prosecution to testify and was set free to return to Russia. The arrest provoked a hail of protests, demonstrations and debates both physical and virtual, on numerous Web sites and discussion boards. Sklyarov became, reluctantly, a cause celebre.

The case deserves all the attention it got and more so. It involves the most fundamental issues of the digital age: What constitutes intellectual property? Should the dual freedoms of speech and research be constrained by commercial interests? Is innovation fostered by securing the creators' economic benefits from their creations?

Is the Internet covered by national law - an American statute, for instance - and can such edicts apply extraterritorially? What if two jurisprudential systems disagree - which one prevails? Should easily reproducible digital content enjoy enhanced legal protections, ignoring previous practices pertaining to other types of intellectual assets?

Inevitably, the case acquired geopolitical dimensions. Despite advanced legislation and repeated raids of underground factories, Russia is still perceived by US corporations as a center of rampant piracy. Russians thought to be at the forefront of computer crime, including identity theft, cracking, the authoring of worms and viruses and other illicit exploits.

Russian law is more lenient and less responsive to commercial vested interests than its American counterpart. Sklyarov's contentious brain child, for instance, may be legal in Russia. Interior Ministry Spokesman, Dmitry Chepchugov, says that Sklyarov wasn't prosecuted hitherto simply because "no petitions or complaints about (him) have been filed in Russia on the part of the copyright owner." What Sklyarov did came "very close" to violating the Russian Penal Code, he admitted to Pravda.ru. - though in later statements to various news agencies, he reversed himself by insisting that "no crime has been committed".

Nor is ElcomSoft a hacking outfit. Its products are sold worldwide. In the United States, the FBI, district attorneys, police departments, the military, the majority of Fortune 500 companies and leading accounting firms are amongst its clients. It was established in 1990 and is a member of the Russian Cryptology Association (RCA), the Computer Security Institute, and the Association of Shareware Professionals (ASP). It is also a Microsoft Independent Software Vendor (ISV) partner. Its software products consistently win awards and plaudits and have been sold in more than 80 countries. Its online guestbook is overflowing with compliments and expressions of unmitigated support and commiseration.

The case is not without its curious twists and turns. Though Adobe has withdrawn its complaint, the government has decided to doggedly proceed. The defense has accused the prosecution of releasing "misleading" statements regarding the deal with Sklyarov. ElcomSoft's behavior has been exemplary: it has withdrawn the product days after it was contacted by Adobe.

This is fertile ground for Russian paranoia. The Federation's foreign ministry urged Russian computer and software "specialists" to exercise caution when on US territory. Accustomed to ill-founded charges based on flimsy or forged "evidence", Russians believe that the accusations against Sklyarov are not merely wrong - but "false" or "trumped up".

Conspiracy theories, a staple of Russian existence, abound. "Many observers are inclined to believe that Americans intend to prosecute the Russian top-class expert with his subsequent recruitment and use of his knowledge." - writes Pravda.ru. The Community of Russian On-Line Periodicals "EZHE" can't resist a triumphant jab at ostensible American technological prowess: "In order to expose the childishly simple encryption used on a e-book reader made by the Adobe Corporation (not much more difficult than pig Latin), (Sklyarov) wrote a program used to decrypt e-books encrypted with Adobe's program."

Russia's Kafkaesque judicial landscape - where might is right and people can still vanish mysteriously - permeates the reactions. Russians project onto America their own nightmarish system. Adobe orders the FBI around and Sklyarov has disappeared without a trace. The FBI failed to inform even the Russian embassy:

"All this programming was done in Russia, where the DMCA does not apply. Mr. Sklyarov then came to the USA, to discuss his work at a convention in Las Vegas. Adobe, aware he would be coming to the U.S., ordered the FBI to arrest him. He is now being held in an undisclosed location, awaiting arraignment." - continues EZHE.

Tribuna, a Russian weekly, spotted a pattern:

"This is not the first arrest of a Russian programmer. Not long ago, the FBI enticed two hackers from Chelyabinsk to the US, where they were arrested in November 2000. When they were arrested their Russian computers were hacked. These arrests look conspicuous against the general background of the FBI's combating hackers. There have been no reports about the FBI's detention of a hacker from China or an Arabian country."

Other, more Luddite, outlets accused Sklyarov of breaking Russian laws as well. NTV, an important TV station, for instance, reported that Sklyarov's apartment has been ransacked by the police in a successful search of incriminating evidence. NTV was later forced to retract the story as utterly unfounded. Interfax, quoted by CompuLenta, an online resource covering the Russian and global computer industry, said last year that Sklyarov "may be contemplating" lawsuits against these media.

Russian programmers enjoy high salaries, frequently travel abroad, are "cosmopolitan" and "intellectual" and, thus, resented as suspicious and "elitist" by lesser beings in destitute Russia. Sklyarov simply had it coming for haughtily acting as though he is above the law (and for associating with foreigners, goes the subtext).

Coverage of the case in the Russian press has abated following the initial surge of xenophobic indignation in July last year. But the indigenous media - both print and electronic - failed the tests of maturity, balanced reporting and adherence to reality. They could have transformed their coverage into a tour de force of the "poor east" against the "rich west", freedom of speech versus stifling multinationals, digital versus print copyright, noble principles contrasted with grubby money. They could have garnered the support of liberal intellectuals and free thinking folks the world over. Instead, they defaulted into their usual mode of wild speculation combined with injured grandiosity. This is the real tragedy underlying this unfolding farce.

Elated investors greeted chairman Bill Gates and chief executive officer Steve Ballmer for Microsoft's victory in the titanic antitrust lawsuit brought against it by the Department of Justice and assorted state attorneys general. They also demanded that Microsoft distribute its pile of cash - $40 billion in monopoly profits - as dividends.

But Microsoft may need that hoard. The battle is far from over. The European Commission, though much weakened by recent European Court of First Instance rulings against its competition commissioner, Mario Monti, can fine the company up to one tenth its worldwide turnover if it finds against it. Microsoft is being investigated by the European watchdog for anti-competitive practices now threatening to spread into the high-end server software and digital media markets.

But the software colossus faces an even more daunting third front in central and eastern Europe and Asia. It is the war against piracy. Both its operating system, Windows, and its office productivity suite, Office, are widely cracked and replicated throughout these regions.

Three years ago, Microsoft negotiated a $3 million settlement with the government of Macedonia, one of the single largest abusers of intellectual property rights in this tiny country. More than 1 percent of Macedonia's GDP is said by various observers to be derived from software and digital content piracy.

According to Yugoslavia's news agency, Tanjug, The governments of Serbia and Yugoslavia purchased, last month, 30,000 software licenses from the Redmond giant. Another 10-15,000 are in the pipeline. Aleksandar Bojovic, public relations manager of Microsoft's representative office in Belgrade was ebullient:

"Before the signing of an agreement on a strategic partnership with authorities of Yugoslavia and Serbia, the percentage of legal software used by the citizens and industry of Serbia and Montenegro was only a few percents. Presently it is about 20 percents. Microsoft is more than surprised at the interest for legalization that exists in Yugoslavia."

According to the Yugoslav newspaper Danas, Microsoft Yugoslavia has developed versions of Windows and Office in Serbian, replete with a spell-checker. There are c. 1 million computers in Yugoslavia. The company undertook, last year, to revamp the Yugoslav labyrinthine health, education, customs and tax systems. It also sent representatives to a delegation of businessmen that visited Bosnia-Herzegovina in February.

Microsoft obstinately refused to price its products differentially - to charge less in poorer markets. The Office suite costs the equivalent of 6 weeks of the average wage in Macedonia and a whopping 3 months' wages in Serbia. This extortionate pricing gave rise to resentment and thriving markets in pilfered Microsoft applications. Pirated software costs between $1.5 per compact disk in Macedonia and $3 in Moscow's immense open-air Gorbushka market.

According to the Russia-based Compulog Computer Consultants, quoted by USA Today, most communist states maintained large-scale hacking operations involving not only the security services, but also the computers and electrical engineering departments of universities and prestigious research institutes. American bans on the sale of certain software applications - such as computer-aided design and encryption - fostered the emergence of an officially-sanctioned subculture of crackers and pirates.

In the last few years, Russian organized crime has evolved to incorporate computer fraud, identity theft, piracy of software and digital media and other related offenses. The Russian mafia employs programmers and graduates of computer sciences. The British Daily Express reported in September that - probably Russian - hackers broke into Microsoft's computer network and absconded with invaluable source codes. These are believed to be now also in the possession of the FSB, the chief successor to Russia's notorious KGB.

The Business Software Alliance, a United States based trade group, claims that 87-92 percent of all business computer programs used in Russia are bootlegged - a piracy rate second only to China's. Microsoft sells c. $80-

100 million a year in the Russian Federation and the CIS. Had it not been for piracy, its revenues could have climbed well above the $1 billion mark.

According to Moscow Times and RosBalt, Microsoft's sales in Russia almost doubled in the last 12 months and it has decided to expand into the regions outlying Moscow and into Kazakhstan and Ukraine. Yet, the company's attempts to stamp out illicit copying in the last years of Russian president Boris Yeltsin's regime - including a much publicized visit by Bill Gates and a series of televised raids on disk stamping factories - floundered and yielded a wave of xenophobic indignation.

Still, central and eastern Europe is a natural growth market for the likes of Microsoft. The region is awash with highly qualified, talented, and - by Western measure - sinfully cheap experts. Purchasing power has increased precipitously in countries like the Czech Republic, Hungary, Slovakia, Slovenia, parts of Russia, and Croatia. Both governments and businesses are at the initial stages of investing in information technology infrastructure. Technological leapfrogging rendered certain countries here more advanced than the West in terms of broadband and wireless networks.

International Trade

A British politician, Richard Cobden once (1857) wrote:

"Free Trade is God's diplomacy and there is no other certain way of uniting people in the bonds of peace."

International, free trade is particularly important to developing, poor, countries (among them the "economies in transition").

Without international trade, the local economy is limited. It does not manufacture and produce more than it can consume. If it produces excess products, commodities, or services - no one buys them, they accumulate as inventory, and they bring about losses to the producers and, often, a recession. So, in the best of cases - even assuming optimal management and unlimited availability of capital - a firm in a closed economy can expect to grow by no more than the rate of growth of the local population.

This is where exports mitigate population growth as a constraint.

An export market is equivalent to a sudden growth in the local population. Suddenly, the firm has more people to sell to, additional places to market its products in, an increasing demand which really is unlimited. No firm in the world is big enough not to be negligible in the global marketplace. With 6.2 billion people and 170 million new ones added every year - it is much cleverer to export than to limit oneself to a market with 2, 20, or even 200 million inhabitants. In sum: local firms - and, as a result, the economy as a whole, can increase their production above the level of local consumption and export the surplus.

This, obviously, has the beneficial effect of increased employment. Export oriented industries in economies in transition are labour intensive. The more the country exports - the more its industries employ. This equation led some economists to say that a country exports its unemployment when it exports products. Every product contains a component of labour. When someone buys an imported product - he really buys the labour invested in this product, among other inputs. See the Technical Appendix for more.

But free trade cuts both ways. Some products are so expensive to manufacture locally, that it is more cost effective to import them cheaply. In aggregate, the local economy benefits from this more efficient use of its (ever limited) resources.

It has been proved in numerous studies that countries benefit from certain kinds of imports no less than they benefit from exports or the resulting enhancement of local manufacturing. This is called the theory of "comparative relative advantage".

Cheap imports (only as a replacement for expensive locally produced goods) have two additional effects: they reduce the costs of operating enterprises (and thus encourage the formation of businesses) - and, naturally, they reduce inflation. Where cheap products are available - inflation, by its very definition, is subdued.

So, instead of wasting money on purchasing expensive products, which are manufactured locally - instead of paying high interest payments on liabilities due to high inflation - the economy can optimally allocate its resources where they are at their productive best.

Free trade assists the economies of all players. It allows them to optimize the allocation of their (scarce) economic resources and, thus, maximize national incomes.

Optimal allocation frees up sizeable resources which were previously engaged in inefficient production, or dedicated to defraying financing expenses, or locked into the consumption of expensive local products. A consumer allowed to buy a cheap, imported car instead of an expensive locally manufactured one, saves the difference and invests it in a savings account in a bank. The bank, in turn, lends the money to firms - and this is the relation between free trade and high savings and, hence, high investment rates. Free trade reduces the overall price level in the economy, more money can be saved, and the savings can be lent to more businesses on better terms. Plants can, thus, be modernized, technological skills can be acquired, more comprehensive education provided, infrastructure can be improved.

Above all, those who trade do not fight. Free trade pacifies countries. It leads to the peaceful and prosperous coexistence of neighbouring nations. It yields mutual collaboration on trade, investments and infrastructure.

But free trade cannot exist in a legal and infrastructural vacuum. To achieve all these good outcomes a country must rationalize its trading activities.

First and, above all, it must gradually dismantle regulatory and tariff barriers to allow the unobstructed flows of goods, services, products, commodities, and information.

I used the word "gradually" judiciously. A poor country must make the transition from a protectionist environment, heavily isolated by regulations, customs, duties, quotas, tariffs and discriminating standards - to completely free trade in minute, well measured steps. The influence on local industries, the level of employment, the national foreign exchange reserves, interest rates, and many other parameters - economic as well as social - should be gauged regularly to prevent unnecessary shocks. But these monitoring and fine tuning should not serve as fig leaf, they should not be an excuse to prevent or delay the freeing of trade. The country must, unequivocally, announce its plans and intentions, replete with timetables and steps to be adopted. And the country must stick by its plans - and not succumb to the inevitable and forceful demands of special interest groups.

On the other hand, the country must encourage foreign investment. (Foreign Direct Investment (FDI) and even portfolio investments are a critical part of free trade. Investors build manufacturing plants, which export their products, or sell them locally, substituting for imports. Direct investors are usually connected - directly or indirectly - to trading networks. Financial (portfolio) investors usually come only much later, when the local capital markets have matured and have become much safer. A country can encourage the inflow of foreign investment by providing investors with tax incentives (tax holidays, tax breaks, even outright grants and subsidized loans). It can provide other incentives - there are too many to enumerate here. Above all, though, it must protect the property rights of investors of all kinds - domestic, as well as foreign. Investors flock to secure places and no incentive in the world can convince them to put their money, where they do not feel certain that they can always - and unconditionally - recover it. Property rights is the countries in transition's weak point in this respect:

the appropriate legislation is lacking, courts are slow, ignorant, and indecisive, law enforcement agencies are immature and uncertain of their authorities and how to exercise them. Some countries are outright xenophobic. This is not conducive to foreign investment.

But all this is not enough. A skilled, well educated workforce is a prerequisite for the development of export industries. Even low-tech industries (textiles, shoes) require the workers to be literate and to know basic arithmetic. As industries mature, the workers are required to train, retrain and re-qualify ceaselessly.

The nation must make education as a top priority. education is as much an infrastructure as roads and electricity. To think differently is to be left behind and to be left behind in today's competitive world is to die a slow economic death.

All this will be to no avail if a country does not make an intentional, conscientious effort to identify those things that it is good at, its "relative, competitive advantages".

But should a nation leave the forces of the marketplace to take their course, unhindered? Alternatively, should a government determine the priorities of the nation within a very long term plan?

Personally, I do not support fanatic views. The market has its flaws. It is never perfect. Governments should intervene (marginally) to fix market imperfections and failures. Otherwise, who will supply public goods like defence or education?

The same is true for trading. Japan and Israel are two prime examples of extremely successful government involvement in determining national priorities and in pursuing them (the current slump in Japan notwithstanding). The all powerful Ministry of Industry and Trade (MITI) in Japan virtually dictated what should be done, where, with whom and how for decades. Israel actively encourages the formation of hi-tech, labour-poor, high value added industries. But both governments recognized the limits of their intervention, and the difference between advice, incentives and coercion.

The government of a country should identify its relative competitive advantages and re-orient itself to materialize them.

This realization phase can be successful only if the country is an active and complying member of and participant in the international community of nations. It must peacefully and willingly adhere to international agreements on trade and investments and it must agree to resolve its conflicts within the international judicial and arbitration frameworks.

Macedonia is in a difficult economic spot - but it is by no means unique. Almost all the newly-formed countries lost almost all their previous export markets simultaneously. COMECON and the USSR disintegrated almost at the same time as Yugoslavia did. Some countries have not adapted to the new situation:

Their GDP was halved, their industrial infrastructure was demolished and they ran ever-widening trade deficits. They preferred to mourn their situation and blame the whole world for it. Others have oriented themselves to become a (geographical and mental) bridge between East (Europe) and West (Europe). They adopted the Western mentality, Western institutions and Western legislation regarding investments, banking and finance. They emphasized their roles as transit countries in the best sense of the word: having a lot to contribute within the process of transit.

What is common to all the more successful countries is that they encouraged joint ventures with foreign investors, suppressed xenophobia and ethnic discrimination, shared economic benefits with their neighbours by collaborating with them, imported mainly capital goods (instead of consumption goods), adopted sound fiscal policies and really privatized. In most of them, lively capital and money markets have developed.

This is the future that Macedonia should aspire to. It can become the Switzerland of the Balkans. It has all that it takes. Ask the financial markets: they are paying for Macedonian government securities (almost) the same price they pay for Slovenian national debt. That means that they think that Macedonia is the Slovenia of tomorrow.

And that, in my view- is not such a bad future, at all.

TECHNICAL APPENDIX

International Trade, Inflation and Stagflation

Situation I

The exporting country has:

a. An overvalued currency;
b. Low inflation or deflation as prices and wages decrease to restore competitiveness.

The exporting country thus exports its deflation (through the low and competitive prices of its goods and services) and its unemployment (through the labour component in its exports).

The importing country's inflation rate is affected by the deflation embedded in imported goods and services. Cheap imports thus exert downward pressure on prices and wages in the importing country.

This, in turn, tends to increase the purchasing power of the local currency and to cause its appreciation.

In other words:

The macro-economic parameters of the importing country tend to REFLECT the macro-economic parameters of the exporting country.

If the exporting country's currency is overvalued - the importing country's currency will tend to appreciate as a result of the export/import transaction.

If the exporting country's inflation is low - it will exert a downward pressure on wages and prices (on inflation) in the importing country.

Unemployment will tend to decrease in the exporting country and increase in the importing country.

Following the export transaction, the importing country will have:

a. An appreciating currency;
b. Deflation or low inflation;
c. Higher unemployment.

Why would anyone import from a country with an OVERvalued currency?

Because it has a monopoly or a duopoly on knowledge, intellectual property, technology, or other endowments.

Situation II

The exporting country has:

a. An undervalued currency;
b. High inflation as prices and wages increase (to restore equitable distribution of income).

The exporting country thus exports its inflation (through the higher though competitive prices of its goods and services) and its unemployment (through the labour component in its exports).

The importing country's inflation rate is affected by the inflation embedded in imported goods and services.

Expensive imports thus exert upward pressure on prices and wages in the importing country.

This, in turn, tends to decrease the purchasing power of the local currency and to cause its devaluation.

In other words:

The macro-economic parameters of the importing country tend to REFLECT the macro-economic parameters of the exporting country.

If the exporting country's currency is undervalued - the importing country's currency will tend to depreciate as a result of the export/import transaction.

If the exporting country's inflation is high - it will exert an upward pressure on wages and prices (on inflation) in the importing country.

Unemployment will tend to decrease in the exporting country and increase in the importing country.

Following the export transaction, the importing country will have:

1. A depreciating currency (devaluation);
2. Higher inflation;
3. Higher unemployment.

The state of higher inflation with higher unemployment is called "stagflation". So, in this scenario, the importing country imports stagflation as part of the goods and services it imports.

Internet Advertising

Spielberg's blockbuster, "Minority Report", is set in the year 2054. The future - at least according to a team of MIT futurologists, hired by the cinematic genius - is the captive of embarrassingly personalized and disturbingly intrusive, mostly outdoor, interactive advertising.

The way Internet advertising has behaved lately, it may well take 50 years to get there.

More than 1 billion people frequent the Internet daily. Americans alone spent $69 billion buying things online in 2004. eMarketer, a market research firm, predicts that e-commerce will climb to $139 billion in 2008. American Internet advertising revenues boomed to $7.3 billion in 2003 and $9.6 billion in 2004. Shares of companies like Yahoo! and Google - sellers of online advertising space and technologies - have skyrocketed.

This is a remarkable reversal from just a few years ago.

All forms of advertising - both online and print - have been in decline in 2000-2. A survey conducted by the New Media Group of PricewaterhouseCoopers (PwC) - the Internet Ad Revenue Report sponsored by the Interactive Advertising Bureau (IAB) - found a 12 percent decline - to $7.2 billion - in Internet advertising in 2001. CMR, The Myers Report, and McCann Erickson have all recorded drops of between 12 and 14 percent in broadcast advertising and of c. 20 percent in radio spots in 2001.

The following year - 2002 - may have been the turning point. A March 2002 Nielsen NetRatings report registered a sharp turnaround in the first quarter of 2002. The number of unique online ads shot up by one third to 70,000. Jupiter Media Matrix predicted a 10 percent increase in online classified ads - to $1.2 billion in 2002. By 2007, it said, online ads will account for 7 percent of total advertising dollars - some $16 billion. Both IDC and INT Media Group spawned similar prognostications for the weaker Asia-Pacific market.

CMR forecast a 5.3 percent growth in online ad revenues in 2002 - compared to an overall average of 2.5 percent. This optimistic projection is based on expected performance in the - hopefully, more buoyant - third and fourth quarters of 2002.

Still, it was clear in early 2002 that ,even if this surge materializes, online advertising would be almost 7 percent below its level only two years before and vertiginously below projections touted by "professionals" as late as January 2001. Internet.com quoted another gloomy prediction, by Goldman Sachs analyst, Anthony Noto: "The likelihood of an online ad rebound remains questionable in the near term." Moreover, growth in advertising in local papers, radio spots, and TV spots was expected to outpace the recovery in online ads.

In hindsight, some advertising categories indeed didn't make it. Cable, syndication, consumer magazines, national newspapers, outdoor, and B2B magazines continued to post sharp decreases.

A sign of the times in 2002 may have been IAB's multi-million dollar advertising campaign. IAB is the online publishing and ad sales industry's largest trade association. In 2002, it tried to pitch the Internet to advertisers in what looked like a desperate effort to increase online ad spending.

Internet.com reviewed the campaign in a June 24, 2002 article:

"The gist of the work is that by encouraging consumers to interact with brand elements, marketers can foster greater awareness, favorability and purchase intent - more so than can static media. The executions share the tagline, 'Interactive is the active ingredient in the marketing mix.'"

They quoted IAB President and Chief Executive Greg Stuart as saying:

"As we continue to mature as a medium, we need to treat interactive as a brand, and the manner in which we position ourselves as an industry is critical to driving the success and adoption of interactive advertising and marketing in the years ahead. We have to speak with the same voice so that we clearly communicate our unique value to all parties."

The collapse in Internet advertising had serious and, in some cases, irreversible implications.

In a report for eBookWeb.org I wrote:

"Most content dot.coms were based on ad-driven revenue models. Online advertising was supposed to amortize start-up and operational costs and lead to profitability even as it subsidized free access to costly content. A similar revenue model has been successfully propping up print periodicals for at least two centuries.

But, as opposed to their online counterparts, print products have a few streams of income, not least among them paid subscriptions. Moreover, print media kept their costs down in good times and bad. Dot.coms devoured their investors' money in a self-destructive and avaricious bacchanalia."

Surprisingly, online advertising did not shrivel only or mainly due to its inefficacy - or avant-garde nature. In a survey conducted in early 2002 by Stein Rogan and Insight Express, an overwhelming four fifths of brand marketers and agency executives felt the the Internet is a mainstream medium and an integral part of the conventional marketing mix. Close to 70 percent rated their opinion regarding the effectiveness of online advertising as more positive now than it was 12 months before. A full sixty percent said that their clients are less resistant to interactive marketing than they were.

So, what went wrong?

According to classical thinking, advertising is concerned with both information and motivation. It imparts information to potential consumers, users, suppliers, investors, the community, or other stakeholders. It motivates consumers to consume, investors to invest, voters to vote, and so on.

Yet, modern economic signal theory allocates to advertising an entirely different - though by no means counterintuitive - role.

From the eBookweb.org report:

"Advertising signals to the marketplace the advertiser's resilience, longevity, wealth, clout, and dominance. By splurging money of advertising, the advertiser actually informs us - the 'eyeballs' - that it is here to stay, sufficiently affluent to finance its ads, stable, reliable, and dominant. If firm X invested a million bucks in advertising - it must be worth more than a million bucks - goes the signal. If it invested so much money in promoting its products, it is not a fly-by-night. If it can throw money at an ad campaign, it is stable and resilient."

Online advertising dilutes this crucial signal and drowns it in noise. Advertisers stopped advertising online because the medium's noise to signal ratio rendered their ads ineffective or even repulsive. Internet users - a "captive audience" - not only became inured to the messages - both explicit and implicit - but found the technology irritating.

Many react with hostility to pop-up ads, for instance. They simply tune off or install ad-filtering software. All major Web browsers allow their users to avoid pop-up ads altogether. But banner ads and embedded ads are an integral part of the Web page and cannot be avoided easily.

Thus desensitized, users rebel.

"They resent the intrusion, are incensed by the coercive tactics of advertisers, nerve wrecked by protracted download times, and unnerved by the content of many of the ads. This is not an environment conducive to clinching deals or converting to sales."

There are two sources of noise in Internet advertising.

Free advertising misses a critical element in the aforementioned signal. Information about the purported financial health and future prospects of advertisers is conveyed only by paid ads. Free adverts tell us nothing about the advertiser. This simple lesson seems to be lost on the Internet which is swamped by free hoardings: free classifieds, free banner ads, free ad exchanges. Worse, it is often difficult to tell a paid ad from a free one.

Then there is the issue of credibility. Dot.coms - the leading online advertisers - are rarely associated with truth in advertising. Internet ads are still afflicted by scams, false promises, faulty products, shoddy or non-existent customer care, broken links, or all of the above. Users distrust Web advertising and ignore it.

The Internet is being appropriated by brick-and-mortar corporations and governments. Global branding will transform online ads into interactive renditions and facsimiles of offline fare. Revenue models are likely to change as well. Subscription fees and "author-pays" will substitute for ad revenues. The days of advertising-sponsored free content are numbered.

Investors, Classification of

In the not so distant past, there was little difference between financial and strategic investors. Investors of all colors sought to safeguard their investment by taking over as many management functions as they could. Additionally, investments were small and shareholders few. A firm resembled a household and the number of people involved – in ownership and in management – was correspondingly limited. People invested in industries they were acquainted with first hand.

As markets grew, the scales of industrial production (and of service provision) expanded. A single investor (or a small group of investors) could no longer accommodate the needs even of a single firm. As knowledge increased and specialization ensued – it was no longer feasible or possible to micro-manage a firm one invested in. Actually, separate businesses of money making and business management emerged. An investor was expected to excel in obtaining high yields on his capital – not in industrial management or in marketing. A manager was expected to manage, not to be capable of personally tackling the various and varying tasks of the business that he managed.

Thus, two classes of investors emerged. One type supplied firms with capital. The other type supplied them with know-how, technology, management skills, marketing techniques, intellectual property, clientele and a vision, a sense of direction.

In many cases, the strategic investor also provided the necessary funding. But, more and more, a separation was maintained. Venture capital and risk capital funds, for instance, are purely financial investors. So are, to a growing extent, investment banks and other financial institutions.

The financial investor represents the past. Its money is the result of past - right and wrong - decisions. Its orientation is short term: an "exit strategy" is sought as soon as feasible. For "exit strategy" read quick profits. The financial investor is always on the lookout, searching for willing buyers for his stake. The stock exchange is a popular exit strategy. The financial investor has little interest in the company's management. Optimally, his money buys for him not only a good product and a good market, but also a good management. But his interpretation of the rolls and functions of "good management" are very different to that offered by the strategic investor. The financial investor is satisfied with a management team which maximizes value. The price of his shares is the most important indication of success. This is "bottom line" short termism which also characterizes operators in the capital markets. Invested in so many ventures and companies, the financial investor has no interest, nor the resources to get seriously involved in any one of them. Micro-management is left to others - but, in many cases, so is macro-management. The financial investor participates in quarterly or annual general shareholders meetings. This is the extent of its involvement.

The strategic investor, on the other hand, represents the real long term accumulator of value. Paradoxically, it is the strategic investor that has the greater influence on the value of the company's shares. The quality of management, the rate of the introduction of new products, the success or failure of marketing strategies, the level of customer satisfaction, the education of the workforce - all depend on the strategic investor. That there is a strong relationship between the quality and decisions of the strategic investor and the share price is small wonder. The strategic investor represents a discounted future in the same manner that shares do. Indeed, gradually, the balance between financial investors and strategic investors is shifting in favour of the latter. People understand that money is abundant and what is in short supply is good management. Given the ability to create a brand, to generate profits, to issue new products and to acquire new clients - money is abundant.

These are the functions normally reserved to financial investors:

Financial Management

The financial investor is expected to take over the financial management of the firm and to directly appoint the senior management and, especially, the management echelons, which directly deal with the finances of the firm.

1. To regulate, supervise and implement a timely, full and accurate set of accounting books of the firm reflecting all its activities in a manner commensurate with the relevant legislation and regulation in the territories of operations of the firm and with internal guidelines set from time to time by the Board of Directors of the firm. This is usually achieved both during a Due Diligence process and later, as financial management is implemented.

2. To implement continuous financial audit and control systems to monitor the performance of the firm, its flow of funds, the adherence to the budget, the expenditures, the income, the cost of sales and other budgetary items.

3. To timely, regularly and duly prepare and present to the Board of Directors financial statements and reports as required by all pertinent laws and regulations in the territories of the operations of the firm and as deemed necessary and demanded from time to time by the Board of Directors of the Firm.

4. To comply with all reporting, accounting and audit requirements imposed by the capital markets or regulatory bodies of capital markets in which the securities of the firm are traded or are about to be traded or otherwise listed.

5. To prepare and present for the approval of the Board of Directors an annual budget, other budgets, financial plans, business plans, feasibility studies, investment memoranda and all other financial and business documents as may be required from time to time by the Board of Directors of the Firm.

6. To alert the Board of Directors and to warn it regarding any irregularity, lack of compliance, lack of adherence, lacunas and problems whether actual or potential concerning the financial systems, the financial operations, the financing plans, the accounting, the audits, the budgets and any other matter of a financial nature or which could or does have a financial implication.

7. To collaborate and coordinate the activities of outside suppliers of financial services hired or contracted by the firm, including accountants, auditors, financial consultants, underwriters and brokers, the banking system and other financial venues.

8. To maintain a working relationship and to develop additional relationships with banks, financial institutions and capital markets with the aim of securing the funds necessary for the operations of

the firm, the attainment of its development plans and its investments.

9. To fully computerize all the above activities in a combined hardware-software and communications system which will integrate into the systems of other members of the group of companies.

10. Otherwise, to initiate and engage in all manner of activities, whether financial or of other nature, conducive to the financial health, the growth prospects and the fulfillment of investment plans of the firm to the best of his ability and with the appropriate dedication of the time and efforts required.

Collection and Credit Assessment

1. To construct and implement credit risk assessment tools, questionnaires, quantitative methods, data gathering methods and venues in order to properly evaluate and predict the credit risk rating of a client, distributor, or supplier.

2. To constantly monitor and analyse the payment morale, regularity, non-payment and non-performance events, etc. – in order to determine the changes in the credit risk rating of said factors.

3. To analyse receivables and collectibles on a regular and timely basis.

4. To improve the collection methods in order to reduce the amounts of arrears and overdue

payments, or the average period of such arrears and overdue payments.

5. To collaborate with legal institutions, law enforcement agencies and private collection firms in assuring the timely flow and payment of all due payments, arrears and overdue payments and other collectibles.

6. To coordinate an educational campaign to ensure the voluntary collaboration of the clients, distributors and other debtors in the timely and orderly payment of their dues.

The strategic investor is, usually, put in charge of the following:

Project Planning and Project Management

The strategic investor is uniquely positioned to plan the technical side of the project and to implement it. He is, therefore, put in charge of:

1. The selection of infrastructure, equipment, raw materials, industrial processes, etc.;
2. Negotiations and agreements with providers and suppliers;
3. Minimizing the costs of infrastructure by deploying proprietary components and planning;
4. The provision of corporate guarantees and letters of comfort to suppliers;
5. The planning and erecting of the various sites, structures, buildings, premises, factories, etc.;
6. The planning and implementation of line connections, computer network connections,

protocols, solving issues of compatibility (hardware and software, etc.);
7. Project planning, implementation and supervision.

Marketing and Sales

1. The presentation to the Board an annual plan of sales and marketing including: market penetration targets, profiles of potential social and economic categories of clients, sales promotion methods, advertising campaigns, image, public relations and other media campaigns. The strategic investor also implements these plans or supervises their implementation.

2. The strategic investor is usually possessed of a brandname recognized in many countries. It is the market leaders in certain territories. It has been providing goods and services to users for a long period of time, reliably. This is an important asset, which, if properly used, can attract users. The enhancement of the brandname, its recognition and market awareness, market penetration, co-branding, collaboration with other suppliers – are all the responsibilities of the strategic investor.

3. The dissemination of the product as a preferred choice among vendors, distributors, individual users and businesses in the territory.

4. Special events, sponsorships, collaboration with businesses.

5. The planning and implementation of incentive systems (e.g., points, vouchers).

6. The strategic investor usually organizes a distribution and dealership network, a franchising network, or a sales network (retail chains) including: training, pricing, pecuniary and quality supervision, network control, inventory and accounting controls, advertising, local marketing and sales promotion and other network management functions.

7. The strategic investor is also in charge of "vision thinking": new methods of operation, new marketing ploys, new market niches, predicting the future trends and market needs, market analyses and research, etc.

The strategic investor typically brings to the firm valuable experience in marketing and sales. It has numerous off the shelf marketing plans and drawer sales promotion campaigns. It developed software and personnel capable of analysing any market into effective niches and of creating the right media (image and PR), advertising and sales promotion drives best suited for it. It has built large databases with multi-year profiles of the purchasing patterns and demographic data related to thousands of clients in many countries. It owns libraries of material, images, sounds, paper clippings, articles, PR and image materials, and proprietary trademarks and brand names. Above all, it accumulated years of marketing and sales promotion ideas which crystallized into a new conception of the business.

Technology

1. The planning and implementation of new technological systems up to their fully operational

phase. The strategic partner's engineers are available to plan, implement and supervise all the stages of the technological side of the business.

2. The planning and implementation of a fully operative computer system (hardware, software, communication, intranet) to deal with all the aspects of the structure and the operation of the firm. The strategic investor puts at the disposal of the firm proprietary software developed by it and specifically tailored to the needs of companies operating in the firm's market.

3. The encouragement of the development of in-house, proprietary, technological solutions to the needs of the firm, its clients and suppliers.

4. The planning and the execution of an integration program with new technologies in the field, in collaboration with other suppliers or market technological leaders.

Education and Training

The strategic investor is responsible to train all the personnel in the firm: operators, customer services, distributors, vendors, sales personnel. The training is conducted at its sole expense and includes tours of its facilities abroad.

The entrepreneurs – who sought to introduce the two types of investors, in the first place – are usually left with the following functions:

Administration and Control

1. To structure the firm in an optimal manner, most conducive to the conduct of its business and to present the new structure for the Board's approval within 30 days from the date of the GM's appointment.

2. To run the day to day business of the firm.

3. To oversee the personnel of the firm and to resolve all the personnel issues.

4. To secure the unobstructed flow of relevant information and the protection of confidential organization.

5. To represent the firm in its contacts, representations and negotiations with other firms, authorities, or persons.

This is why entrepreneurs find it very hard to cohabitate with investors of any kind. Entrepreneurs are excellent at identifying the needs of the market and at introducing technological or service solutions to satisfy such needs. But the very personality traits which qualify them to become entrepreneurs – also hinder the future development of their firms. Only the introduction of outside investors can resolve the dilemma. Outside investors are not emotionally involved. They may be less visionary – but also more experienced.

They are more interested in business results than in dreams. And – being well acquainted with entrepreneurs – they insist on having unmitigated control of the business, for fear of losing all their money. These things antagonize the entrepreneurs. They feel that they are losing their creation to cold-hearted, mean spirited, corporate predators. They rebel and prefer to remain small or even to close shop than to give up their cherished freedoms. This is where nine out of ten entrepreneurs fail - in knowing when to let go.

Iran, Economy of

Iran's porous border with Afghanistan is almost 600 miles (1000 km) long. No one knows for sure how many Afghani refugees crossed it in the last 20 years, but well over 2 million would be a fair estimate. Now that Iran transformed all newcomers into illegal aliens, thousands are crossing the border stealthily, joining families and former neighbors in Mashhad and other cities. Subject to US-led sanctions, Iran shouldered the multi-billion dollar burden of feeding, clothing, and employing past refugees out of its own dwindling resources. The current conflict is no different. Aid agencies, spearheaded by the World Food Program, are withdrawing their mountains of supplies from Iran's border. Where there are no official refugees, they say, there can be no aid.

But illicit border-crossing is only one of Iran's host of economic problems. It is a heavily indebted, nefariously corrupted, and hopelessly mismanaged country. Its decision making processes are malignantly politicized and centralized. Its population (especially the women and its minorities) are oppressed by a self-serving, inanely retrograde, clerical establishment. Its reform movement and rump of free press are hobbled by a vicious judiciary and a fractured clergy in a fully theocratic country and terrified by the social costs of a genuine overhaul of the economy. Khatami (Iran's popular President), for instance, shows very little interest in matters economic. The

Council of Guardians shot down every legislative effort to encourage foreign investments by extending property rights, though it let Iran apply to the WTO (its application is still blocked by the USA) and accede to the New York Convention (UN convention on awards granted in foreign arbitration). Iran is an economic zombie, kept alive with infusions of rising oil revenues - the serendipitous result of a global surge in oil prices.

Rumors are that, for its tacit collaboration with the USA in its anti-terror campaign, Iran will be rewarded with the long overdue suspension of US sanctions against non-US investors in Iran's oil industry (under the 1996 Iran/Lybia Sanctions Act renewed in July this year). The USA will also waive its resistance to Iranian accession to the WTO. Last year, Madeleine Albright, the then Secretary of State, suspended or cancelled a few minor sanctions (mainly against the importation of luxury goods manufactured in Iran). This coincided with a politically futile trip by President Khatami to New York. He then proceeded to China and negotiated a raft of economic collaboration agreements with its leadership.

The rumors may be true this time. But the partial lifting of some of the sanctions would do little to address Iran's fundamental and structural problems and a lot to highlight the USA's hitherto self-defeating intransigence.

Iran is a young country. A full one third of the burgeoning population (it grows by more than 3% annually) are less than 25 years of age. At least 12 million new jobs will be required by 2010 to absorb this demographic tsunami. The current economy generates less than 500,000 new jobs a year - many of which are parasitic, bureaucratic, positions in Iran's vitality-sapping religious nomenclature.

Unemployment, currently at least at 20% (officially at 13%), is projected to reach 5-6 million frustrated employment seekers by 2005.

This mismatch between the promise of the 1979 revolution and its dreary outcomes leads to nothing short of social disintegration. Divorce rates and drug abuse are up to decadent Western levels. There is a future-threatening brain drain and the common fantasy is immigration in search of a better, more promising, life in the Great Satan (i.e., the USA), or elsewhere in the West. The mammoth wave of the immigration of Iran's political and intellectual elite (with the $28 billion they owned) following the 1979 revolution - is equalled by today's relentless exodus.

Iran has just emerged from a debilitating 8 years long trench warfare with its neighbor, Iraq (at the time, a major trade partner). It is still under annually renewed and pointless American sanctions which date back to 1980 and which greatly afflict its oil industry, based as it is on American equipment and ruined by the savage and recurrent warfare. Constitutional legislation prohibiting the granting of mineral concessions to foreigners did not help. Iran was able to conclude deals worth $15 billion, including contracts to upgrade oil rigs and increase production with Japanese and Italian firms only recently and, prior to that, with French, Italian, and Malaysian firms regarding its off-shore fields. Daily output is predicted to go up by 700,000 barrels, which would bring Iran's total daily production to 4.4 million barrels.

The foreign entities will act under a "buy-back" contract and receive compensation from NIOC (the all-mighty and, claim the conservatives, thoroughly venal National Iranian

Oil Company, currently controlled by the reformists). These "fees" for exploration and development costs will, though not stated clearly, represent a percentage of intake as in conventional production-sharing agreements. Iran sells natural gas to Turkey and has signed in 1993 a memorandum with India regarding an LNG pipeline which was supposed to traverse the territory of Pakistan. It successfully negotiated the sharing of a major oil field in its disputed border with Kuwait. And it is hungrily eyeing the markets of China and Central Asia.

Though OPEC's second largest producer, Iran, according to the U.S. Department of Energy's "Country Analysis Brief" dated October 2001, has only 9% of the world's proven oil reserves - but an impressive 15% of its gas reserves. It exports little else (though non-oil exports, mainly carpets and pistachios, doubled lately) and its budget is reliant on oil revenues. The impressive "growth" in its GDP (6% in 2000, probably 3-4% this year) and its overwhelmingly positive trade surplus (c. 6% of GDP) reflect merely the changing fortunes in oil prices. Iran's income from sales of oil, derivatives, and gas more than doubled since the nadir of 1998. Yet, even this was not enough to dent Iran's daunting short term portion of its external debt (an otherwise manageable $21 billion) or to substantially raise GDP per capita (less than $1200). The stable currency (rial) is propped only by a gush of inflationary petro-dollars (inflation stands at 14%) as well as by the planned merger of the official (1700 to the $) and black market (8000 to the $) rates. Iran's multi-billion dollar "Stabilization Fund" (the storehouse of its excess oil revenues) may have helped as well.

To complicate matters, Iran is in the throes of a devastating drought in its third year (on top of another 10 arid years in the last 20). It has cost the economy c. $8-10 billion, has ruined the countryside, and flooded the cities, whose decrepit infrastructure is stretched to the point of dismemberment, with millions of destitute farmers. An antiquated, leak prone, water system compounds the 30% drop in rainfall and the many wrongly located water-consuming industrial projects. Now drinking water is scarce and, in some municipalities, buildings are sinking into the crumbling sewers. The government dares not raise water prices to realistic levels, lest it provokes a repeat of the riots a few months ago.

Iran's agricultural sector accounts for 20% of its GDP and 25% of its workforce. Most of it is water-intensive (rice, maize, grapes, tobacco, sugarcane) and thus susceptible to the vagaries of a natural disaster such as the recent drought. Luckily, timber production and off-shore fishing are less vulnerable and have hitherto survived. Still, Iran is a net importer of foodstuffs.

Just a short 18 months ago, things seemed so different. The new 5 year plan, declared in March 2000, called for a "total restructuring" of Iran's economy including the privatization of its bonyads - the lucrative state monopolies controlled by the ayatollahs (the post office, railways, petrochemicals, and upstream oil and gas). The fostering of a vibrant private sector and the reinvigoration of a shareholding middle class, coupled with a drastic reduction in subsidies for food staples and fuel, were predicted to yield an average GDP growth of 6% and 750,000 new jobs annually. The overriding concept was diversification away from oil dependence and into other industries (such as petrochemicals). Free trade zones were established as a way to circumvent the constant sabotage by the implacably xenophobic Council of Guardians.

Even Iran's Ali Khamenei (which carries the North Korean sounding title of "Supreme Leader") called upon the clergy to refuse to engage in business activities. "This is what distinguishes our system from other (systems)" - he exclaimed (in a speech in Isfahan, November 5, 2001). Yet, it was the very same Supreme Leader - the head of the clerical pyramid - who publicly signed into law a series of economic projects just minutes after his afore-quoted speech.

Yet the goodwill of Iran's reformists - now in their fifth year in ostensible power - ran afoul of zealots in their own religious establishment and on Capitol Hill. Internal undermining of free market initiatives coupled with the tremulous geopolitics of Iran's neighborhood and the mutual enmity cultivated by Ayatollahs and Congressmen - served to halt all progress to the great detriment of Iranians and the world at large. Iran's march towards ever greater openness is inexorable. Whether this is achieved through reform or through bloody mayhem is up to the citizens of this tortured country and to sensible decision making elsewhere. The transformation of Iran cannot be achieved solipsistically. It needs help and understanding and patience and encouragement. Alas, the West, mainly the USA, have shown too little of these to make a difference. Perhaps September 11 will change all this. What the atrocity proved is that we are all inter-dependent and that New York is no further from Afghanistan than is refugee-flooded Mashhad.

Iraq, Economy of

The Security Council just approved a tough resolution calling upon Iraq to disarm or face military action. The decade-old sanctions regime has provided countries such as Ukraine, Belarus and the Serb part of Bosnia-Herzegovina with lucrative commercial opportunities. According to international and Israeli media, they all illicitly sold arms and materiel - from active carbon filters to uranium - to the Iraq's thuggish rulers, though Ukraine still denies it vehemently.

The impending war and the lifting of sanctions likely to follow will grind these activities to a halt. This would not be the first time the countries of central and eastern Europe - from the Balkan to the steppes of central Asia - bear the costs of Western policies against Iraq.

In the wake of the Gulf War, Iraq defaulted on its debts to all and sundry. The members of COMECON, the now-defunct communist trade bloc, were hit hardest. According to Mikhail Margelov, chairman of the International Affairs Committee of Russia's Federation Council (upper house), Iraq still owes Russia alone c. $7-12 billion in pre-1990 principal, mainly for arms purchases.

Macedonian construction groups were active in Iraq between 1950-1990. They are owed tens of millions of dollars - the equivalent of 5 percent of GDP, say to sources in the government. Yugoslav, Czech, Polish, and formerly East German firms are in the same predicament.

A typical case: the Belarus news agency Belapan reported recently how Leonid Kozik, leader of the Federation of Trade Unions of Belarus, co-chairman of the Belarusian-Iraqi Joint Commission on Trade and Economic Cooperation and a close aide to Belarusian President Aleksander Lukashenka, traveled to Iraq in an effort to recoup millions of dollars owed to the Belarusian metals and energy concern Belmetalenerga. The unfortunate company - the country's exclusive export channel to Iraq - sold to it a range of goods, including 500 tractors worth more than $5 million back in 1999.

The chances of recovering these debts diminish by the day. East-West Debt, an international financial company specializing in purchasing and recovery of overdue trade or bank debt in high-risk countries, published this advisory recently: "Many enterprises, banks and insurance companies are still holding uninsured trade debts on Iraq, due to exports or loans originating from before 1990. Please be aware that these claims on Iraq may become time-barred."

Russia reasonably claims to have sustained $30 billion in lost business with Iraq since 1991. Even now, dilapidated as it is, Iraq is a large trade partner. According to the United Nations, bilateral trade under the oil-for-food program since 1996 amounted to $4.3 billion. The real figure is higher. Russia's oil industry is private and keeps much of its revenues off the books. Tens of thousands of Russians used to purchase Iraqi goods in Turkey and sell them back home - a practice known as the "shuttle trade".

Russia and Iraq have confirmed in August that they are negotiating $40-60 billion worth of cooperation agreements in the oil, agriculture, chemical products, pharmaceuticals, fertilizers, irrigation, transportation, railroads and energy sectors. According to the Washington Post, some of the 67 10-year accords relate to oil exploration in Iraq's western desert. An Iraqi delegation, headed by the minister of military industry, visited Belarus last month in an effort to conclude a similar economic package. But such contracts are unlikely to be materialized as long as the sanctions remain intact.

Radio Free Europe/Radio Liberty reports that Russian firms already control two fifths of sales of Iraqi oil in world markets. Even American companies use Russian fronts to trade with the embargoed country, claim sources in the energy sector. The Financial Times exposed two years ago similar arrangements between United States based suppliers, oil and service companies and west European entities.

According to the New York Times, a Russian consortium, led by Lukoil, signed a 23-year, $3.5 billion agreement with Baghdad to rehabilitate some of its crumbling oil fields. According to the BBC, Lukoil also inked unusually favorable production-sharing agreements with the desperate Iraqi government.

Whether these $20 billion dollar concessions will be honored by Baghdad's post-war new rulers is questionable. Even the current regime is incensed that Lukoil hasn't started implementing the contracts due to UN sanctions. According to Asia Times, the Iraqi government has recently excluded the Russian firm from its list of accredited suppliers under the oil-for-food program.

A Russian state-owned oil company, Zarubezhneft, is said by the London Observer to have signed a $90 billion contract to develop the bin-Umar oilfield. It subcontracted some drilling rights in the West Qurna fields to Tatneft, another Russian outfit. The Washington Post reported a $52 million service contract signed last October between Slavneft and the Iraqi authorities.

The International Energy Agency's World Energy Outlook 2001 claims that the Iraqis have awarded foreign oil contracts worth a staggering $1.1 trillion, much of it to Russian, French, and Chinese firms. Russia is well-placed to enjoy Iraq's graces while Saddam is in power. It is scrambling to secure similar access in an American-sponsored post-conflict reign. According to the Observer, hence much of the haggling in the United Nations over language and America's freedom of action.

Even more crucially, Russia's aspirations to replace Saudi Arabia as the world's largest and swing producer and to become America's primary source of oil may be dashed by United States control of Iraq's enormous proven reserves. The rising tensions in the Gulf may be providing Russia and its extractive behemoths with a serendipitous windfall - but, in the long run, Russia's rising oil star is threatened by a permanent American stranglehold over Iraq's 112 billion barrels.

A successful American campaign not only jeopardizes Russia's future interests - but its present income as well. A drop in oil prices - more than likely as Iraq is pacified and its oil production surges - will hurt Russia. Below a certain price for crude, Russia's domestic fields are not worth developing.

Between the rock of contract-freezing sanctions and the hard place of American dominance, Russia was forced to vote in favor of the United States sponsored resolution in the Security Council. It may signal a new period of cohabitation - or, more likely, the beginning of a long tussle over commercial interests and economic benefits.

If the looming war was all about oil, Iraq would be invaded by the European Union, or Japan - whose dependence on Middle Eastern oil is far greater than the United States'. The USA would have, probably, taken over Venezuela, a much larger and proximate supplier with its own emerging tyrant to boot.

At any rate, the USA refrained from occupying Iraq when it easily could have, in 1991. Why the current American determination to conquer the desert country and subject it to direct rule, at least initially?

There is another explanation, insist keen-eyed analysts.

September 11 shredded the American sense of invulnerability. That the hijackers were all citizens of ostensible allies - such as Egypt and Saudi Arabia - exposed the tenuous and ephemeral status of US forces in the Gulf. So, is the war about transporting American military presence from increasingly hostile Saudis to soon-to-be subjugated Iraqis?

But this is a tautology. If America's reliance on Middle Eastern oil is non-existent - why would it want to risk lives and squander resources in the region at all? Why would it drive up the price of oil it consumes with its belligerent talk and coalition-building? Why would it fritter away the unprecedented upswell of goodwill that followed the atrocities in September 2001?

Back to oil. According to British Petroleum's Statistical Review of World Energy 2002, the United States voraciously - and wastefully - consumes one of every four barrels extracted worldwide. It imports about three fifths of its needs. In less than eleven years' time, its reserves depleted, it will be forced to import all of its soaring requirements.

Middle Eastern oil accounts for one quarter of America's imports. Iraqi crude for less than one tenth. A back of the envelope calculation reveals that Iraq quenches less than 6 percent of America's Black Gold cravings. Compared to Canada (15 percent of American oil imports), or Mexico (12 percent) - Iraq is a negligible supplier. Furthermore, the current oil production of the USA is merely 23 percent of its 1985 peak - about 2.4 million barrels per day, a 50-years nadir.

During the first eleven months of 2002, the United States imported an average of 449,000 barrels per day (bbl/d) from Iraq. In January 2003, with Venezuela in disarray, approximately 1.2 million bbl/d of Iraqi oil went to the Americas (up from 910,000 bbl/d in December 2002 and 515,000 bbl/d in November).

It would seem that $200 billion - the costs of war and postbellum reconstruction - would be better spent on America's domestic oil industry. Securing the flow of Iraqi crude is simply too insignificant to warrant such an exertion.

Much is made of Iraq's known oil reserves, pegged by the Department of Energy at 112 billion barrels, or five times the United States' - not to mention its 110 trillion cubic feet of natural gas. Even at 3 million barrels per day - said to be the realistically immediate target of the occupying forces and almost 50 percent above the current level - this subterranean stash stands to last for more than a century.

Add to that the proven reserves of its neighbors - Kuwait, Saudi Arabia, the United Arab Emirates - and there is no question that the oil industry of these countries will far outlive their competitors'. Couldn't this be what the rapacious Americans are after? - wonder genteel French and Russian oilmen. After all, British and American companies controlled three quarters of Iraq's mineral wealth until 1972 when nationalization denuded them.

Alas, this "explanation" equally deflates upon closer inspection. Known - or imagined - reserves require investments in exploration, development and drilling. Nine tenths of Iraq's soil are unexplored, including up to 100 billion barrels of deep oil-bearing formations located mainly in the vast Western Desert. Of the 73 fields discovered - only 15 have been developed. Iraq's Oil Minister, Amir Rashid, admitted in early 2002 that only 24 Iraqi oil fields were producing.

The country has almost no deep wells, preponderant in Iran, for instance. Though the cost of production is around $1-1.5 per barrel, one tenth the cost elsewhere - while Texas boasts 1,000,000 drilled wells, Iraq barely sports 2000. The Department of Energy's report about Iraq concludes:

"Iraq generally has not had access to the latest, state-of-the-art oil industry technology (i.e., 3D seismic), sufficient spare parts, and investment in general throughout most of the 1990s, but has instead reportedly been utilizing questionable engineering techniques (i.e., overpumping, water injection/"flooding") and old technology to maintain production."

The quality of Iraqi oil deteriorated considerably in the recent decade. Its average API gravity declined by more than 10 percent, its water cut (intrusion of water into oil reservoirs) increased and its sulfur content shot up by one third. The fields date back to the 1920s and 1930s and were subjected to abusive methods of extraction. Thus, if torched during a Gotterdammerung - they may well be abandoned altogether.

According to a report published by the United Nations two years ago, Iraqi oil production is poised to fall off a cliff unless billions are invested in addressing technical and infrastructural problems. Even destitute Iraq forks out $1.2 billion annually on repairing oil facilities.

The Council of Foreign Relations and the Baker Institute estimated, in December last year, that the "costs of repairing existing oil export installations alone would be around $5 billion, while restoring Iraqi oil production to pre-1990 levels would cost an additional $5 billion, plus $3 billion per year in annual operating costs".

Not to mention the legal quagmire created by the plethora of agreements signed by the soon to be deposed regime with European, Indian, Turkish and Chinese oil behemoths. It would be years before Iraqi crude in meaningful quantities hits the markets and then only after tens of billions of dollars have been literally sunk into the ground. Not a very convincing business plan.

Conspiracy theorists dismiss such contravening facts impatiently. While the costs, they expound wearily, will accrue to the American taxpayer, the benefits will be reaped by the oil giants, the true sponsors of president Bush, his father, his vice-president and his secretary of defense. In short, the battle in Iraq has been spun by a cabal of sinister white males out to attain self-enrichment through the spoils of war.

The case for the prosecution is that, cornered by plummeting prices, the oil industry in America had spent the last ten years defensively merging and acquiring in a frantic pace. America's twenty-two major energy companies reported overall net income of a mere $7 billion on revenues of $141 billion during the second quarter of last year. Only forty five percent of their profits resulted from domestic upstream oil and natural gas production operations.

Tellingly, foreign upstream oil and natural gas production operations yielded two fifths of net income and worldwide downstream natural gas and power operations made up the rest. Stagnant domestic refining capacity forces US firms to joint venture with outsiders to refine and market products.

Moreover, according to the energy consultancy, John S. Herold, replacement costs - of finding new reserves - have soared in 2001 to above $5 per barrel. Except in the Gulf where oil is sometimes just 600 meters deep and swathes of land are immersed in it. In short: American oil majors are looking abroad for their long-term survival. Iraq always featured high on their list.

This stratagem was subverted by the affaire between Saddam Hussein and non-American oil companies. American players shudder at the thought of being excluded from Iraq by Saddam and his semipternal dynasty and thus rendered second-tier participants.

According to the conspiracy minded, they coaxed the White House first to apply sanctions to the country in order to freeze its growing amity with foreign competitors - and, now, to retake by force that which was confiscated from them by law. Development and production contracts with Russian and French companies, signed by Saddam Hussein's regime, are likely to be "reviewed" - i.e., scrapped altogether - by whomever rules over Baghdad next.

An added bonus: the demise of OPEC. A USA in control of the Iraqi spigot can break the back of any oil cartel and hold sway over impertinent and obdurate polities such as France. How would the ensuing plunge in prices help the alleged instigators of the war - the oil mafia - remains unclear. Still, James Paul propounded the following exercise in the Global Policy Forum this past December:

"(Assuming) the level of Iraqi reserves at 250 billion barrels and recovery rates at 50% (both very conservative estimates). Under those conditions, recoverable Iraqi oil would be worth altogether about $3.125 trillion. Assuming production costs of $1.50 a barrel (a high-end figure), total costs would be $188 billion, leaving a balance of $2.937 trillion as the difference between costs and sales revenues. Assuming a 50/50 split with the government and further assuming a production period of 50 years, the company profits per year would run to $29 billion. That huge sum is two-thirds of the $44 billion total profits earned by the world's five major oil companies combined in 2001. If higher assumptions are used, annual profits might soar to as much as $50 billion per year."

The energy behemoths on both sides of the pond are not oblivious to this bonanza. The Financial Times reported a flurry of meetings in recent days between British Petroleum and Shell and Downing Street and Whitehall functionaries. Senior figures in the ramshackle exile Iraqi National Congress opposition have been openly consorting with American oil leviathans and expressly promising to hand postwar production exclusively to them.

But the question is: even if true, so what? What war in human history was not partly motivated by a desire for plunder? What occupier did not seek to commercially leverage its temporary monopoly on power? When were moral causes utterly divorced from realpolitik?

Granted, there is a thin line separating investment from exploitation, order from tyranny, vision from fantasy. The United States should - having disposed of the murderous Saddam Hussein and his coterie - establish a level playing field and refrain from giving Iraq a raw deal.

It should use this tormented country's natural endowments to reconstruct it and make it flourish. It should encourage good governance, including transparent procurement and international tendering and invite the United Nations to oversee Iraq's reconstruction. It should induce other countries of the world to view Iraq as a preferred destination of foreign direct investment and trade.

If, in the process, reasonable profits accrue to business - all for the better. Only the global private sector can guarantee the long-term prosperity of Iraq. Many judge the future conduct of the USA on the basis of speculative scenarios and fears that it is on the verge of attaining global dominance by way of ruthlessly applying its military might. This may well be so. But to judge it on this flimsy basis alone is to render verdict both prematurely and unjustly.

It is payback time. The United States has every intention of sidelining France, Germany and Russia in the lucrative reconstruction of a war-ravaged Iraq. U.S. Ambassador to the United Nations, John Negroponte, said, last Wednesday, that Washington is bent on "streamlining" the 8 years old U.N. oil-for-food program, now on hold since last Monday.

Money from Iraqi oil sales currently flows to an escrow account, co-managed by the Security Council's Office of the Iraq Program (OIP) and the Iraqi government. More than $42 billion worth of contracts for humanitarian supplies and equipment have been signed since December 1996.

The U.N. states that "supplies and equipment worth almost $26 billion have been delivered to Iraq, while another $11.2 billion worth of humanitarian supplies and equipment are in the production and delivery pipeline". Of these, reports the Washington Post, $8.9 billion in humanitarian goods, including $2.4 billion worth of food, are "ready to be imported into Iraq". The program's budget is c. $10 billion a year.

America and Britain wish to make Kofi Annan, the Secretary General of the United Nations, the sole custodian of the program, exclusively empowered to approve applications and disburse funds - as he has hitherto been doing in north Iraq. According to their proposals and the Secretary General's 8-page letter, the program's remit will be extended to cover war refugees as well.

Other novelties: Annan would be authorized to renegotiate contracts - for instance, with Russian, French and Chinese energy behemoths - and prioritize purchases. Additional routes and sites - both inside and outside the besieged country - would be approved for Iraq's energy exports and for the delivery and inspection of humanitarian supplies.

Stratfor, the strategic forecasting consultancy, explains why this stratagem is anti-Russian and, more so, anti-French:

"The process would greatly speed up the aid disbursement process and cut out the middlemen who profit from the contractual go-betweens ... (which) have been almost exclusively French and Russian companies ... French and Russian banks usually have channeled the funds to the appropriate places ... The contracts were bribes to Paris and Moscow to secure French and Russian support for Iraq within the United Nations."

The non-disbursed portion of the fund has now ballooned to equal 2-3 years of Iraqi oil revenues, or more than $40 billion. Iraqi Vice President, Taha Yassin Ramadan, scathingly criticized Annan yesterday for seeking to expand the exclusive role of the U.N. in administering the oil-for-food program. He said the proposal was "based on a colonialist, racist and despicable illusion that pushes the despot oppressors in Washington and London towards eliminating the state of Iraq from existence".

The increasingly cantankerous Mohammed Al-Douri, Iraq's disheveled Ambassador to the U.N., invoked the inevitable conspiracy theory. Iraq, he seethed, is to be eliminated and transformed "into colonies under the control of the world American and Zionist oil mafia". It is "a great insult to the United Nations". Annan's scheme "calls for the forfeiting of the oil of the Iraqi state and implementing the colonial illusion of the removal of the State of Iraq." - he thundered.

The Washington Post quotes a "confidential U.N. paper" as saying that "the U.N. image is already tarnished among the Iraqi people. It will be further damaged if the question of Iraq's oil resources is not managed in a transparent manner that clearly brings benefit to the Iraqi people."

The stalemate costs the under-nourished and disease-plagued people of Iraq dearly. More than three fifths of them - some 14 million souls - rely on the program for daily necessities. Over the weekend, experts from the 15 members of the Council, presided over by Germany, met to iron out the details. They were aided by Deputy Secretary-General Louise Fréchette, Benon Sevan, Executive Director of the OIP, UN Legal Counsel Hans Corell and Under-Secretary-General for Humanitarian Affairs Kenzo Oshima.

Negroponte reiterated Washington's mantra that the United States "will ensure that Iraq's natural resources, including its oil, are used entirely for the benefit of the Iraqi people". But Annan did not sound convinced when he exhorted the USA and the United Kingdom in the letter he delivered last week to the Security Council:

"The primary responsibility for ensuring that the Iraqi population is provided with adequate medicine, health supplies, foodstuffs and materials and supplies for essential civilian needs will rest with the authority exercising effective control in the country ... (But) without in any way assuming or diminishing that ultimate responsibility, we, in the United Nations, will do whatever we can to help."

Thus, continues Annan's missive, money in the U.N. account, originally earmarked for equipment and infrastructure, would be diverted to purchase food and medicine "on a reimbursable basis". Who would reimburse the fund he left unsaid. Nor did he limit the newfangled "interim" oil-for-food regime in time.

Whatever the outcome of the recent tussle, the U.N. would still have to rely on the Iraqi government to distribute goods and provide services in the southern and central parts of this California-sized polity. The United Nations' own staff has been withdrawn upon the commencement of hostilities. Annan already conceded that "the Iraqi State Oil Marketing Organization should be allowed to continue to retain ... the authority to conclude oil contracts with national purchasers".

But Saddam Hussein's regime fails to see the urgency. Baghdad said last Monday that it had distributed food to the populace to last them through August. Even non-governmental organizations in the field claim that no shortages are to be expected until May. So, what's the hurry? - wonder the authorities aloud, as they cower in their offices, awaiting the next, inevitable, blast.

Iraq had no middle class to speak of until the oil boom of the 1960s-1970s. At the turn of the previous century, Baghdad sprawled across a mere tenth of its current area. However, since then and as late as 1987, the Iraqi capital was renowned throughout the Arab realm for its superior infrastructure, functioning services, splendor, conspicuous consumption and educated populace. "Baghdadi" in many Arab dialects meant "big spender".

Two thirds of all Iraqi children attended secondary school, thousands studied abroad, women actively participated in the workforce. The oil wealth attracted hundreds of thousands of menial laborers from Africa and Asia. It was Saddam Hussein, the country's tyrant, who rattled the moribund and tradition-bound entrenched interests and ratcheted up living standards by imposing land reform, increasing the minimum wage and expanding healthcare.

Even the Iran-Iraq war which decimated tens of thousands of intellectuals and professionals barely dented this existence. Rather, the - mostly Sunni - middle class was done in by the sanctions imposed on Iraq, the aggressor in the first Gulf War, after 1991.

Iraq's relatively affluent and well-traveled urban denizens had access to all the amenities and consumer goods - now proffered by the impoverished owners in improvised curb markets. As wages and the dinar plummeted, once-proud Iraqis were reduced to agonizing, humiliating and sometimes life-threatening penury.

Prostitution, street kids and homelessness have flourished. Divorce and crime rates are sharply up. Young couples cannot afford to marry, so promiscuity and abortions are in vogue. On the other extreme, Islam - both moderate and fundamentalist - is making headway into a hitherto devoutly secular society. Headscarved women are not a rarity anymore.

Official unemployment is c. 20 percent but, in reality, it is at least double that. Polyglot professionals with impressive resumes drive taxis, moonlight as waiters, or sell vegetables from rickety stalls.

According to Humam Al Shamaa, professor of economy and finance at Baghdad University, quoted by the Asia Times, one in every two Iraqis are currently employed in agriculture - most of it subsistence farming, raising cattle and poultry. Many an urbane urbanite now tend to tiny plots, trying to eke a living out of the fertile banks of the Two Rivers - the Euphrates and the Tigris. Industry - cement, petrochemicals - is at a standstill due to the dearth of raw materials oft-proscribed by the ponderous sanctions committee.

The Boston Globe recounts the tale of an Iraqi Airlines pilot whose monthly earnings plunged from $1500 to $2.50. Malnutrition and disease prey on the traumatized and destitute remnants of the bourgeoisie, the erstwhile nobility of the Arab world. The virtual elimination of the purchasing power of one of the richest Middle Eastern countries has had a profound impact on neighbors and trade partners across the region.

The UN Human Development Index has chronicled the precipitous decline of Iraq's ranking to its 127th rung. The New York-based Centre for Economic and Social Rights says that "Iraqis have been extremely isolated from the outside world for 12 years. The mental, physical and educational development of an entire generation has been affected adversely by the extraordinary trauma of war and sanctions".

Public services - from primary healthcare through electricity generation to drinking water - were roughly halved in the past 12 years. Quality has also suffered. Iraq's gross domestic product plunged by four fifths. With infectious diseases on the rampage and a debilitating stress load, life expectancy dropped - men now survive to the ripe old age of 57.

Infant mortality, at 93 in 1000 live births, soared. Three fifths of the population depend on an efficient system of government handouts. An exit tax of more than $350 virtually fenced in all but the most well-heeled Iraqis.

The American administration, in the throes of preparations for the reconstruction of a postbellum Iraq, acknowledges that the rehabilitation of the war-torn country's middle class is the cornerstone of any hoped-for economic revival.

But income inequality and a criminalized regime led to huge wealth disparities. The tiny, fabulously rich elite beholden to Saddam (the "war rats") are removed from the indigent masses. They make the bulk of their ill-gotten gains by maintaining Saddam-blessed import monopolies on every manner of contraband from building materials and machine spare parts to cars, televisions and beauty products. The United States estimates that the dictator and his close, clannish circle have secreted away more than $6 billion in illicit commissions on oil sales alone.

But the proceeds of smuggling and intellectual property piracy have trickled down to a growing circle of traders and merchants. So has the $30 billion influx from the oil-for-food scheme, now in its eighth year - though, as Hans von Sponeck, head of the program between 1998-2000, observed in the Toronto Globe and Mail:

"Until May of 2002, the total value of all food, medicines, education, sanitation, agricultural and infrastructure supplies that have arrived in Iraq has amounted to $175 per person a year, or less than 49 cents a day ... This has made postwar reconstruction impossible, and ensured mass unemployment and continuing deterioration of schools, health centers and transportation. 'Smuggled' oil revenues represent only a small fraction of oil-for-food funds. Even here, an estimated three-quarters of these funds have been directed to social services."

Still, Iraq's economy has been partly remonetized and is less insulated than it was in 1996. Even the stock exchange has revived.

Whatever the length of the war, its outcome is said to be guaranteed - the ignominious demise of the hideous terror regime of Saddam Hussein. Then, the scenario goes, the American and British "liberators" will switch from regime-change mode to the nation-building phase. Iraq will once again become the economic locomotive of the entire region, prosperous and secure.

But the bombed and starved denizens of Iraq may be holding a different viewpoint. Quoted in The Californian, Terry Burke and Alan Richards, professors at the University of California, Santa Cruz, noted that "the invasion and air attacks are forging intense hatred against the United States that will undermine any hope of gracefully replacing Saddam Hussein's dictatorship".

It would be instructive to remember that the 1958 overthrow of the monarchy by the Free Officers, followed by the Ba'ath party in 1968 and, later on, by Saddam Hussein, represented the interests of the lower middle class and the petty bourgeoisie: shopkeepers, low and mid-ranking officials and graduates of training schools, law schools, and military academies.

The most important economic policies in the past four decades - the agrarian reform and the nationalization of oil - catered to the needs and aspirations of these socio-economic strata. The backbone of Saddam Hussein's regime is comprised of bureaucrats and technocrats - not of raving rapists and torture-hungry sadists, as Western propaganda has it.

Saddam's days may well be numbered. But the levers of power, based on tribal affiliation, regional location, religious denomination and sectarian interests - will survive intact. If the West really aspires to resuscitate a stable Iraq - it has no choice but to collaborate with the social structures spawned by the country's long and erratic history. The Ottomans did, the British did - the Americans will do to.

Iraqi Jews - a quarter of a million strong - are known in Israel for their haughtiness and broad education, the latter often the cause of the former. They were forced to flee Arab-nationalist Iraq in 1941-1951, following the rise of Nazism and, later, the establishment of the State of Israel.

Yet, though they have left Baghdad physically after 2600 years of continuous presence - many of them are still there emotionally. This holds true for numerous other Iraqi exiles, expatriates and immigrants in the far-flung diaspora. There are 90,000 Iraqis in the USA alone, according to the latest data from the Census Bureau.

But nostalgia may be the only common denominator. Exile groups jostle aggressively for the spoils of war: political leadership, sinecures, economic concessions, commercial monopolies and access to funds. The Washington Times reported yesterday that the Pentagon and the State Department back different cliques. It quoted one Republican congressional aide as saying: "There's a deep and messy war in the administration, and it's in the weeds."

Arab countries are promoting Sunni future leaders. Pro-democracy souls support representatives of the hitherto oppressed Shiite majority. Most exiles oppose a prolonged postwar U.S. presence or even an interim administration. They opt for a government of Iraqi technocrats with a clear United Nations mandate. The fractious Iraqi opposition and the two main Kurdish factions set up an Iraqi Interim Authority, a government-in-waiting with 14 ministries and a military command.

The Brussels-based International Crisis Group warned last Tuesday against a provisional administration composed substantially of exiles and expatriates:

"It would be a mistake to short-circuit the domestic political contest by prematurely picking a winner. Under either of these scenarios, the bulk of Iraqis inside Iraq, Sunni and Shiite, Arab, Kurd and others, who have been brutally disenfranchised for over three decades, would remain voiceless."

The exile groups are out of touch with local realities and, as the Washington Times notes, compromised in the eyes of the Iraqis by their extensive contacts with the CIA and the USA, their political amateurism and their all-pervasive venality.

The finances of such self-rule could come from the $3.6 billion in Iraqi assets in the United States - about half of which have been recently re-frozen. The coffers of the United Nations administered oil-for-food program bulge with $40 billion in undistributed funds - enough to bankroll the entire reconstruction effort. Saddam and his clan are thought to have stashed at least $6 billion abroad. Everyone, though, tiptoes around the sensitive issue of reimbursing the war expenses of the coalition of the willing.

The Pentagon has other ideas in mind. It has recently formed the Office of Reconstruction and Humanitarian Assistance, headed by a retired general, Jay Garner. A few exiles, worried by this "colonial" tendency, have infiltrated Iraq, at great personal risk, to ensure that an Iraqi alternative is in place when Operation Iraqi Freedom achieves its eponymous goal.

Iraqi immigrants are fiercely nationalistic. Though few love Saddam Hussein and his interminable reign of terror - fewer are willing to countenance the occupation of their homeland by invading forces, regardless of their provenance. Many bitterly recall the Shiite rebellion in 1991 when a policy reversal of the United States allowed the dictator to bloodily suppress the uprising.

According to officials in Amman, more than 6500 Iraqis - out of 200 to 300 thousand - left Jordan in Iraqi-arranged free transportation to fight the "aggressors", as suicide bombers if need be. Others are streaming in from Lebanon, Syria, Yemen and North Africa.

Iraqi exiles in Iran - mostly Shiites and invariably mortal foes of the tyrant from Baghdad - have nonetheless denounced the invasion and called it, ominously, a "war on Islam". Aware of this duality, Donald Rumsfeld, the American Defense Secretary, recently warned that Shiite combatants "will be taken as a potential threat to coalition forces. This includes the Badr Corps, the military wing of the Supreme Council on Islamic Revolution in Iraq."

But other Iraqis, Kurds included, are training, in U.S.-sponsored camps in east and central Europe, to liaise with the local population to help non-governmental organizations and the coalition forces deliver humanitarian aid. The program - now suspended - is financed with money allocated from the $97 million 1998 Iraq Liberation Act.

According to the Boston Globe:

"During the four-week course, the volunteers learn battlefield survival skills including navigation, nuclear and biological weapons defense, marksmanship, first aid, and the laws of war and human rights. They also study civil-military operations such as processing refugees, distributing humanitarian aid, and rebuilding infrastructure."

Iraqi professionals abroad with vital skills in administration, agriculture, oil extraction, finance, economics, law, medicine and education are preparing to return. Draft reconstruction plans call for tax incentives and soft loans for homebound entrepreneurs, investors and skilled manpower. There are many of these. Arabs say that Egyptians write, Lebanese publish and Iraqis read.

Aware of this untapped wealth of talent and experience, the American have belatedly started recruiting dozens of expats and immigrants for the future administration of the war-torn country. Some 40 lawyers from Europe and North America will complete tomorrow a fortnight of training provided courtesy of the Justice Department.

The Pentagon and the State Department are running similar programs with 100 and 240 participants, respectively. According to the Knight-Ridder Newspapers, "the ('Future of Iraq') working groups deal with such topics as defense policy, civil society, public health, transitional justice, news media, national security, public finance and anti-corruption efforts".

According to the Washington Post, there is even an Iraqi military contingent of up to 3000 exiles underwritten by the Pentagon and training in Hungary. Some of them are slated to serve as guides and translators for the coalition forces in their homeland. The program is suspended now but the camp in Hungary remains open and it is tipped to be renewed.

And then there is the hoped-for reversal of the last four decades of capital flight. Iraqi merchants, traders, military officers, members of the security services, politicians, bureaucrats and professionals are thought to have secreted away, out of the reach of the rapacious regime, some $20-30 billion. Some of it is bound to come back and inject the dilapidated economy with much needed liquidity and impetus.

Last August, a group of Iraqi-born economists gathered at the Department of State in Washington. One of the participants, Dr. Salah Al-Sheikhly, a former Governor of Iraq's Central Bank, outlined to Washington File his vision of the future contribution of the diaspora to a liberated Iraq:

"People talk of the Iraqi Diaspora as if we have been idle. On the contrary, economists like myself have been working within the agencies of the United Nations and other international institutions. We have been consultants in many Arab countries. And many of us gathered around the table (in Washington) have extensive experience within the kinds of financial institutions that can assist Iraq enter the new world economy."

The French were at it again last Friday. Any reduction in Iraq's mountainous $120 billion external debt should be negotiated within the Paris Club of creditor nations, they insisted. It ought not - indeed, cannot - be tackled bilaterally. And what about another $200 billion in war reparations and contractual obligations? This, said French Foreign Ministry spokesman Francois Rivasseau, is to be discussed.

A day earlier, Paul Wolfowitz, the American Deputy Defense Secretary, prompted the French, Russian and German governments to write off Iraq's debts to them, so as to facilitate the recovery of the debtor's $15 to 25 billion a year economy. He echoed U.S. Treasury Secretary John Snow who suggested, in an interview to Fox News Channel, that Iraq's debts should be discarded even as was the dictator who ran them up.

At first, Putin made conciliatory noises upon exiting a gloomy meeting with the two other co-founders of the discredited "peace camp". Russia, he reminded the media, is number one in erasing debts owed it by poor countries.

But he was swiftly contradicted by the Chairman of the Duma's Committee on the State Debt and Foreign Assets Vladimir Nikitin, who called the American proposals "more than bizarre". Iraq's debt to Russia - some "well verified and grounded" $8 billion - is not negotiable. Contradicting his own contradiction, he then added that discussions on debts have to be held bilaterally.

Gennady Seleznyov, the Chairman of the lower house of the Russian parliament, concurred. For good measure, he also demanded $2 billion from the USA for contractual losses due to the war. The Russian government and especially Finance Minister and Deputy Prime Minister, Alexei Kudrin, cautioned Wolfowitz that applying his proposal consistently would lead to the scrapping of the debts of another departed evil regime - the U.S.S.R.

Russia needs Iraq's money - especially if oil prices were to tumble. According to Russia's Central Bank, the Federation's foreign debt was up $2.7 billion in 2002 and reached $153.5 billion, of which $55.3 billion is in Soviet-era debt, $48.4 billion were accrued in post-Soviet times and the rest is comprised of various bonds and obligations.

But the U.S. is unfazed. US Ambassador to Russia Alexander Vershbow reiterated to the Russian news agency, Rosbalt, his government's position thus: "We intend to organize a conference of creditors in order to discuss ways of finding a balance between the rights of the creditors and the rights of the Iraqi people to develop their economy. In my opinion, it would be unwise to immediately demand large sums of money from the new Iraqi government."

In this debate, everyone is right.

Iraq's only hope of qualifying for the status of a Highly Indebted Poor Country (HIPC) is by reaching iron-clad debt rescheduling agreements with both the Paris and the London Clubs. Still, as the Americans envision, creditors can unilaterally forgive Iraqi debt - especially one arising from Saddam Hussein's misdeeds - without hampering the process with the World Bank and without hindering future access to global or internal capital markets.

This is especially true when it comes to the United Nations Compensation Commission which administers Iraqi reparations to victims of Iraq's aggression against Kuwait in 1990-1.

Signs of utter confusion abound. The International Monetary and Financial Committee of the International Monetary Fund, headed by Gordon Brown, Britain's Chancellor, is committed to the Paris Club multilateral route. Yet, James Wolfensohn, the President of the World Bank, a twin institution, plumps for a bilateral resolution of this novel controversy.

Anticipating a beneficent outcome, $2 billion in traded Iraqi sovereign and commercial loans, harking back to the 1980s, have recently doubled in value to c. 20 cents to the dollar. According to The Economist, brokers are betting on a 70 to 90 percent reduction of Iraq's debt. This is way too exuberant. Moreover, not all creditors are created equal.

Iraq owes the IMF and the World Bank a mere $1.1 billion. But there is an abundance of unpaid high priority trade credits and bilateral loans. Private banks and commercial firms come a dismal third. Moreover, following Nigeria's example, Iraq may choose to ignore Paris Club creditors and deploy its scarce resources to curry favor with those willing and able to extend new financing - namely, private financial intermediaries.

Trading Iraqi debt - sovereign notes, letters of credit and papers issued by the central bank and two other financial institutions, Rafidain Bank and Rashid Bank, is onerous. The Economist describes it thus:

"Trading, or even holding, Iraqi paper is loaded with traps. Its validity can expire every few years, according to the statute of limitations in various jurisdictions. Renewing it requires some acknowledgment from the borrower, and that was difficult even before the war. Assigning the debt from buyer to seller requires the borrower's assent, and the Iraqi banks have been unco-operative since 1988. The trick is to apply during public holidays, or when communications are down (as they are now), because the borrower's failure to respond within ten working days can be taken as agreement."

No one has a clear idea of how much Iraq owes and to whom.

According to Exotix, a sovereign debt brokerage, Iraq owes commercial creditors $4.8 billion and other Gulf states $55 billion - regarded by Iraq as grants to cover the costs of its war with Iran in the 1980s. It owes Paris Club members - excluding Russia and France ($8 billion apiece) - $9.5 billion, the countries of Central Europe, mainly Germany - $4 billion and others - about $26 billion, including $5 billion to the U.S. government and American businesses.

The tortured country's foreign debt alone amounts to $5000 per every denizen. With reparations and commercial obligation, Iraq's destitute inhabitants are saddled with more than $16,000 in debt per capita - or 15-20 times the country's gross national product. Iraq hasn't serviced its loans for well over a decade now.

Others dispute these figures. Frederick Barton compiled, together with Bathsheba Crocker, an inventory of Iraq's outstanding financial obligations for the Center for Strategic and International Studies in Washington.

According to Barton-Crocker, quoted by the Gulf satellite channel, al-Jazeera and by the Christian Science Monitor, Iraq owes $199 billion in compensation claims to more than a dozen nations, another $127 billion in foreign debts and $57 billion in pending foreign contracts - public and private. Iraq owes Russia $12 billion, Kuwait $17 billion, the Gulf States $30 billion and less than $2 billion each to Turkey, Jordan, Morocco, Hungary, India, Bulgaria, Poland, and Egypt.

Most of the pending contracts are with Russian firms ($52 billion) but the French, Chinese, Dutch, United Arab Emirates and Egyptians have also inked agreements with Hussein's regime. The United states and American firms are owed little if anything, concludes al-Jazeera. Debt forgiveness would allow a more sizable portion of Iraq's oil revenues to be ploughed into the American-led reconstruction effort, to the delight of U.S. and British firms.

Russia and France are not alone in their reluctance to bin Iraqi credits. Austrian Minister of Finance, Karl-Heinz Grasser, was unambiguous on Tuesday: "We see no reason why we should waive 300 million Euros of Iraqi debts". He noted that Iraq - with the second largest proven oil reserves in the world - is, in the long run, a rich country.

In the build-up to the coalition, the United States promised to buy the debt Iraqis owe to countries like Bulgaria ($1.7 billion) and Romania. In Macedonia, Dimitar Culev of the pro-government daily "Utrinski Vesnik", openly confirms that his country's participation in the coalition of the willing had to do, among other, longer-term considerations, with its hopes to recover Iraqi debts and to participate in the postwar bonanza.

Poland's Deputy Labor and Economy Minister, Jacek Piechota, on Tuesday, affirmed that Poland intends to recover the $560 million owed it by Iraq by taking over Iraqi assets in a forthcoming "privatization". Another option, he suggested, was payment in oil.

Nor are such designs unique to sovereign polities. According to Dow Jones, Hyundai hopes to recover $1.1 billion through a combination of crude oil and reconstruction projects. During the Clinton administration, American creditors almost helped themselves to between $1.3 and $1.7 billion of frozen Iraqi funds with the assistance of the U.S. Foreign Claims Settlement

Commission. Luckily for the looming new Iraqi government, the legislation languished in acrimony.

The debt question is not academic. As the London Times observes: "As things stand, no one can write a single cheque on Iraq's behalf until the question of its towering debts is sorted out. Not a single barrel of oil can be sold until it is clear who has first claim to the money; no reputable oil company would touch it without clear title."

According to Pravda, to add mayhem to upheaval, the Iraqi opposition indignantly denies that it had broached the subject with the USA. Iraq, they vow, will honor its obligations and negotiate with each creditor separately. But, some add ominously, members of the "friends of Saddam" fan club - alluding to Russia, Ukraine and Belarus among others - are unlikely to get paid.

The Iraqi opposition is as fractured as the Western alliance. Some exiles - like Salah al-Shaikhly from the London-based Iraqi National Accord - promote the idea of a big write-off cum grace period akin to the 66 percent reduction in the stock of Yugoslav obligations. Debt for equity swaps are also touted.

The trio of creditors - especially France and Russia - might have considered debt reduction against a guaranteed participation in the lucrative reconstruction effort. But a fortnight ago the House of Representatives approved a non-binding amendment to the supplementary budget law calling upon the administration to exclude French, Russian, German and Syrian companies from reconstruction contracts and to bar their access to information about projects in postbellum Iraq.

Possibly irked by persistent American U-2 aerial spy missions above its fringes, Russia fired yesterday, from a mobile launcher, a "Topol" RS-12M Intercontinental Ballistic Missile (ICBM). On Wednesday, Agriculture Minister Alexei Gordeyev, offered Iraq aid in the form of wheat. The Russian Grain Union, the industry lobby group, claims to have already provided the besieged country with half a million tons of grain under the oil-for-food program.

Russia linked with Syria in declining to approve the new oil-for-food draft resolution as long as it implied a regime change in Iraq. The Duma - having failed to ratify a key nuclear treaty with the USA - called to increase defense spending by at least 3.5 percent of gross domestic product, or about $4 billion this year.

Only 28 percent of Russians polled now view the United States favorably, compared with 68 percent a mere few months ago. A majority of 55 percent disapprove of the USA in a country that was, until very recently, by far the most pro-American in Europe. A Russian telecom, Excom, is offering unlimited free phone calls to the White House to protest U.S. "aggression".

Washington, on its part, has accused the Russian firm, Aviaconversiya, of helping Iraqi forces to jam global positioning system (GPS) signals. Other firms - including anti-tank Kornet missile manufacturer, KBP Tula - have also been fingered for supplying Iraq with sensitive military technologies.

These allegations were vehemently denied by President Vladimir Putin in a phone call to Bush - and ridiculed by the companies ostensibly involved. Russia exported c. $5 billion of military hardware and another $2.6 billion in nuclear equipment and expertise last year, mostly to India and China - triple the 1994 figure.

Russia and the United States have continually exchanged barbs over the sale of fission technology to Iran. In retaliation, Atomic Energy Minister, Alexander Rumyantsev, exposed an Anglo-German-Dutch deal with the Iranians, which, he said, included the sale of uranium enrichment centrifuges.

Is Putin reviving the Cold War to regain his nationalist credentials, tarnished by the positioning, unopposed, of American troops in central Asia, the unilateral American withdrawal from the Anti-Ballistic Missile (ABM) treaty and the expansion of NATO and the European Union to Russia's borders?

Or, dependent as it is on energy exports, is Russia opposed to the war because it fears an American monopoly on the second largest known reserves of crude? Russia announced on Thursday that it would insist on honoring all prewar contracts signed between Iraq and Russian oil companies and worth of billions of dollars - and on the repayment of $8-9 billion in Iraqi overdue debt to Russia.

According to Rosbalt, every drop of $1 in oil prices translates into annual losses to the Russian treasury of $2 billion. Aggregate corporate profits rose in January by one fifth year on year, mostly on the strength of surging crude quotes. The Economist Intelligence Unit expects this year's GDP to grow by 3.8 percent. Foreign exchange reserves are stable at $54 billion.

The threat to Russia's prominence and market share is not imminent. Iraqi oil is unlikely to hit world markets in the next few years, as Iraq's dilapidated and outdated infrastructure is rebuilt. Moreover, Russian oil is cheap compared to the North Sea or Alaskan varieties and thus constitutes an attractive investment opportunity as the recent takeover of Tyumen Oil by British Petroleum proves. Still, the long-term risk of being unseated by a reconstructed Iraq as the second largest oil producer in the world is tangible.

Russia has spent the last six months enhancing old alliances and constructing new bridges. According to Interfax, the Russian news agency, yesterday, Russia has made yet another payment of $27 million to the International Monetary Fund. The Russian and Romanian prime ministers met and signed bilateral agreements for the first time since 1989. This week, after 12 years of abortive contacts, the republics of the former Yugoslavia agreed with the Russian Federation on a framework for settling its $600 million in clearing debts.

Recent spats notwithstanding, the Anglo-Saxon alliance still regards Russia as a strategically crucial ally. Last week, British police, in a sudden display of unaccustomed efficacy, nabbed Russian oligarch and mortal Putin-foe, Boris Berezovsky, charged by the Kremlin with defrauding the Samara region of $13 million while he was director of LogoVaz in 1994-5.

The Russian foreign minister, Igor Ivanov, did not remain oblivious to these overtures. Russia and the USA remain partners, he asserted. RIA Novosti, the Russian news agency, quoted him as saying: "If we settle the Iraqi problem by political means and in an accord, the road will open to teamwork on other, no less involved problems."

As Robert Kagan correctly observes in his essay "Of Paradise and Power: America and Europe in the New World Order", the weaker a polity is militarily, the stricter its adherence to international law, the only protection, however feeble, from bullying. Putin, presiding over a decrepit and bloated army, naturally insists that the world must be governed by international regulation and not by the "rule of the fist".

But Kagan - and Putin - get it backwards as far as the European Union is concerned. Its members are not compelled to uphold international prescripts by their indisputable and overwhelming martial deficiency. Rather, after centuries of futile bloodletting, they choose not to resort to weapons and, instead, to settle their differences juridically.

Thus, Putin is not a European in the full sense of the word. He supports an international framework of dispute settlement because he has no armed choice, not because it tallies with his deeply held convictions and values. According to Kagan, Putin is, in essence, an American: he believes that the world order ultimately rests on military power and the ability to project it.

Russia aspires to be America, not France. Its business ethos, grasp of realpolitik, nuclear arsenal and evolving values place it firmly in the Anglo-Saxon camp. Its dalliance with France and Germany is hardly an elopement. Had Russia been courted more aggressively by Secretary of State, Colin Powell and its concerns shown more respect by the American administration, it would have tilted differently. It is a lesson to be memorized in Washington.

Iraq's latest war was yet another seemingly mortal blow to its eerily resilient economy. According to Fred Horan of Cornell University, Iraq's GNP per capita contracted by one third in the aftermath of its protracted and bloodied war with Iran.

Similar drops in gross national consumption and government spending were recorded by Dr. Kamil Mahdi of the Center for Arab Gulf Studies in Exeter University. The CIA pegs the cost of the Iran-Iraq conflict at $100 billion. This was three years before the first Gulf War and the decade of debilitating sanctions that followed it.

Mahdi provides an overview of the devastation:

"A decade of war followed by a major air campaign against Iraq's infrastructure and eight years of severe and comprehensive sanctions have devastated the country's economy. Lost production and diversion of resources to military activities are far from being the only economic costs. Accumulated effects on society include the loss of life, physical impairment, breakdown of societal institutions, declining morale, emigration, and all the associated hemorrhage of skills and intellectual capabilities. The effects of induced technological backwardness, of destruction and accelerated degradation of the infrastructure, and of the increased environmental damage of short-term palliative solutions need also be mentioned."

Still, the Wall Street Journal, Time Magazine, and the BBC have all reported in the run-up to the second Gulf war, in 2002, that the streets of Baghdad were teeming with new cars and Chinese double-decker buses, its bustling markets replete with luxury products, restaurants are making a brisk business, and dozens of art galleries prospered where two languished only 4 years before.

By mid-2002, the razed bridges and airport have been rebuilt. Electricity has been mostly restored. Sumptuous mosques have sprouted everywhere. Almost $2 billion were devoted to new palatial mansions for Saddam and his family, wrote the "Washington Post" on February 27, 2001. Kurdish media related how 250 kilograms of gold were applied by imported Indian and Moroccan craftsmen in two of the palaces. Iraqi state television reported in June 2002 that Saddam exhorted his ministers to avoid corruption and nepotism.

Reconstruction reached the much-neglected Kurdish north as well. The year 2001 report of the "Ministry" of Reconstruction and Development (MORAD) in Irbil lists thousands of housing units, dormitories, schools, and guest houses built this year with an investment of $70 million.

The "Kurdistan Regional Government" announced proudly the $6 million completed restoration of the landmark Sheraton. It joined half a dozen other luxury hotels constructed with allocations from the oil-for-food program then administered by the UN on behalf of the Iraqi government and money from Turkish investors.

But not all was rosy in what used to be the "safe zones". Irrigation projects, electricity, the telephone system, schools, teacher training, health provision, hospitals, clinics, roads, and public transport - were (and still are) all in dire need of cash infusions. This was largely Saddam's doing. UPI reported in 2002 that Arab employees of the UN were pressured by Saddam Hussein "to do his bidding" in the north. Iraq refused to collaborate with UN authorities to release from its warehouses heavy equipment destined for the Kurdish parts, reported Radio Free Europe.

Iraq was thought at the time to be pursuing it program of weapons of mass destruction. It definitely was in the market for components and materials for nuclear bombs, warned the "Washington Times". Iraqi defectors confirmed the information and delineated a blood-curdling - and expensive - effort to reinstate the country's capacity to produce nuclear, chemical, and biological armaments.

According to Stratfor, in mid 2002, "Iraq (was) procuring weapons systems - such as advanced conventional weapons rather than nuclear capabilities - that would more immediately affect the outcome of a war with the United States. It is specifically seeking to enhance its air-defense capabilities, improve its ground-to-ground missiles and upgrade major battlefield weapons systems for ground forces."

Iraq felt sufficiently affluent to declare a one month oil embargo in April 2002 at a cost of $1.2 billion, to protest US partiality towards Israel. It also generously supported the families of Palestinian "martyr" suicide bombers with grants of $25,000 plus another $25,000 per each house demolished in the Jenin refugee camp by the Israelis. Smaller amounts were distributed as disability and recuperation benefits, mostly through the "Arab Liberation Front", reported the "Daily Telegraph".

Family members of the "heroes" got free enrollment in Iraqi institutions of higher education. Weeks before the war, Iraq donated 10 million euros to the Intifada. Radio Free Europe/Radio Liberty estimated that this display of Arab solidarity has cost Iraq $1 billion.

This hoary bravado masked a dilapidated infrastructure, decrepit hospitals and schools, spiraling prices, malnourished and diseased children, and a middle class reduced to penury. According to the World Bank, Iraq's population grows by 2.9 percent annually, from a base of 23 million citizens.

Infant mortality is 61-93 per thousand live births, depending on the source. Of those who survive, another 121 children perish by the age of 5. UNICEF estimated that at least 500,000 children died that shouldn't have under normal circumstances. The Iraqi Mission to the United Nations put the number at 713,000 plus a million adults. In 2002, the CNN described an ominous shortage of clean water. Inflation hovered around 100 percent.

In hindsight, none of these data proved to be reliable. Estimates varied widely. The CIA said that the trade deficit in 2000 was $1 billion and the external debt amounted to a whopping $139 billion. Not so, countered the Economist Intelligence Unit (EIU) - external debt was a mere $53 billion in 2001. The EIU also forecasted a 2 percent drop in GDP in 2002 - but a growth of 6 percent in 2003 commensurate with a recovery in oil production.

Still, things were not as bad as relentless Iraqi propaganda made them out to be. Infant mortality figures are suspect as are most other Iraqi statistics. The BBC interviewed an Iraqi defector whose two year old daughter was maimed by interrogators. He claimed to have participated in fake "baby funerals". There is no telling if this were true or a part of the propaganda war waged at the time by the would-be combatants.

According to the BBC, Iraqi life expectancy for men in 2002 was 66 years. Women outlived them by 2 years on average. Annual income per capita was c. $600. GDP per capita was $715, down from $3000 only a decade before - or maybe double that per the Economist Intelligence Unit.

Even these figures were misleading. According to the CIA 2001 World Factbook, Iraq's GDP per capita in terms of purchasing power was a more respectable $2500. GDP has grown by 15 percent in 2000 - or 4 percent according to The Economist Intelligence Unit - though admittedly from a dismally low base.

An efficient rationing system kept Iraqis well fed on 2200-2500 calories per day, according to the UN. A thriving black market facilitated the smuggling of cigarettes, software, home appliances, video films, weaponry, food, carpets - and virtually every other necessity or luxury - into Iraq from Syria, Jordan, Turkey, Iran, Cyprus, and the West Bank.

UN reports consistently accused Iraq of under-utilizing the funds at its disposal.

Between June and December 2000 - as the US State Department gleefully announced - Iraq disposed of only 13 percent of the money allocated to health supplies, 6 percent of the allotment for education, and 3 percent of the cash available for spare parts for its crumbling oil industry.

It neglected to mention, though, that, during the same period, more than 1150 contracts were still pending approval in a nightmarish bureaucratic battleground between the US and the UK and other members of the Sanctions Committee. This was before the introduction of "smart sanctions" in early 2002. The new scheme allowed Iraq to import all things civilian not itemized in a 332-page dual use "Goods Review" list.

Iraq received over $4.5 billion of food and medicines a year through the UN-administered oil for food and medicines program. When the war broke out, another $13 billion were in the pipeline. According to the UN, Iraq had sold more than $56 billion of oil between 1996-2002. Iraq's export income could not be used to defray the costs of local goods and services or to pay salaries. The UN dispensed with $15 billion in Iraqi oil proceeds since 1991 to compensate countries and individuals affected by Iraq's aggression.

Another unsupervised source of income was the surcharges Iraq levied on its oil. Middlemen and trading companies paid the official - bargain - price into a UN account and hidden commissions to Saddam's regime. The UN told the "Wall Street Journal" that between 20 and 70 cents per barrel have accrued in these illicit accounts since December 1, 2000.

The Congressional General Accounting Office stated that "conservatively ... Iraq has illegally earned at least $6.6 billion since 1997 - $4.3 billion from smuggling and $2.3 billion in illegal surcharges on oil and commissions from its commodities contracts".

This translates to c. $1 billion per year. Yet, it may have been a wild over-estimate. The typical surcharge had long been more like 15 cents a barrel. Moreover, downward pressure on oil prices in 2000-2 coupled with renewed UN vigilance put a stop to this lucrative arrangement. Retroactive pricing of Iraq's oil by the UN had considerably damaged Iraq's exports to Russian and other amenable lifters of its oil. There was a "substantial shortfall in the funds available for programme implementation", as the UN put it.

The UN Secretary General himself criticized the program in June 2002:

"The programme has continued to suffer because of a number of factors, including: the cumbersome procedures involved in formulating the distribution plan, and the late submission of the plan which has seem subjected to thousands of amendments; slow contracting for essential supplies by the Iraqi Government and the United Nations agencies and programmes; and the inordinate delays and irregularities in the submission of applications for such contacts to the Secretariat by both the suppliers and the agencies and programmes concerned."

In a letter addressed to the Acting Chairman of the Security Council's 661 sanctions committee on 1 August 2002, the Executive Director of the Iraq Programme, Benon Sevan, expressed "grave concern" regarding the cumulative shortfall in funds and warned of "very serious consequences on the humanitarian situation in Iraq".

Mr. Sevan appealed to the members of the Committee and the Government of Iraq to "take all necessary measures to resolve the difficulties encountered in improving the critical funding situation, including, in particular, the long outstanding question of the pricing mechanism for Iraqi crude oil exports ... The cooperation of all concerned is essential."

The UN registers the outcomes:

"As at 2 August, the revenue shortfall had left 1,051 approved humanitarian supply contracts, worth over $2.25 billion, without available funds. The sectors affected by the lack of funds were: food with $356 million; electricity with $353 million; food handling with $325 million; agriculture with $297 million; housing with $286 million; water and sanitation with $216 million; health with $159 million; telecommunication and transportation with $152 million and; education with $111 million."

Saddam's Iraq bribed countries near and far with cheap oil. In the months before the outbreak of hostilities, it signed nine free trade or customs agreements with, among others, Lebanon, Oman, and the United Arab Emirates as well as with Syria, an erstwhile irreconcilable foe. According to the "Washington Post", 200,000 barrels a day flowed through the re-opened pipeline to the Syrian port of Banias - in breach of UN Resolution 986 (i.e., the oil for food program).

Syria sold to Iraq goods worth at least $100 million a month, including, according to the "Times" of London, tanks and other weaponry. The two countries agreed to establish a joint telephone company and to abolish capital controls. t the time, Syria and Jordan were the only two countries with air links to Baghdad and other Iraqi destinations.

Iraq also pledged to construct an oil refinery in Lebanon and re-open a defunct pipeline running to Lebanon's ports. It inked $100 million worth of import contracts with Algeria and removed 14 Jordanian enterprises from its blacklist of companies which trade with Israel. Iraq catered to Jordan's energy needs by supplying it with heavily discounted oil carried by trucks across the border. A 100,000 barrels-per-day pipeline was slated to become operational by October 2004. A free trade agreement was being negotiated.

Not surprisingly, the Jordanians protested vocally against renewed inspections of freight in the porous Red Sea port of Aqaba. Even Iraq's mortal enemies started mellowing. A border crossing between Saudi Arabia and Iraq was inaugurated with great pan-Arabic fanfare in mid-2002. It was instantly inundated by more than $1 billion in bilateral trade, according to the London-based Arabic daily, "al-Hayat".

The list of renegades continues. Iraq and Sudan vowed to establish a free trade zone. Until it clamped down on the practice in 2002, Turkey turned a blind eye to a $1 billion annual diesel-against-everything market on its border with the rogue state. Egypt allowed more than 90 of its companies to participate in a commercial fair in Baghdad in April 2002.

Egyptian business concluded contracts worth $350 million with Iraq between December 2001 and May 2002, trumpeted the Egyptian news agency, MENA. This on top of more than $4 billion of contracts signed since 1996.

Residential and commercial projects with Egyptian construction groups were on track.

Russia peddled to Iraq more than $5 billion of goods between 1997 and 2002, confirmed then Middle East and North Africa department head in the Russian Foreign Ministry, Mikhail Bogdanov. The Iraqis put the figure higher, at $30 billion in bilateral trade. Even American companies were able to hawk $230 million worth of food and pharmaceuticals, according to the Wall Street Journal. Iraq sold $90 million of oil to South Africa's Strategic Field Fund, charged the South African opposition Democratic Alliance.

The Ukrainian UNIAN news agency reported the purchase of technical equipment by Baghdad even as the "Financial Times" aired the allegations of a former Ukrainian presidential security guard that his country sold a sophisticated $100 million radar system to the outcast regime.

Iraqi largesse comes with strings attached. ITAR-TASS reported in August 2002 that the "Ural" auto works shipped 400 trucks to Iraq every month. Interfax said in April 2002 that a Russian oil company, Zarubezhneft, was invited to develop an oil field in southern Iraq with proven reserves of more than 3 billion barrels.

According to Stratfor, prior to the war, Iraq still owed Russia $10-12 billion for Soviet era materiel. But Iraq was open about its conditioning of future orders on Russian anti-American assertiveness. Similarly, it had cut wheat imports from Australia by half due to the latter's unequivocal support of American policies.

Iraqi business at the time appeared alluring. The country is vast, mineral-rich, and with a well-educated and sinfully cheap workforce. Hence the decision by 185 multinationals, recounted in 2002 by the "Wall Street Journal", to forgo almost $3 billion in Gulf War related reparations claims - in return for aid contracts under the oil-for-food program.

Still, Iraq's financial clout was constrained by the rundown state of its oil fields. Lacking spare parts and investments in exploration and development, it produced c. 2 million barrels per day - about two thirds its capacity. According to the US government, one third of this quantity was smuggled, in contravention of the oil-for-food program. Iraq's pipelines lead to Turkey and to the south of the ravaged country. This made it vulnerable to Turkish or Saudi-Arabian and Kuwaiti collusion in a US-led campaign against its regime.

Moreover, U.S. oil companies, such ExxonMobil, ChevronTexaco, and Valero Energy purchased nearly half of Iraq's oil exports. Iraq desperately tried to diversify but its interlocutors were confined to the likes of Belarus with whom it held talks about revamping its oilfields and petrochemicals industry. With 100 billion barrels in proven reserves, Iraq now attracts the attentions of Western oil companies following the regime change brought on by the war. Iraqi citizens must be holding their breath.

Israel, Economy of

At $105 billion annual Gross Domestic Product (GDP), Israel's economy is larger than Bulgaria's ($19 billion gross domestic product per year), the Czech Republic

(91), Hungary (77), Romania (53), Slovakia (27), Ukraine (47), Kazakhstan (28), Pakistan (72), Singapore (97), Vietnam (35), Argentina (99), Chile (69), Colombia (77), Kenya (10), Nigeria (45), South Africa (101), Algeria (59), Egypt (78), Iraq (26), Jordan (10), Lebanon (19) and dozens of other countries.

Israel's GDP per capita exceeds $15,600 a year. The USA spends $10 billion on foreign aid - $3 billion of which go to Israel. The USA pledged to increase its foreign aid by $5 billion as of next year.

(Source: The Economist Intelligence Unit, 2003)

A Danish firm, SID, as it was canceling an order with an Israeli supplier, dispatched to it this unusually blunt message: "When the soldiers of the Israeli army brutalize the areas of the Palestinians ... we do not feel it is the time to do business with your country. We hope this ugly war will end soon." Consumer boycotts of Israeli products are being touted - often through the Internet - from Belgrade to Moscow and from Copenhagen to Brussels.

Alarmed by this unprecedented erosion in their international image, Israeli industrialists donated food, clothing, and medicines to the inhabitants of the still-smoldering refugee camp in Jenin. The Israeli Electricity Company has contributed 4 transformers to the East Jerusalem Electricity Company, intended to help mend the ravaged grid in Tul-Karem. These gestures are aimed at ameliorating the EU's wrath as it convened in Luxembourg in April 2002 - together with Russia - to debate possible trade sanctions against Israel.

The European Parliament and the Belgian ministry of foreign affairs have already recommended to the Council of Ministers to suspend the EU's Association Agreement with the beleaguered state. It provides Israel with favorable terms and privileged access to its largest trading partner. The country exported c. $8 billion of goods to the EU in 2000.

An effective, though unofficial, arms embargo is already in place. Israel complained that Germany withheld shipment of spare parts for the Merkava tank. Other EU countries banned the export to Israel of all military gear that can be used against civilians.

Belgium denied rumors regarding a unilateral boycott of Israeli goods, including diamonds. It will act, it muttered ominously, only in tandem with all other EU members. Belgium exports c. $4 billion of rough diamonds annually to Israel's diamond industry.

The EU is unlikely to revoke the agreement - but it is likely to invoke its human rights provisions in bilateral "consultations" with the Jewish state. Despite its warm endorsement of deeper American involvement in the region, the EU is competing with the ubiquitous USA for clout - mainly of the economic sort - in the Middle East. A joint EU-US-Russian statement, issued in Madrid in April 2002, was followed by then US Secretary of State Colin Powell's trip and a re-assertion of America's (reluctant) dominance. In a desperate effort to remain relevant, Germany has floated its own peace plan.

The April 2002 and subsequent rounds of the Barcelona Process of co-operation between the EU and 12 countries of the Mediterranean Basin were an awkward affair. Israel was invited, as well as all its Arab adversaries, including the tattered Palestinian Authority. But it is difficult to envision a free trade pact between all the participants by 2010 - the end goal of the Process.

Still, EU sanctions may be the least of Israel's concerns. Its economy seems to be imploding. Small business debts, worth some $5 billion (out of $15 billion outstanding), may have gone sour. Bank Hapoalim, Israel's largest, has consistently undershot Bank of Israel's (the Central Bank) capital adequacy ratio of 9 percent - and misreported it in 2002. Small businesses constitute one fifth of the asset portfolio and two fifths of the operating profit of Bank Leumi - Israel's second largest bank. In 2001, bad debt allowances in the banking sector almost doubled to $1 billion.

Israel's Minister of Finance, a life-long political activist, wavers between levying a compulsory war "loan" and drastic cuts in budget spending. The Director General of the Ministry in 2002, Ohad Marani, was less ambiguous. Cuts in government spending would have to amount to c. $2.1-2.5 billion to offset the gaping hole left by the fighting.

No one bothers to explain how could expenditures be so pervasively cut in mid-fiscal year. The Treasury talks about freezing "populist" laws which cost the budget c. $200 million annually. But even if political hurdles to such an unpopular move are overcome - this is less than one tenth of the cuts needed in order to constrain the deficit to 3 percent of Israel's fast contracting GDP.

In the year to January 2002, Israel's industrial production dived by 10 percent and its GDP by 3.5 percent. The budget deficit in FY 2001 reached 4.6 percent of GDP. The trade deficit topped $5 billion in 2002 - compared to $3.7 billion in 2001 - and proved to be the beginning of a worrisome trend.

More likely, taxes - including VAT - will have to continue to be raised after climbing steeply in 2001. In a speech to the Israeli Venture Association Conference in Tel-Aviv, on April 14, 2002 Marani gloomily warned of a "financial collapse" and an "economic crisis".

Dan Gillerman, the affable then president of the Federation of Israel's Chambers of Commerce, warned against raising taxes:

"Such a move would give a final blow to the economy's backbone, especially as the same population that pays taxes also does reserve duty, and is economically productive."

The government's chief economic advisor by law, the Governor of Bank of Israel, (David Klein at the time), is usually a much-respected economist and technocrat. Yet, typically, he is on the verge of resigning. He bitterly complains of being isolated by Treasury officials. Klein, for instance, was was quoted in "The Jerusalem Post" as saying:

"There is a total lack of communication between the Finance Ministry and Bank of Israel. The Treasury has not included me in any discussions over the economic package. I am not a partner in debate on the deficit target or discussions over new taxes."

The Minister of Finance periodically promises to present an economic plan to the Knesset. In 2002, while he procrastinated, a survey of 575 businesses, conducted by the central bank, documented a sixth consecutive quarter of economic slowdown.

Domestic orders were sharply reduced - though exports held stable. Surprisingly both the hi-tech sector (including telecommunications) and traditional industries fared better than mid-tech manufacturing. Perhaps because they were battered senseless in 2000-2001 and had nowhere to go but up. For the first time since 1998, Israeli firms also expect higher inflation and accelerated depreciation. The New Israeli Shekel has depreciated by almost 15 percent in the last few years.

This - and a sharp reduction in inventories - are the two lonely sprouts in this economic wasteland. The devaluation has rendered many Israeli products competitive exactly when a global recovery has commenced. A massive inventory builddown may translate into a sharp upswing once the economy recovers.

Still, Dun and Bradstreet's index of purchasing managers plunged below the 50 percent line in March 2002, indicating a contraction in the activities of manufacturers. Domestic demand shrank by 3.5 percent and exports have yet to pick up the slack. The employment component of the index stood at a dismal 45 percent.

Klein, then Governor of Bank of Israel, warned, at the time, that further depreciation might result in additional interest rate hikes, following a recent dizzying shift from easing to tightening. But he had little choice. The March 2002 CPI figure was a low 0.5 percent (2.4 percent in the

12 months to March 2002) - but future figures were higher than the 0.3-0.4 percent forecast by pundits and government alike.

In March 2002, inflation was already catapulted by depreciation cum deficit spending to an annual 4% on a quarterly basis, up from 1.4 percent in 2001 and an average of 2.7 percent in 1999-2002. As the fighting escalated, Israel ended up in the familiar 7-11 percent inflation range.

The IMF urges the Israeli authorities to tighten fiscal and ease monetary policy. Hitherto - the December 2001 economic package notwithstanding - they have done exactly the opposite. The IMF blames the shekel's precipitous depreciation on Bank of Israel's sudden departure from gradualist policies when it hastily shaved 2 percentage points off interest rates in 2001.

Small wonder that S&P revised Israel's outlook from "stable" to "negative". Only the country's $24 billion in foreign exchange reserves prevented the downgrading of its long-term foreign currency debts from the "A minus" rating they currently enjoy.

The desperation of Israeli businessmen can be gauged from an interview granted in April 2002 by Dov Nardimon, general manager of Israel W&S management consultancy to Israel's leading paper "Yedioth Aharonot". Nardimon pinned his hopes on a recovery led by surging demand for old-fashioned military products, such as munitions and gas masks. This will revive the moribund metallurgic, chemical, and electrical industries in 2002-3, he predicted. Growing global security awareness will enhance Israeli defense exports.

Regrettably, he proved to have been right. Foreign direct investment in February 2002 amounted to c. $300 million (compared to $200 million in January). The bulk of this amount went to defense-related hi-tech firms. The American Department of Defense invested c. $3 million in Atox - an Israeli R&D firm which is in the throes of developing molecules that suppress the activity of biological weapons.

But with all its woes, Israel is still the undisputed regional economic Gulliver. Its cumulative net capital inflow, in excess of $110 billion, outweighs its GDP. It has more foreign exchange reserves per capita than Japan. Its GDP per capita is a European $16,000.

The real victims of the Intifada are its instigators, the Palestinians. According to the World Bank, the Palestinian economy lost $2.4 billion by December 2001. Israeli economists add another $1-2 billion in triturated infrastructure and lost earnings since then.

The bulk of the damage is the result of Israeli closures - a manifestly inefficacious defensive measure against proliferating suicide bombers as well as a punitive reflex. Between 120-150,000 Palestinians used to work inside the "green line" separating Israel from the occupied territories - mainly as day laborers in construction workers, in tourism and in restaurants. Yet another 50,000 found employment illegally. Officially the number - and with it remittances - have now dropped to zero. In reality, about 50-70,000 Palestinians still cross the line daily.

The IMF estimates that Israel withholds c. $400 million in revenues - mostly VAT and tax receipts - owed to the Authority. As a result, Palestinian tax collection dropped to one fifth its pre-Intifada level. The Authority owes half a billion dollars in arrears. Household savings are utterly depleted and PA GDP dropped 12 percent in 2001 alone, according to the World Bank.

The Palestinian Authority - whose Web site now re-directs to "Electronic Intifada", a counter-spin news page - puts the unemployment rate at 25 percent. The real figure is at least 40 percent. Half the population subsists on less than $2 a day - the official poverty line.

The United Nations Office of the Special Coordinator in the Occupied Territories mostly concurs with these findings.

Had it not been for $1 billion annually doled out by donors as diverse as the EU, USA, Iraq, and Saudi-Arabia - 120,000 civil servants would have joined the ranks of the pulverized private sector and the destitute unemployed.

Israel's trade with the PA - c. $3 billion annually - has all but vanished. It was forced to open its gates to unwanted and unskilled African and Asian migrant labour to compensate for the disastrous deficiency in Palestinian semi-skilled labour. This, perhaps, would be the most lasting lesson of this sorry episode: that the PA is economically dependent on Israel and that no complete separation is a feasible solution. The parties are doomed to swim together or sink together. Up until now, they both seemed to prefer sinking.

Its leader seems more comfortable in battle fatigues than in civil suits. He has been long pursuing a policy of bloody oppression and annexation. The regime is often castigated due to rampant human rights violations. The country possesses weapons of mass destruction, though it repeatedly denies the allegations. It refuses to honor numerous Security Council resolutions. President Bush senior once subjected it to sanctions. The United States is already training its sights on this next target: Israel.

The chieftains of the New World Order have made it abundantly clear that Iraq's capitulation inexorably led to the official release of the much-leaked "road map" for peace in the Middle East propounded by the "Quartet" - the USA, UK, United Nations and Russia. A series of disclosures in the Israeli media made it equally evident that prime minister Ariel Sharon's crew still beg to differ from substantial portions of the foursome's vision. Instead, Sharon has come up with his Gaza Withdrawal First plan and his newfound amity with the post-Arafat Palestinian Authority.

Still, to demonstrate to skeptic and embittered Muslims everywhere that its motives in waging war on Iraq were more altruistic than ulterior, the Administration will impose an even-handed peace on a reluctant Israel. Should it resist, the Jewish state will find itself subjected to the kind of treatment hitherto reserved for the founding members of the axis of evil - economic sanctions to the fore.

Can it withstand such treatment?

Institutional Investor has downgraded Israel's 2002 country credit rating to 45th place - seven rungs lower than in early 2000. It is ranked behind Kuwait, Cyprus, Qatar, and Oman. Moody's, Fitch and Standard and Poor's (S&P) has refrained from a further rating action, following a series of demotions in 2001-2003.

The country's economy - especially its dynamic construction, tourism and agricultural segments - has been weakened by five years of civil strife both within the green line and throughout the occupied territories. This has been reflected in the shekel's and the stock exchange's precipitous declines, by one fifth each in 2001-2002. Profits in the banking sector slumped by more than three quarters in the same period due to augmented loan loss provisions.

A halting recovery from the effects of a global recession and the bursting of the hi-tech bubble have not helped. Gross domestic product growth in 2000 was a spectacular 7 percent. In the next two years, however, the economy has contracted. The calling up of reservists to active duty, the dwindling of immigration - from 78,400 in 1999 down to 31,491 three years later - and the disappearance of the Palestinian shopper depressed consumption, services and retail sales.

Uriel Lynn, chairman of the Israeli Chamber of Commerce, told BBC News Online, that the country has lost about $2.5 billion "in terms of business product". Defense spending spiked at 10 percent of the budget, double the American ratio and triple the military outlays of the typical EU member.

Social solidarity is fraying. The Histadrut (General Federation of Labor in Israel) - run by members of the shriveled opposition Labor party - often declares labor disputes, heralding general strikes. This in response to reforms promulgated by the Ministry of Finance, now headed by a hardliner, the former prime minister Benjamin Netanyahu.

The private sector accounts for 70 percent of GDP in Israel and is already stretched to the limit. Instead, the hard-pressed ministry wants to sack thousands in the bloated public services and cut the salaries and pension rights of the remaining civil servants by 8 percent. Government consumption amounts to one third of GDP and public debt exceeds it.

In a reversal of decades of tradition, collective wage agreements will be abolished. The finance ministry is trying to reduce the spiraling budget deficit - now pegged at more than 6 percent of GDP - by $2 billion to c. 3.5-4.5 percent of GDP, depending on one's propensity for optimism.

Netanyahu also pledged to trim down the top marginal tax rate from a whopping 60 to 49 percent and to aggressively privatize state holdings in companies such as El Al, Bezeq Telecommunications, Oil Refineries and Israel Electric Company. He told the Israeli daily Ha'aretz that the fate of an American package comprising $1 billion in extra military aid and $9 billion in loan guarantees depends on such "proper economics".

Trying to balance fiscal profligacy, David Klein, the former governor of the Bank of Israel, kept real interest rates high, cutting them by increments of 0.2 percent (to 8.7 percent in March 2003). Inflation in 2002, at 5.7 percent, was way above the 1998-2002 average of 3.7 percent.

Partly due to this contractionary bias, more than 50,000 small businesses closed their doors in 2002. According to the CNN, another 60,000 will follow suit by yearend. The number of tourists plunged by a staggering three fifths.

Foreign investment crumbled from $11 billion in 2000 to $4 billion in 2002.

Unemployment is stubbornly stuck above 10 percent - and double this figure in the Arab street. The State of the Economy Index, published by the central bank, fell for the 30th consecutive month in February 2003. Of 1.6 million employees in the business sector, 61,000 were fired since January 2001.

It is the fifth year of recession: the economy contracted by 1 percent in 2002 and by 0.9 percent in 2001. Nor is it over yet. Business Data Israel (BDI), a forecasting consultancy, reckons that the damage to Israel's economy of the short war in Iraq amounts to $1 billion, or 1 percent of GDP.

One fifth of the population survives under the poverty line. Strains between well to do newcomers, mainly from the former Soviet republics, and impoverished veterans are growing - as do tensions between destitute immigrants and their adopted homeland. Many emigrate from Israel back to the Commonwealth of Independent States, to Germany, Australia and New Zealand.

American aid - some $2.7 billion a year - largely goes to repay past debts. Then U.S. Secretary of State Colin Powell has announced in January 2003 the U.S.-Middle East Partnership Initiative. Local groups will be encouraged to invest in the private sectors of their countries. But the Partnership is geared to tackle the needy Arab polities rather than the far-advanced and sated Israel.

Consider next door Palestine, now severed from its main market employer next door.

A World Bank report released in early March 2003 stated that half the 3.5 million denizens of the Palestinian Authority live under an impossibly depleted $2 a day poverty line. One in two employees in the private sector lost their jobs and GDP declined by two fifths in the first two years of the intifada.

The UN Conference on Trade and Development (UNCTAD) warned in September 2002 that the economy of the West Bank and the Gaza Strip was drained of up to $2.4bn due to closures, mass unemployment, and damages to infrastructure. "The profound changes that have taken place in the functioning of the economy ... are unlikely to be easily reversed even if stability is attained", the report concluded gloomily.

Israel withholds more than $400 million in back taxes it had collected on behalf of the Palestinian Authority. Business Week predicts that donor aid - more than $1 billion annually at current levels - will dry up in the wake of the Iraq conflict with resources diverted to reconstruct a nascent and oil-rich democracy on the Euphrates.

Hence Blair's sense of urgency (and the summit with Palestinian leaders that he convened in London at the beginning of 2005). With victory in Iraq, Israel faces a united "land-for-peace" front, encompassing ostensible adversaries such as France and the United States. Unity on the Palestinian question will salve the wounds self-inflicted on the Euro-Atlantic coalition on the road to Baghdad.

Few place bets on Israel's ability to resist such concerted action, led by the sole superpower. The Economist Intelligence Unit foresee the imminent collapse of Sharon's narrow right-wing government - this despite a modest economic revival and the coalition with his erstwhile foes, the Labor party, headed by Shimon Peres.

The current account deficit, prognosticated the EIU in 2003, should fall to 1.7 percent of a GDP growing, in real terms, by 3.1 percent in 2004 (compared to a rosy scenario of 0.3 percent in 2003). This proved to be unrealistic. Exports have sharply plunged to less than $28 billion in 2002, two fifths of it to the USA and a similar proportion to the European Union.

Still, with a GDP per head of about $16,000 (or $20,000 in purchasing power parity terms), Israel is one of the richest countries in the world - particularly if its thriving informal economy is considered and if the global hi-tech sector recovers which is widely tipped to happen. According to Jane's Defense Weekly, Israel is the third largest exporter of armaments, materiel and military services, ahead of Russia.

The country's foreign exchange reserves per capita, at $3500, are higher than Japan's. Its external debt - c. $27 billion - is puny and almost entirely guaranteed by the United States. Only one tenth of it is held by ordinary foreign investors. Israel can withstand years of economic sanctions unaffected - as it has done well into the 1970s. The Jewish state also enjoys the support of a virulently nationalistic diaspora, willing to dip into bulging pocketbook in times of need.

Another scenario, however unlikely, would see the European Union siding with Israel against a bullying United States and its sidekick, the United Kingdom. Two years ago, Italy's outspoken prime minister, Silvio Berlusconi, normally a staunch supporter of president George Bush, floated the idea of further enlarging the EU to incorporate Russia, Turkey and Israel.

But visionaries like Stef Wertheimer, an Israeli industrial tycoon, talk wistfully of a regional "mini" Marshall Plan. It calls for massive infusions of aid and credit, overseen by the International Monetary Fund (IMF) and the World Bank, into the eastern Mediterranean - Jordan, Turkey, the Palestinian Authority and Israel's minorities - at least until GDP per capita throughout the region surges fivefold, to $6,000 per year.

Such misguided development nostrums are alluring. They cater to the Western misconception that terrorism is born of poverty and ignorance. Removing these alleged causes of violence, goes the refrain, will end all aggression. Throwing money at problems is an inveterate American and European reflex. Prosperity and democracy are keys to stability and moderation, they preach.

But the unpalatable truth is that Israel is the haughty outpost of Western civilization in an area distinctly un-Western and anti-Western. Terrorism is about clashing values and opposing worldviews, not about the allocation of scarce jobs and the benefits of technology parks.

People like Osama bin-Laden are rich and well-educated. Muslim fundamentalists - in between atrocities - provide health, welfare benefits and schooling to millions of the poor and the deprived. They don't seem to think, like

Wertheimer and his patronizing ilk, that higher standards of living negate their mission to oppose American culture, ethos and hegemony by all means, fair or foul.

In a bid to strengthen the hand of the newly elected Palestinian president, Mahmoud Abbas, the Israelis have released hundreds of Palestinian prisoners and pulled, in March 2005, from Jericho and Tulkarm. In a significant change of heart, Hamas, the militant Palestinian organization, vowed to compete in future parliamentary elections and, thus, potentially, to repeat its impressive showing on the municipal level.

As the pro-war and anti-war camps are holding a string of summits, a consensus has emerged in Europe - including Britain - that the "road map" for peace in the Middle East would be a futile exercise without some "teeth". Israeli-Palestinian reconciliation may prove to be the glue that reunites the fractious Euro-Atlantic structures.

But while the United State is reluctant to impose a settlement on the Israelis - the specter of sanctions against the Jewish state has re-emerged in the Old Continent's corridors of power. A committee of the European Parliament is said to be laboring away at various scenarios of escalating sanctions against Israel. The European Commission may be readying its own proposals.

The views of the Conservative American administration are summed up by David Pryce-Jones, Senior Editor of National Review:

"Israelis and Palestinians face each other across the new ideological divide in a dilemma that bears comparison to Germany's in the Cold War ... Israel must share territory with Palestinians, a growing number of whom are proven Islamic terrorists, and who identify with bin Laden's cause, as he identifies with theirs ... The Oslo peace process is to the Middle East what Ostpolitik was to Germany and central Europe. Proposals to separate the two peoples physically on the ground spookily evoke the Berlin Wall."

Still, such sentiments aside, in the long-run, Muslims are the natural allies of the United States in its role as a budding Asian power, largely supplanting the former Soviet Union. Thus, the threat of militant Islam is unlikely to cement a long term American-Israeli confluence of interests.

Rather, it may yet create a new geopolitical formation of the USA and moderate Muslim countries, equally threatened by virulent religious fundamentalism. Later, Russia, China and India - all destabilized by growing and vociferous Muslim minorities - may join in. Israel will be sacrificed to this New World Order.

The writing is on the wall, though obscured by the fog of war and, as The Guardian revealed in April 2003, by American reliance during the conflict in Iraq on Israeli intelligence, advanced armaments and lessons in urban warfare. The "road map" announced by President George Bush as a sop to his politically besieged ally, Tony Blair, and much contested by the extreme right-wing government of Ariel Sharon, calls for the establishment of a Palestinian state by 2005.

Israel is expected to promptly withdraw from all the territories it re-seized during the 30 months of second intifada. Blair has openly called on it to revert to the pre-

Six Day War borders of 1967. In a symbolic gesture, the British government decided two years ago to crack down on food products imported from Jewish settlements in the West Bank and Gaza and mislabeled "Made in Israel" or "Produce of Israel". The European Union pegs the total value of such goods at $22 million.

Wariness of Israel in both Europe and the Arab world was heightened in April 2003, when then National Infrastructure Minister, Yosef Paritzky, saw fit to inform the Israeli daily, Ha'aretz, about a plan to revive a long defunct oil pipeline running from Mosul to Haifa, a northern seaport. This American-blessed joint venture will reduce Israel's dependence on Russian crude and the cost of its energy imports. It would also require a regime change in Syria, whose territory the pipeline crosses.

Partly to prevent further Israeli provocations of an extremely agitated and radicalized anti-Western Arab street, European leaders revived the idea of economic sanctions, floated - and flouted - in 2002. The EU accounts for one third of Israel's exports and two fifths of its imports. It accords Israeli goods preferential treatment.

In April 2002, in the thick of the bloody intifada, Germany and Belgium suspended military sales to Israel. Norway boycotted some Israeli agricultural commodities. The Danish Workers Union followed suit. The European Parliament called to suspend Israel's Association Agreement with the EU. Though Belgium supported this move, harsher steps were avoided so as to allow Colin Powell, then U.S. Secretary of State, to proceed with his peace mission to the Middle East.

Israel has been subjected to boycotts and embargoes before. In the first four decades of Israel's existence as well as in the last five years, the Arabs imposed strict market access penalties on investors and trade partners of the Jewish state. The United States threatened its would-be ally with economic and military sanctions after the Suez War in 1956, forcing it to return to Egypt its territorial gains in the desert campaign.

For well over a decade afterwards, Israel was barred from direct purchases of American weaponry, securing materiel through West German intermediaries and from France. After the Six Day War, French President Charles de Gaulle imposed an arms embargo on the country. Faced with Arab intransigence and virulent enmity towards Israel in the Khartoum Summit in 1967, the USA stepped in and has since become Israel's largest military supplier and staunchest geopolitical supporter.

Yet, even this loyal ally, the United States, has come close to imposing sanctions on Israel on a few occasions.

In 1991, Yitzhak Shamir, the Israeli Prime Minister at the time, was reluctantly dragged into the Madrid Arab-Israeli peace conference by a victorious post Gulf war administration. He proceeded to negotiate in bad faith and continued the aggressive settlement policies of his predecessors.

In consequence, a year later, President George H.W. Bush, the incumbent's father, withheld $10 billion in sorely needed loan guarantees, intended to bankroll the housing of 1 million Jewish immigrants from the imploding Soviet Bloc. Shamir's successor, Yitzhak

Rabin, succumbed to American demands, froze all new settlements and regained the coveted collateral.

Only concerted action by the EU and the USA can render a sanctions regime effective. Israel is the recipient of $2.7 billion in American annual military aid and economic assistance. In the wake of this round of fighting in the Gulf, it will benefit from $10 billion in guaranteed soft loans. It has signed numerous bilateral tax, trade and investment treaties with the United States. American sanctions combined with European ones may prove onerous.

Israel is also finding itself increasingly on the wrong side of the "social investing" fence. Activist and non-governmental organizations are applying overt pressure to institutional investors, such as pension funds and universities, to divest or to refrain from ploughing their cash into Israeli enterprises due to the country's "apartheid" policies and rampant and repeated violations of human rights and international law.

They are joined by student bodies, academics, media people and conscientious Jews the world over.

According to The Australian, a petition launched in 2002 by John Docker, a Jewish-Australian author and Fellow of the Australian National University's Humanities Research Centre and Christian Lebanese Australian senior lecturer and author Ghassan Hage of Sydney University's Anthropology Department, "calls (for a) ban on joint research programs with Israeli universities, attending conferences in Israel and disclosing information to Israeli academics".

It is one of many such initiatives. In the long run such grassroots efforts may prove to be have the most devastating effects on Israel's fragile and recessionary economy. Multinationals are far more sensitive to global public opinion than they used to be only a decade ago. So are governments and privatized academic institutions.

Israel may find itself ostracized by consent rather than by decree. Already a pariah state in many quarters, it is being fingered by European left-leaning intellectuals as being in cahoots with the lunatic fringes of Christian and Jewish fundamentalism. Yet, if sanctions cause a recalcitrant Israeli right to trade occupied land for a hitherto elusive peace, history may yet judge them to be a blessing in disguise.

Israel, Hi-Tech Sector of

During the 1990's, the number of Israeli firms on NASDAQ was the second or third largest (depending on the year) after American and Canadian ones. Israeli IPO's were hot. Israeli hi-tech was cool. The Internet was conquered by Israeli ingenuity and chutzpah.

Since then the market has matured. Dotcoms bombed. NASDAQ is down 60% even after the post September 11 protracted bounce. With the exception of the USA, Israel's main export markets are in the throes of a tortured recovery from a global recession. Israel appears to be suffering from the Singapore syndrome - over-dependence on a single sector. Hi tech products constituted a mere 22% of Israel's $7.7 billion in exports in 1991 - but more than 36% of the $18.7 billion it exported nine years later.

The signs have been decidedly mixed since the dawn of the new millennium. In a single week in 2002, VocalTec, a Voice over IP (VOIP) technology developer and manufacturer, reported a year on year drop of 53% in revenues in the fourth quarter. Versity - a verification software company - boasted its first profit on revenues up by 50%.

That same week, Manpower Israel announced that the number of hi-tech want ads (a fair proxy for employment in the hi-tech sector and for investment in R&D of future products) fell by 52% to 1996 levels (vs. an overall fall of 28%, though the trend has accelerated in the fourth quarter). Demand for hi-tech managers and programmers was down by c. 64%. Manpower attributed these developments to September 11, global recession, the collapse in the equity markets, and the 15 months' long Intifada. Very few foreign investors bothered to attend Ernst and Young's Journey 2001 October conference. Even its sponsor, Silicon Bank of California, didn't show up.

These are bad news for the recession-hit Israeli economy. Hi-tech has been a net contributor of jobs, a generator of small to medium enterprises (SME's), a leader of export growth, and, in short: Israel's economic engine. The government had reacted by abolishing the capital gains tax on foreign venture capital investments in Israeli firms and by tightening collaboration with other casualties of the global downturn in the technology markets, notably with India.

Israel intends to get involved in the telecommunications, medical technology, and software production sectors in India. A ministerial committee recommended that the government invest $450 million over five years in biotechnology projects. It is a sign of the times that this interventionist suggestion is seriously considered and implemented.

Coupled with low inflation (i.e., low local costs), the shekel's sharp 10% depreciation in 2001-2005 (to 4.60 to the dollar currently) boosted Israeli exports by $1 billion, said the relieved Israeli Export Institute. Most of this windfall will accrue to export-orientated hi-tech firms. It will prop their competitiveness by increasing their shekel proceeds when they convert their foreign exchange revenues and by allowing them to discount their products.

But the malaise of Israel's hi-tech sector has deeper roots. Israeli firms are R&D champions - innovative and daring. But they are weak when it comes to marketing and sales. Many of them are badly managed, still run by the entrepreneurs who established them. Israeli addiction to venture capital and equity financing fostered a strong image of Israel as a high risk emerging economy based on dotcoms and their "creative" financing and accounting methods. In many cases, maverick Israeli startups failed to position themselves as market leaders which develop and produce for mature markets.

The good news are that venture capitalists invested over $6 billion (or $3.8 billion, excluding portfolio investments) in more than 500 promising products and technologies in Israel (50% of it in 2000 compared to only $1 billion in 2001). Of 2500 hi- tech firms, at least half are bankrupt or poised to close their doors. Still, between $1.2 and $2 billion are available for VC investment. Israeli VC funds do not publish return on investment figures but rumors are that they managed to outperform the American benchmark of 43% p.a. If true, they will probably re-enter the fray.

This cushion of selectively available financing may prevent a total meltdown of the sector. Investments in companies backed by VC in their first round of financing actually increased by 16% in the fourth quarter of 2001 (though 36% of local VC funds made no investment at all). Investment by foreign sources of financing dominated the scene.

According to the Money Tree Survey, conducted by a leading Israeli accountancy firm, Kesselman & Kesselman PriceWaterHouseCoopers (PwC) and quoted in Israel's business daily, "Globes", there is a shift from software, Internet, and the biomedical sciences back to the hitherto discredited telecommunications, semiconductors, and networking fields. Almost no seed money is available - but despite the Internet's fall from grace, financing of Internet-related ventures (mainly software and data maintenance) remained unchanged compared to the third quarter of 2001 (though more than 70% down on 2000). The average size of a typical VC investment is down 50% on 2000 - to $3.6 million (up from $2.8 million in Q3 2001).

In other words: financiers are more careful and more choosey - not necessarily bad news, except for "exit speculators".

Actually, more money is available for mature, market dominant, high potential, fully developed products. The dearth of seed capital may adversely affect the future growth rates of the technology sector in Israel - but, in the short to medium term, it is likely to stabilize this mercurial Bedlam.

Israel's ace may be the biotechnology sector. Startups are well capitalized and gradually becoming profitable (c. 20% of Israel's 160 biotechnology firms did in 2001, another 25% in 2002). With close to $1 billion in sales and less than 4,000 workers - their value added and total factor productivity are enormous. According to Ilanot Batucha, a brokerage firm, there are 300 drugs in phase 3 FDA mandated clinical trials. If 200 of these new drugs are approved - they will join more than 100 drugs already approved and selling, no small coup for Israel's pharmaceutical minions. In 2001, the number of deals declined - but the average size of the deals increased. Biotechnology may well Israel's old-new horizon.

Jackson-Vanik Amendment

The State of Israel was in the grip of anti-Soviet jingoism in the early 1970's. "Let My People Go!" - screamed umpteen unfurled banners, stickers, and billboards. Russian dissidents were cast as the latest link in a chain of Jewish martyrdom. Russian immigrants were welcomed by sweating ministers on the sizzling tarmac of the decrepit Lod Airport. Russia imposed exorbitant "diploma taxes" (reimbursement of educational subsidies) on emigrating Jews, thus exacerbating the outcry.

The often disdainful newcomers were clearly much exercised by the minutia of the generous economic benefits showered on them by the grateful Jewish state. Yet, they were described by the Israeli media as zealous Zionists, returning to their motherland to re-establish in it a long-interrupted Jewish presence. Thus, is a marvelous fiat of spin-doctoring, economic immigrants became revenant sons.

Congress joined the chorus in 1974, with the Jackson-Vanik Amendment to the Trade Reform Act - now Title IV of the Trade Act. It was Sponsored by Senator Henry ("Scoop") Jackson of Washington and Rep. Charles Vanik of Ohio, both Democrats.

It forbids the government to extend the much coveted "Most Favored Nation (MFN)" status - now known as "Normal Trade Relations" - NTR - with its attendant trade privileges to "non-market economy" countries with a dismal record of human rights - chiefly the right to freely and inexpensively emigrate.

This prohibition also encompasses financial credits from the various organs of the American government - the Export-Import Bank, the Commodity Credit Corporation (CCC), and the Overseas Private Investment Corporation (OPIC).

Though applicable to many authoritarian countries - such as Vietnam, the subject of much heated debate with every presidential waiver - the thrust of the legislation is clearly anti-Russian. Henry Kissinger, the American Secretary of State at the time, was so alarmed, that he flew to Moscow and extracted from the Kremlin a promise that "the rate of emigration from the USSR would begin to rise promptly from the 1973 level".

The demise of the USSR was hastened by this forced openness and the increasing dissidence it fostered. Jackson-Vanik was a formidable instrument in the cold warrior's arsenal. More than 1.5 million Jews left Russia since 1975. At the time, Israelis regarded the Kremlin as their mortal enemy. Thus, when the Amendment passed, official Israel was exuberant. The late Prime Minister Yitzhak Rabin wrote this to President Gerald Ford:

"The announcement that agreement has been obtained facilitating immigration of Soviet Jews to Israel is causing great joy to the people of Israel and to Jewish communities everywhere. This achievement in the field of human rights would not have been possible but for your personal sympathy for the cause involved, for your direct concern and deep interest."

And, to Senator Henry Jackson, one of the two sponsors of the bill:

"Dear Scoop,

The agreement which has been achieved concerning immigration of Soviet Jews to Israel has been published in this country -a few hours ago and is evoking waves of joy throughout Israel and no doubt throughout Jewish communities in every part of the globe. This great achievement could not have been possible but for your personal leadership which rallied such wide support in both Houses of Congress, for the endurance with which you pursued this struggle and for the broad human idealism which motivated your activities on behalf of this great humanitarian cause. At this time therefore I would like to send you my heartfelt appreciation and gratitude."

US trade policy is often subordinated to its foreign policy. It is frequently sacrificed to the satisfaction of domestic constituencies, pressure groups, and interest lobbies. It is used to reward foreign allies and punish enemies overseas.

The Jackson-Vanik Amendment represents the quintessence of this relationship. President Clinton tacitly admitted as much when he publicly decoupled trade policy from human rights in 1994.

The disintegration of the Evil Empire - and the privatization of Russian foreign trade - has rendered the law a relic of the Cold War. Russian Jews - including erstwhile "refuseniks", such as Natan (Anatoly) Sharansky - now openly demand to rescind it and to allow Russia to "graduate" into a Permanent Normal Trade Relations (PNTR) status by act of Congress.

American Jews - though sympathetic - would like guarantees from Russia, in view of a rising wave of anti-Semitism, that Jews in its territory will go unharmed. They also demand the right of unhindered and unsupervised self-organization for Jewish communities and a return of Jewish communal property confiscated by the Soviet regime.

Congress is even more suspicious of Russian intentions. Senator Gordon Smith, a Republican from Oregon, recently proposed an amendment that would deprive Russia of foreign aid if it passes legislation impinging on religious freedom. Together with Hillary Clinton, a Democrat from New York, he introduced a damning Jackson-Vanik resolution, saying:

"Any actions by the United States Government to 'graduate' or terminate the application of the Jackson-Vanik Amendment to any individual country must take into account ... appropriate assurances regarding the continued commitment of that government to enforcing and upholding the fundamental human rights envisioned in the Amendment. The United States Government must demonstrate how, in graduating individual countries, the continued dedication of the United States to these fundamental rights will be assured."

The Senate still refuses to repeal the Jackson-Vanik Amendment despite its impact on six former Soviet republics and other countries and despite passionate pleas from the administration. On May 22 it passed a non-binding resolution calling for PNTR with Russia. Jackson-Vanik remained in place because of the row with Russia over imports of US poultry.

Senator Joseph Biden, Chairman of the Senate Foreign Relations Committee, who represents a major poultry producing state (Delaware) made these statesmanlike comments following the session:

"I can either be Russia's best friend or worst enemy. They keep fooling around like this, they're going to have me as their enemy."

Mikhail Margelov, Chairman of the Foreign Relations Committee of the Federation Council, understandably retorted, according to Radio Free Europe/Radio Liberty quoting from strana.ru:

"By citing the controversy over chicken legs, the Democrats have openly acknowledged that Jackson-Vanik does not protect Russian Jews, but American farmers."

According to ITAR-TASS, he presented to President Putin a report which blamed Russia's "unstable" trade relations with the USA on the latter's "discriminatory legislative norms".

The Amendment has been a dead letter since 1994, due to a well-entrenched ritual of annual Presidential waiver which precedes the granting of NTR status to Russia. The waiver is based on humiliating semi-annual reviews. The sole remaining function of Jackson-Vanik seems, therefore, to be derogatory.

This infuriates Russians of all stripes - pro-Western reformers included. "This demonstrates the double standards of the U.S." - Anatoly B. Chubais, the Chairman of UES, Russia's electricity monopoly, told BusinessWeek. "It undermines trust." Putin called the law "notorious".

In October last year, the Russian Foreign Ministry released this unusually strongly-worded statement:

"The Jackson-Vanik Amendment has blocked the granting to Russia of most favored nation status in trade with the USA on a permanent and unconditional basis over many years, inflicting harm upon the spirit of constructive and equal cooperation between our countries. It is rightly considered one of the last anachronisms of the era of confrontation and distrust."

Considering that China - with its awful record of egregious human rights violations - was granted PNTR last year, Russia rightly feels slighted. Its non-recognition as a "market economy" under the Jackson-Vanik Amendment led to the imposition of import restrictions on some of its products (e.g. steel). The Amendment also prevents Russia from joining the WTO.

Worst of all, the absence of PNTR also inhibits foreign investment and the conclusion of long term contracts.

Boeing expressed to the Associated Press its relief at the decision to normalize trade relations with China thus:

"Stability is key in our business. We must look 18 to 24 months ahead in terms of building parts, planes and servicing them. It has been difficult for China to make such agreements when they don't know if they would have an export license the following year or whether the United States would allow the planes to be delivered."

Justice, Distributive

The public outcry against executive pay and compensation followed disclosures of insider trading, double dealing, and outright fraud. But even honest and productive entrepreneurs often earn more money in one year than Albert Einstein did in his entire life. This strikes many - especially academics - as unfair. Surely Einstein's contributions to human knowledge and welfare far exceed anything ever accomplished by sundry businessmen? Fortunately, this discrepancy is cause for constructive jealousy, emulation, and imitation. It can, however, lead to an orgy of destructive and self-ruinous envy.

Such envy is reinforced by declining social mobility in the United States. Recent (2006-7) studies by the OECD (Organization for Economic Cooperation and Development) clearly demonstrate that the American Dream is a myth. In an editorial dated July 13, 2007, the New-York Times described the rapidly deteriorating situation thus:

"... (M)obility between generations — people doing better or worse than their parents — is weaker in America than in Denmark, Austria, Norway, Finland,

Canada, Sweden, Germany, Spain and France. In America, there is more than a 40 percent chance that if a father is in the bottom fifth of the earnings' distribution, his son will end up there, too. In Denmark, the equivalent odds are under 25 percent, and they are less than 30 percent in Britain.

America's sluggish mobility is ultimately unsurprising. Wealthy parents not only pass on that wealth in inheritances, they can pay for better education, nutrition and health care for their children. The poor cannot afford this investment in their children's development — and the government doesn't provide nearly enough help. In a speech earlier this year, the Federal Reserve chairman, Ben Bernanke, argued that while the inequality of rewards fuels the economy by making people exert themselves, opportunity should be "as widely distributed and as equal as possible." The problem is that the have-nots don't have many opportunities either."

Still, entrepreneurs recombine natural and human resources in novel ways. They do so to respond to forecasts of future needs, or to observations of failures and shortcomings of current products or services. Entrepreneurs are professional - though usually intuitive - futurologists. This is a valuable service and it is financed by systematic risk takers, such as venture capitalists. Surely they all deserve compensation for their efforts and the hazards they assume?

Exclusive ownership is the most ancient type of such remuneration. First movers, entrepreneurs, risk takers, owners of the wealth they generated, exploiters of resources - are allowed to exclude others from owning or exploiting the same things. Mineral concessions, patents, copyright, trademarks - are all forms of monopoly ownership. What moral right to exclude others is gained from being the first?

Nozick advanced Locke's Proviso. An exclusive ownership of property is just only if "enough and as good is left in common for others". If it does not worsen other people's lot, exclusivity is morally permissible. It can be argued, though, that all modes of exclusive ownership aggravate other people's situation. As far as everyone, bar the entrepreneur, are concerned, exclusivity also prevents a more advantageous distribution of income and wealth.

Exclusive ownership reflects real-life irreversibility. A first mover has the advantage of excess information and of irreversibly invested work, time, and effort. Economic enterprise is subject to information asymmetry: we know nothing about the future and everything about the past. This asymmetry is known as "investment risk". Society compensates the entrepreneur with one type of asymmetry - exclusive ownership - for assuming another, the investment risk.

One way of looking at it is that all others are worse off by the amount of profits and rents accruing to owner-entrepreneurs. Profits and rents reflect an intrinsic inefficiency. Another is to recall that ownership is the result of adding value to the world. It is only reasonable to expect it to yield to the entrepreneur at least this value added now and in the future.

In a "Theory of Justice" (published 1971, p. 302), John Rawls described an ideal society thus:

"(1) Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all. (2) Social and economic inequalities are to be arranged so that they are both: (a) to the greatest benefit of the least advantaged, consistent with the just savings principle, and (b) attached to offices and positions open to all under conditions of fair equality of opportunity."

It all harks back to scarcity of resources - land, money, raw materials, manpower, creative brains. Those who can afford to do so, hoard resources to offset anxiety regarding future uncertainty. Others wallow in paucity. The distribution of means is thus skewed. "Distributive justice" deals with the just allocation of scarce resources.

Yet, even the basic terminology is somewhat fuzzy. What constitutes a resource? what is meant by allocation? Who should allocate resources - Adam Smith's "invisible hand", the government, the consumer, or business? Should it reflect differences in power, in intelligence, in knowledge, or in heredity? Should resource allocation be subject to a principle of entitlement? Is it reasonable to demand that it be just - or merely efficient? Are justice and efficiency antonyms?

Justice is concerned with equal access to opportunities. Equal access does not guarantee equal outcomes, invariably determined by idiosyncrasies and differences between people. Access leveraged by the application of natural or acquired capacities - translates into accrued wealth. Disparities in these capacities lead to discrepancies in accrued wealth.

The doctrine of equal access is founded on the equivalence of Men. That all men are created equal and deserve the same respect and, therefore, equal treatment is not self evident. European aristocracy well into this century would have probably found this notion abhorrent. Jose Ortega Y Gasset, writing in the 1930's, preached that access to educational and economic opportunities should be premised on one's lineage, up bringing, wealth, and social responsibilities.

A succession of societies and cultures discriminated against the ignorant, criminals, atheists, females, homosexuals, members of ethnic, religious, or racial groups, the old, the immigrant, and the poor. Communism - ostensibly a strict egalitarian idea - foundered because it failed to reconcile strict equality with economic and psychological realities within an impatient timetable.

Philosophers tried to specify a "bundle" or "package" of goods, services, and intangibles (like information, or skills, or knowledge). Justice - though not necessarily happiness - is when everyone possesses an identical bundle. Happiness - though not necessarily justice - is when each one of us possesses a "bundle" which reflects his or her preferences, priorities, and predilections. None of us will be too happy with a standardized bundle, selected by a committee of philosophers - or bureaucrats, as was the case under communism.

The market allows for the exchange of goods and services between holders of identical bundles. If I seek books, but detest oranges - I can swap them with someone in return for his books. That way both of us are rendered better off than under the strict egalitarian version.

Still, there is no guarantee that I will find my exact match - a person who is interested in swapping his books for my oranges. Illiquid, small, or imperfect markets thus inhibit the scope of these exchanges. Additionally, exchange participants have to agree on an index: how many books for how many oranges? This is the price of oranges in terms of books.

Money - the obvious "index" - does not solve this problem, merely simplifies it and facilitates exchanges. It does not eliminate the necessity to negotiate an "exchange rate". It does not prevent market failures. In other words: money is not an index. It is merely a medium of exchange and a store of value. The index - as expressed in terms of money - is the underlying agreement regarding the values of resources in terms of other resources (i.e., their relative values).

The market - and the price mechanism - increase happiness and welfare by allowing people to alter the composition of their bundles. The invisible hand is just and benevolent. But money is imperfect. The aforementioned Rawles demonstrated (1971), that we need to combine money with other measures in order to place a value on intangibles.

The prevailing market theories postulate that everyone has the same resources at some initial point (the "starting gate"). It is up to them to deploy these endowments and, thus, to ravage or increase their wealth. While the initial distribution is equal - the end distribution depends on how wisely - or imprudently - the initial distribution was used.

Egalitarian thinkers proposed to equate everyone's income in each time frame (e.g., annually). But identical incomes do not automatically yield the same accrued wealth. The latter depends on how the income is used - saved, invested, or squandered. Relative disparities of wealth are bound to emerge, regardless of the nature of income distribution.

Some say that excess wealth should be confiscated and redistributed. Progressive taxation and the welfare state aim to secure this outcome. Redistributive mechanisms reset the "wealth clock" periodically (at the end of every month, or fiscal year). In many countries, the law dictates which portion of one's income must be saved and, by implication, how much can be consumed. This conflicts with basic rights like the freedom to make economic choices.

The legalized expropriation of income (i.e., taxes) is morally dubious. Anti-tax movements have sprung all over the world and their philosophy permeates the ideology of political parties in many countries, not least the USA. Taxes are punitive: they penalize enterprise, success, entrepreneurship, foresight, and risk assumption. Welfare, on the other hand, rewards dependence and parasitism.

According to Rawles' Difference Principle, all tenets of justice are either redistributive or retributive. This ignores non-economic activities and human inherent variance. Moreover, conflict and inequality are the engines of growth and innovation - which mostly benefit the least advantaged in the long run. Experience shows that unmitigated equality results in atrophy, corruption and stagnation. Thermodynamics teaches us that life and motion are engendered by an irregular distribution of energy. Entropy - an even distribution of energy - equals death and stasis.

What about the disadvantaged and challenged - the mentally retarded, the mentally insane, the paralyzed, the chronically ill? For that matter, what about the less talented, less skilled, less daring? Dworkin (1981) proposed a compensation scheme. He suggested a model of fair distribution in which every person is given the same purchasing power and uses it to bid, in a fair auction, for resources that best fit that person's life plan, goals and preferences.

Having thus acquired these resources, we are then permitted to use them as we see fit. Obviously, we end up with disparate economic results. But we cannot complain - we were given the same purchasing power and the freedom to bid for a bundle of our choice.

Dworkin assumes that prior to the hypothetical auction, people are unaware of their own natural endowments but are willing and able to insure against being naturally disadvantaged. Their payments create an insurance pool to compensate the less fortunate for their misfortune.

This, of course, is highly unrealistic. We are usually very much aware of natural endowments and liabilities - both ours and others'. Therefore, the demand for such insurance is not universal, nor uniform. Some of us badly need and want it - others not at all. It is morally acceptable to let willing buyers and sellers to trade in such coverage (e.g., by offering charity or alms) - but may be immoral to make it compulsory.

Most of the modern welfare programs are involuntary Dworkin schemes. Worse yet, they often measure differences in natural endowments arbitrarily, compensate for lack of acquired skills, and discriminate between types of endowments in accordance with cultural biases and fads.

Libertarians limit themselves to ensuring a level playing field of just exchanges, where just actions always result in just outcomes. Justice is not dependent on a particular distribution pattern, whether as a starting point, or as an outcome. Robert Nozick "Entitlement Theory" proposed in 1974 is based on this approach.

That the market is wiser than any of its participants is a pillar of the philosophy of capitalism. In its pure form, the theory claims that markets yield patterns of merited distribution - i.e., reward and punish justly. Capitalism generate just deserts. Market failures - for instance, in the provision of public goods - should be tackled by governments. But a just distribution of income and wealth does not constitute a market failure and, therefore, should not be tampered with.

K

Kleptocracy

Human vice is the most certain thing after death and taxes, to paraphrase Benjamin Franklin. The only variety of economic activity, which will surely survive even a nuclear holocaust, is bound to be crime. Prostitution, gambling, drugs and, in general, expressly illegal activities generate c. 400 billion USD annually to their perpetrators, thus making crime the third biggest industry on Earth (after the medical and pharmaceutical industries).

Many of the so called Economies in Transition and of HPICs (Highly Indebted Poor Countries) do resemble post-nuclear-holocaust ashes. GDPs in most of these economies either tumbled nominally or in real terms by more than 60% in the space of less than a decade. The average monthly salary is the equivalent of the average daily salary of the German industrial worker. The GDP per capita – with very few notable exceptions – is around 20% of the EU's average and the average wages are 14% the EU's average (2000). These are the telltale overt signs of a comprehensive collapse of the infrastructure and of the export and internal markets. Mountains of internal debt, sky high interest rates, cronyism, other forms of corruption, environmental, urban and rural dilapidation – characterize these economies.

Into this vacuum – the interregnum between centrally planned and free market economies – crept crime. In most of these countries criminals run at least half the economy, are part of the governing elites (influencing them behind the scenes through money contributions, outright bribes, or blackmail) and – through the mechanism of money laundering – infiltrate slowly the legitimate economy.

What gives crime the edge, the competitive advantage versus the older, ostensibly more well established elites?

The free market does. When communism collapsed, only criminals, politicians, managers, and employees of the security services were positioned to benefit from the upheaval. Criminals, for instance, are much better equipped to deal with the onslaught of this new conceptual beast, the mechanism of the market, than most other economic players in these tattered economies are.

Criminals, by the very nature of their vocation, were always private entrepreneurs. They were never state owned or subjected to any kind of central planning. Thus, they became the only group in society that was not corrupted by these un-natural inventions. They invested their own capital in small to medium size enterprises and ran them later as any American manager would have done. To a large extent the criminals, single handedly, created a private sector in these derelict economies.

Having established a private sector business, devoid of any involvement of the state, the criminal-entrepreneurs proceeded to study the market. Through primitive forms of market research (neighbourhood activists) they were able to identify the needs of their prospective customers, to monitor them in real time and to respond with agility to changes in the patterns of supply and demand. Criminals are market-animals and they are geared to respond to its gyrations and vicissitudes. Though they were not likely to engage in conventional marketing and advertising, they always stayed attuned to the market's vibrations and signals. They changed their product mix and their pricing to fit fluctuations in demand and supply.

Criminals have proven to be good organizers and managers. They have very effective ways of enforcing discipline in the workplace, of setting revenue targets, of maintaining a flexible hierarchy combined with rigid obeisance – with very high upward mobility and a clear career path. A complex system of incentives and disincentives drives the workforce to dedication and industriousness. The criminal rings are well run conglomerates and the more classic industries would have done well to study their modes of organization and management. Everything – from sales through territorially exclusive licences (franchises) to effective "stock" options – has been invented in the international crime organizations long before it acquired the respectability of the corporate boardroom.

The criminal world has replicated those parts of the state which were rendered ineffective by unrealistic ideology or by pure corruption. The court system makes a fine example. The criminals instituted their own code of justice ("law") and their own court system. A unique – and often irreversible – enforcement arm sees to it that respect towards these indispensable institutions is maintained. Effective – often interactive – legislation, an efficient court system, backed by ominous and ruthless agents of enforcement – ensure the friction-free functioning of the giant wheels of crime. Crime has replicated numerous other state institutions. Small wonder that when the state disintegrated – crime was able to replace it with little difficulty. The same pattern is discernible in certain parts of the world where terrorist organizations duplicate the state and overtake it, in time. Schools, clinics, legal assistance, family support, taxation, the court system, transportation and telecommunication services, banking and industry – all have a criminal doppelganger.

To summarize:

At the outset of transition, the underworld constituted an embryonic private sector, replete with international networks of contacts, cross-border experience, capital agglomeration and wealth formation, sources of venture (risk) capital, an entrepreneurial spirit, and a diversified portfolio of investments, revenue generating assets, and sources of wealth. Criminals were used to private sector practices: price signals, competition, joint venturing, and third party dispute settlement.

To secure this remarkable achievement – the underworld had to procure and then maintain – infrastructure and technologies. Indeed, criminals are great at innovating and even more formidable at making use of cutting edge technologies. There is not a single technological advance, invention or discovery that criminals were not the first to utilize or the first to contemplate and to grasp its full potential. There are enormous industries of services rendered to the criminal in his pursuits. Accountants and lawyers, forgers and cross border guides, weapons experts and bankers, mechanics and hit-men – all stand at the disposal of the average criminal. The choice is great and prices are always negotiable. These auxiliary professionals are no different to their legitimate counterparts, despite the difference in subject matter. A body of expertise, know-how and acumen has accumulated over centuries of crime and is handed down the generations in the criminal universities known as jail-houses and penitentiaries. Roads less travelled, countries more lenient, passports to be bought, sold, or forged, how to manuals, classified ads, goods and services on offer and demand – all feature in this mass media cum educational (mostly verbal) bulletins. This is the real infrastructure of crime. As with more mundane occupations, human capital is what counts.

Criminal activities are hugely profitable (though wealth accumulation and capital distribution are grossly non-egalitarian). Money is stashed away in banking havens and in more regular banks and financial institutions all over the globe. Electronic Document Interchange and electronic commerce transformed what used to be an inconveniently slow and painfully transparent process – into a speed-of-light here-I-am, here-I-am-gone type of operation. Money is easily movable and virtually untraceable. Special experts take care of that: tax havens, off shore banks, money transactions couriers with the right education and a free spirit. This money, in due time and having cooled off – is reinvested in legitimate activities. Crime is a major engine of economic growth in some countries (where drugs are grown or traded, or in countries such as Italy, in Russia and elsewhere in CEE). In many a place, criminals are the only ones who have any liquidity at all. The other, more visible, sectors of the economy are wallowing in the financial drought of a demonetized economy. People and governments tend to lose both their scruples and their sense of fine distinctions under these unhappy circumstances. They welcome any kind of money to ensure their very survival. This is where crime comes in. In Central and Eastern Europe the process was code-named: "privatization".

Moreover, most of the poor economies are also closed economies. They are the economies of nations xenophobic, closed to the outside world, with currency regulations, limitations on foreign ownership, constrained (instead of free) trade. The vast majority of the populace of these economic wretches has never been further than the neighbouring city – let alone outside the borders of their countries. Freedom of movement is still restricted. The only ones to have travelled freely – mostly without the required travel documents – were the criminals. Crime is international. It involves massive, intricate and sophisticated operations of export and import, knowledge of languages, extensive and frequent trips, an intimate acquaintance with world prices, the international financial system, demand and supply in various markets, frequent business negotiations with foreigners and so on. This list would fit any modern businessman as well. Criminals are international businessmen. Their connections abroad coupled with their connections with the various elites inside their country and coupled with their financial prowess – made them the first and only true businessmen of the economies in transition. There simply was no one else qualified to fulfil this role – and the criminals stepped in willingly.

They planned and timed their moves as they always do: with shrewdness, an uncanny knowledge of human psychology and relentless cruelty. There was no one to oppose them – and so they won the day. It will take one or more generations to get rid of them and to replace them by a more civilized breed of entrepreneurs. But it will not happen overnight.

In the 19th century, the then expanding USA went through the same process. Robber barons seized economic opportunities in the Wild East and in the Wild West and really everywhere else. Morgan, Rockefeller, Pullman, Vanderbilt – the most ennobled families of latter day America originated with these rascals. But there is one important difference between the USA at that time and Central and Eastern Europe today. A civic culture with civic values and an aspiration to, ultimately, create a civic society permeated the popular as well as the high-brow culture of America. Criminality was regarded as a shameful stepping stone on the way to an orderly society of learned, civilized, law-abiding citizens. This cannot be said about Russia, for instance. The criminal there is, if anything, admired and emulated. The language of business in countries in transition is suffused with the criminal parlance of violence. The next generation is encouraged to behave similarly because no clear (not to mention well embedded) alternative is propounded. There is no – and never was – a civic tradition in these countries, a Bill of Rights, a veritable Constitution, a modicum of self rule, a true abolition of classes and nomenclatures. The future is grim because the past was grim. Used to being governed by capricious, paranoiac, criminal tyrants – these nations know no better. The current criminal class seems to them to be a natural continuation and extension of generations-long trends. That some criminals are members of the new political, financial and industrial elites (and vice versa) – surprises them not.

In most countries in transition, the elites (the political-managerial complex) make use of the state and its simulacrum institutions in close symbiosis with the criminal underworld. The state is often an oppressive mechanism deployed in order to control the populace and manipulate it. Politicians allocate assets, resources, rights, and licences to themselves, and to their families and cronies. Patronage extends to collaborating criminals. Additionally, the sovereign state is regarded as a means to extract foreign aid and credits from donors, multilaterals, and NGOs.

The criminal underworld exploits the politicians. Politicians give criminals access to state owned assets and resources. These are an integral part of the money laundering cycle. "Dirty" money is legitimized through the purchase of businesses and real estate from the state. Politicians induce state institutions to turn a blind eye to the criminal activities of their collaborators and ensure lenient law enforcement. They also help criminals eliminate internal and external competition in their territories.

In return, criminals serve as the "long and anonymous arm" of politicians. They obtain illicit goods for them and provide them with illegal services. Corruption often flows through criminal channels or via the mediation and conduit of delinquents. Within the shared sphere of the informal economy, assets are often shifted among these economic players. Both have an interest to maintain a certain lack of transparency, a bureaucracy (=dependence on state institutions and state employees) and NAIRU (Non Abating Internal Recruitment Unemployment). Nationalism and racism, the fostering of paranoia and grievances are excellent tactics of mobilization of foot soldiers. And the needs to dispense with a continuous stream of patronage and provide venues for the legitimization of illegally earned funds delay essential reforms and the disposal of state assets.

This urge to become legitimate - largely the result of social pressure - leads to a deterministic, four stroke cycle of co-habitation between politicians and criminals. In the first phase, politicians grope for a new ideological cover for their opportunism. This is followed by a growing partnership between the elites and the crime world. A divergence then occurs. Politicians team up with legitimacy-seeking, established crime lords. Both groups benefit from a larger economic pie. They fight against other, less successful, criminals, who wish to persist in their old ways. This is low intensity warfare and it inevitably ends in the triumph of the former over the latter.

Knowledge

"Knowledge is Power" goes the old German adage. But power, as any schoolboy knows, always has negative and positive sides to it. Information exhibits the same duality: properly provided, it is a positive power of unequalled strength. Improperly disseminated and presented, it is nothing short of destructive. The management of the structure, content, provision and dissemination of information is, therefore, of paramount importance to a nation, especially if it is in its infancy (as an independent state).

Information has four dimensions and five axes of dissemination, some vertical and some horizontal.

The four dimensions are:

1. ***Structure*** – information can come in various physical forms and poured into different kinds of vessels and carriers. It can be continuous or segmented, cyclical (periodic) or punctuated, repetitive or new, etc. The structure often determines what of the information (if at

all) will be remembered and how. It encompasses not only the mode of presentation, but also the modules and the rules of interaction between them (the hermeneutic principles, the rules of structural interpretation, which is the result of spatial, syntactic and grammatical conjunction).

2. ***Content –*** This incorporates both ontological and epistemological elements. In other words: both "hard" data, which should, in principle, be verifiable through the employment of objective, scientific, methods – and "soft" data, the interpretation offered with the hard data. The soft data is a derivative of a "message", in the broader sense of the term. A message comprises both world-view (theory) and an action and direction-inducing element.

3. ***Provision –*** The intentional input of structured content into information channels. The timing of this action, the quantities of data fed into the channels, their qualities – all are part of the equation of provision.

4. ***Dissemination –*** More commonly known as media or information channels. The channels which bridge between the information providers and the information consumers. Some channels are merely technical and then the relevant things to discuss would be technical: bandwidth, noise to signal ratios and the like. Other channels are metaphorical and then the relevant determinants would be their effectiveness in conveying content to targeted consumers.

In the economic realm, there are five important axes of dissemination:

1. ***From Government to the Market*** – the Market here being the "Hidden Hand", the mechanism which allocates resources in adherence to market signals (for instance, in accordance with prices). The Government intervenes to correct market failures, or to influence the allocation of resources in favour or against the interests of a defined group of people. The more transparent and accountable the actions of the Government, the less distortion in the allocation of resources and the less resulting inefficiency. The Government should declare its intentions and actions in advance whenever possible, then it should act through public, open tenders, report often to regulatory and legislative bodies and to the public and so on. The more information provided by this major economic player (the most dominant in most countries) – the more smoothly and efficaciously the Market will operate. The converse, unfortunately, is also true. The less open the government, the more latent its intents, the more shadowy its operations – the more cumbersome the bureaucracy, the less functioning the market.

2. ***From Government to the Firms*** – The same principles that apply to the desirable interaction between Government and Market, apply here. The Government should disseminate information to firms in its territory (and out of it) accurately, equitably and speedily. Any delay or distortion in the information, or preference of one recipient over another – will thwart the efficient allocation of economic resources.

3. ***From Government to the World*** – The "World" here being multilateral institutions, foreign governments, foreign investors, foreign competitors and the economic players in general providing that they are outside the territory of the information disseminating Government. Again, any delay, or abstention in the dissemination of information as well as its distortion (disinformation and misinformation) will result in economic outcomes worse that could have been achieved by a free, prompt, precise and equitable (=equally available) dissemination of said information. This is true even where commercial secrets are involved! It has been proven time and again that when commercial information is kept secret – the firm (or Government) that keeps it hidden is HARMED. The most famous examples are Apple (which kept its operating system a well-guarded secret) and IBM (which did not), Microsoft (which kept its operating system open to developers of software) and other software companies (which did not). Recently, Netscape has decided to provide its source code (the most important commercial secret of any software company) free of charge to application developers. Synergy based on openness seemed to have won over old habits. A free, unhampered, unbiased flow of information is a major point of attraction to foreign investors and a brawny point with the likes of the IMF and the World Bank. The former, for instance, lends money more easily to countries, which maintain a reasonably reliable outflow of national statistics.

4. ***From Firms to the World*** – The virtues of corporate transparency and of the application of the properly revealing International Accounting Standards (IAS, GAAP, or others) need no evidencing. Today, it is virtually impossible to raise money, to export, to import, to form joint ventures, to obtain credits, or to otherwise collaborate internationally without the existence of full, unmitigated disclosure. The modern firm (if it wishes to interact globally) must open itself up completely and provide timely, full and accurate information to all. This is a legal must for public and listed firms the world over (though standards vary). Transparent accounting practices, clear ownership structure, available track record and historical performance records – are sine qua non in today's financing world.

5. ***From Firms to Firms*** – This is really a subset of the previous axis of dissemination. Its distinction is that while the former is concerned with multilateral, international interactions – this axis is more inwardly oriented and deals with the goings-on between firms in the same territory. Here, the desirability of full disclosure is even stronger. A firm that fails to provide information about itself to firms on its turf, will likely fall prey to vicious rumours and informative manipulations by its competitors.

Positive information is characterized by four qualities:

1. ***Transparency –*** Knowing the sources of the information, the methods by which it was obtained, the confirmation that none of it was unnecessarily suppressed

(some would argue that there is no "necessary suppression") – constitutes the main edifice of transparency. The datum or information can be true, but if it is not perceived to be transparent – it will not be considered reliable. Think about an anonymous (=non-transparent) letter versus a signed letter – the latter will be more readily relied upon (subject to the reliability of the author, of course).

2. ***Reliability –*** is the direct result of transparency. Acquaintance with the source of information (including its history) and with the methods of its provision and dissemination will determine the level of reliability that we will attach to it. How balanced is it? Is the source prejudiced or in any way an interested, biased, party? Was the information "force-fed" by the Government, was the media coerced to publish it by a major advertiser, was the journalist arrested after the publication? The circumstances surrounding the datum are as important as its content. The context of a piece of information is of no less consequence that the information contained in it. Above all, to be judged reliable, the information must "reflect" reality. I mean reflection not in the basic sense: a one to one mapping of the reflected. I intend it more as a resonance, a vibration in tune with the piece of the real world that it relates to. People say: "This sounds true" and the word "sounds" should be emphasized.

3. ***Comprehensiveness –*** Information will not be considered transparent, nor will it be judged reliable if it is partial. It must incorporate all the aspects of the world to which it relates, or else

state explicitly what has been omitted and why (which is tantamount to including it, in the first place). A bit of information is embedded in a context and constantly interacts with it. Additionally, its various modules and content elements consistently and constantly interact with each other. A missing part implies ignorance of interactions and epiphenomena, which might crucially alter the interpretation of the information. Partiality renders information valueless. Needless to say, that I am talking about RELEVANT parts of the information. There are many other segments of it, which are omitted because their influence is negligible (the idealization process), or because it is so great that they are common knowledge.

4. ***Organization –*** This, arguably, is the most important aspect of information. It is what makes information comprehensible. It includes the spatial and temporal (historic) context of the information, its interactions with its context, its inner interactions, as we described earlier, its structure, the rules of decision (grammar and syntax) and the rules of interpretation (semantics, etc.) to be applied. A worldview is provided, a theory into which the information fits. Embedded in this theory, it allows for predictions to be made in order to falsify the theory (or to prove it). Information cannot be understood in the absence of such a worldview. Such a worldview can be scientific, or religious – but it can also be ideological (Capitalism, Socialism), or related to an image which an entity wishes to project. An image is a theory about a person or a group of people. It is both supported by information – and

supports it. It is a shorthand version of all the pertinent data, a stereotype in reverse.

There is no difference in the application of these rules to information and to interpretation (which is really information that relates to other information instead of relating to the World). Both categories can be formal and informal. Formal information is information that designates itself as such (carries a sign: "I am information"). It includes official publications by various bodies (accountants, corporations, The Bureau of Statistics, news bulletins, all the media, the Internet, various databases, whether in digitized format or in hard copy).

Informal information is information, which is not permanently captured or is captured without the intention of generating formal information (=without the pretence: "I am information"). Any verbal communication belongs here (rumours, gossip, general knowledge, background dormant data, etc.).

The modern world is glutted by information, formal and informal, partial and comprehensive, out of context and with interpretation. There are no conceptual, mental, or philosophically rigorous distinctions today between information and what it denotes or stands for. Actors are often mistaken for their roles, wars are fought on television, fictitious TV celebrities become real. That which has no information presence might as well have no real life existence. An entity – person, group of people, a nation – which does not engage in structuring content, providing and disseminating it – actively engages, therefore, in its own, slow, disappearance.

Kosovo, Economy of

Should the United Nations administer Iraq? Is it - as Kofi Annan, its General Secretary, insists, the best-qualified to build nations? Or will it act as a bureaucracy out to perpetuate itself by preventing true transformation and indigenous rule? Kosovo is a lucrative post for more than 10,000 exorbitantly overpaid international administrators and perked consultants as well as 40,000 itinerant peacekeepers.

The U.N. has been reasonably successful elsewhere both in peacekeeping and administration - notably in East Timor, Afghanistan and Sierra Leone. It widely thought to have dismally failed in Bosnia-Herzegovina. But the lessons of its involvement in Kosovo - the second longest and least reserved - may be of particular relevance.

In the wake of NATO's Operation Allied Force in 1999, Kosovo was practically severed from Yugoslavia and rendered a U.N.-protectorate under resolution 1244 of the Security Council. UNMIK (United Nations Mission in Kosovo) was formed to serve as the province's interim administrator. It was charged with institutions-building and a transition to self-governance by the now overwhelmingly Albanian populace.

Its mission was divided to four "pillars": Police and Justice, Civil Administration, Democratization and Institution Building (overseen by the Organization for Security and Cooperation in Europe) and Reconstruction and Economic Development (managed by the European Union). Four years later, Kosovo has its own government, installed last month - and a viable police force.

UNMIK had to spent the first 18 months of its mandate re-establishing basic services in a land scorched by 78 days of massive bombardment. It also put in place the rudiments of a municipal administration. A parliament and presidency followed. Surprisingly resilient, they survived two - bloodied - elections. The U.N. is planning to transfer, over the next few months, many of its "competencies" to the three-party broad coalition in power. Last month, a transfer council was established to manage the transition.

But Kosovo is an unsettled place. Its status is unresolved. Is it to be independent, as its legislators demand - or an inseparable part of Serbia, as the late assassinated Serbian prime minister, Zoran Djindjic claimed? UNMIK's travel documents and its license plates, for instance, are still not recognized by many countries.

Investors - including wealthy diaspora Kosovars - are deterred by this uncertainty and the social and civil unrest it fosters. Had it not been for KFOR, the 35,000-strong NATO-commanded military detachment, Kosovo might well have reverted to civil war, or crime-infested anarchy. That, astoundingly, Kosovo has no law to deal with foreign investment does not help.

Partly because of that, Kosovo's economy is still a shambles. The United Nations - and the acronym soup of multilateral development banks, aid agencies and non-governmental organizations that descended on the region - failed to come up with a coherent plan for endowing Kosovo with a sustainable economy.

Where UNMIK, with European Union assistance, did intervene - in setting up institutions and abetting economic legislation - it has done more harm than good. The establishment of workers' councils, for instance, inhibited the proper management of socially owned enterprises and rigidified the budding labor market with dire consequences.

One in two Kosovars is unemployed. Whatever activity there is, is confined to trading (read: smuggling), retail and petty services. The wild construction or reconstruction of 250,000 houses wrecked by the war is fizzling out and the absence of both mortgage financing and a sizable domestic industry of construction materials are detrimental to the sector's viability.

Tenders for complex infrastructure jobs are usually snatched by foreign competitors. Reputable Kosovar-owned construction multinationals hint at discrimination and worse. But the business segment of the economy is illusive and dilapidated. Of 861 socially-owned firms identified by the International Crisis Group, only 330 are viable, according to UNMIK.

Kosovo has no private sector to speak of - though it has registered 50,000 small and medium, mostly paper, typically ad-hoc, enterprises. Of 2774 members of the Kosovo Chamber of Commerce - 1667 were fly-by-night construction outfits.

The majority of economic assets are still in public or "social" hands. In an interview granted to the Far Eastern Review last year, Ali Jakupi, Minister of Trade and Industry of Kosovo, diplomatically pointed the finger at UNMIK's glacial pace of reform.

Land ownership is a contentious issue. The privatization of utilities is a distant dream, despite the creation of the Kosovo Trust Agency, a convoluted attempt to dispense of certain assets while skirting the legal no man's land which is Kosovo.

Despite all efforts, commercial law is scant and poorly enforced. No one understands why the number of commercial bank licenses is limited, why, until recently, UNMIK worked only through one bank and why establishing an insurance company is such a harrowing - and outlandishly expensive - ordeal. Kosovo is the only place on earth where price cartels (for instance, in the assurance sector) are not only legal - but mandatory.

Kosovar banks still keep most of their clients' deposits abroad for lack of an indigenous legal framework of collateral and bankruptcy. Interest rates are prohibitively high and repayment terms onerous. The only ray of light in a decrepit financial system is the euro, Kosovo's official currency and a source of monetary stability and trust.

The new Ministry of Finance and Economy has introduced customs duties and a few taxes with modest success. But the government's revenue base is pitiful and a Byzantine, import-biased, tax law makes export-oriented manufacturing a losing proposition. Kosovo's trade deficit is almost equal to its gross domestic product. Had it not been for generous remittances from Kosovar expats and immigrants - pegged at $1 to 1.5 billion a year, the province's economy would have crumbled long ago.

Nor has Kosovo's infrastructure been rehabilitated despite the $5 billion poured into the province hitherto. Electricity, for instance, is intermittent and unpredictable.

The roads are potholed and few, the railways derelict. Fixed line penetration is low, though mobile telephony is booming. This sorry state was avoidable.

Kosovo is not as poor as it is made out to be by interested parties. It has enormous lead reserves, coal and lignite veins and loads of zinc, silver, gold, nickel, cobalt and other minerals, including rumored mines of uranium. The territory actually used to export electricity to both Macedonia and Montenegro.

Official statistics ignore a thriving informal economy, encompassing both the illicit and the merely unreported. Kosovo is a critical node in human trafficking, cigarette and oil derivatives smuggling, car theft and, to a lesser, extent, drugs and weapons trading networks. Revenues in service businesses - cafes, restaurants, gambling institutions, prostitution - go unreported. Kosovo is one of the global centers of piracy of intellectual property, notably software and movies.

The Central Fiscal Authority of Kosovo estimated that, in 2001, duties and taxes were paid only on $590 million worth of imports (at the time, c. $540 million euros) - only about 30 percent of the total. These figures are proof of the entrepreneurial vitality of the Kosovars and their aversion to state interference.

USAID chief Dale Pfeiffer praised Kosovo, in an interview granted to the daily paper, Koha Ditore:

"There is bureaucracy, there is a corruption, but if we compare with neighboring countries, it seems to be at a lower level. Since 1999, Kosovo is building its own new governmental structures. Mainly, your government is more modern than government in Serbia, Macedonia or even Bosnia. I think that corruption is not even same at the level as neighboring countries. Although corruption is something that can grow very easily, currently it doesn't seem to be a big obstacle for businesses."

Still, he reverted to typical counterfactual condescension. Federal Yugoslavia, of which Kosovo was a part, was a modern state, more advanced than many EU members. Yet, Pfieffer professed to be worried.

"Day by day, more competencies are being given to the Kosovo Government. My concern is, does the Government have the ability to manage its own competencies. I think there should be a balance; you must gain competencies which can be applied."

Many observers think that had it not been hobbled by the indecision and overbearing officialdom of the international community, Kosovo would have fared better. Even evident economic assets - such as nature parks, vineyards and ski slopes - were left undeveloped. Because it hasn't met EU regulations - Kosovo is unable to export its wines, juices and agricultural produce.

But to hold this view is to ignore UNMIK's contribution to the containment of organized crime - mostly imported from Albania and Macedonia. Admittedly, though, UNMIK failed to defend minority rights. Kosovo has been ethnically cleansed of its Serbs. The UN High Commissioner for Refugees (UNHCR) and OSCE warned last month that minorities "continue to face security problems and lack access to basic services (such as) education, health services and equitable employment."

Kosovo teaches us lessons which should be diligently applied in Iraq. The involvement of a long-term active military component intended to guarantee basic law and order is crucial. U.N. administrations are good at reconstruction, rehabilitation - including humanitarian aid - and institution-building.

But they are utterly incompetent when it comes to the economy and to protecting minorities from the majority's wrath. Pecuniary matters are best left to private sector firms and consultants while helpless minorities better start praying.

Worse still, as opposed to an occupying army, whose top priority is to depart - U.N. bureaucracies fast gravitate towards colonialism. The U.N.-paid and U.N.-sanctioned rulers of both Kosovo and Bosnia-Herzegovina exercise powers akin to erstwhile British viceroys. Nor do they have any incentive to terminate their position - gratifying as it is to both their egos and their wallets.

UNMIK is the reification of the concept of conflict-of-interest. If it succeeds to render the natives economically and politically independent - it is no longer needed. If it fails - it survives on a bloated budget. To be an international official in Kosovo is to endure the constant clashes between one's professional conscience and one's propensity to live the good life. Only saints win such battles. Whatever UNMIK is - it is decidedly not saintly.

But, as Augustin Palokaj, Brussels correspondent for Koha Ditore, notes, comparing Kosovo to Iraq can go too far:

"Kosovo has no oil and one-third of the population of Baghdad, and it is not interesting for investments ... Iraq will have an easier time when it comes to political status. Iraq is, and will remain, a state. It is still not known what Kosovo's fate will be. Unlike in Kosovo, there will be both aid and investment in Iraq. The Iraqi people will decide on the status of their country, whereas the Security Council, that is to say China and Russia, will decide about Kosovo."

And does he think the United Nations should administer a postwar Iraq?

"The UN would only complicate things, but the Americans will give it a role, just for the sake of it, which will satisfy the bureaucrats that must get their huge salaries. Americans are also aware of the danger that if the UN takes over the administration of postwar Iraq ... criminals from various countries would be infiltrated into Iraq, as they have done in Kosovo. How can peace be established by an organization whose policemen allowed eight war crimes suspects to escape from prison, as happened to UN policemen in Kosovo. Instead of feeling shame for such things, the chiefs of UNMIK Police produce propaganda about their successes. The key American role in postwar Iraq will prove what was learned from Kosovo."

Kyoto Protocol

The 185 member states of the United Nations Climate Change Convention met repeatedly since 2003 in order to contemplate what steps may be needed to implement the Kyoto protocol, now ratified by more than 130 countries, including Russia and the European Union. Signatories have ten years - starting in 2003 - to cut their emissions of greenhouse gases.

In the decade or so of transition, the countries of central and eastern Europe have suffered droughts and floods in equal measure. They attribute this shift in climate patterns to global warming. Ironically, the crumbling of their smokestack industrial infrastructure reduced their emissions by 38 percent between 1990-2000, according to a report presented at the conference. In Estonia, transition's poster kid, emissions declined by 56 percent, according to ETA, the news agency.

The OECD countries increased theirs by 8.4 percent over the same period. This disparity between rich and poor nations in Europe casts a cynical light over the European Union's constant environmental castigation of east Europeans. The EU adopted the Kyoto protocol in May 2002 and committed itself to a total reduction of 8 percent of emissions by 2012.

Even if wildly optimistic forecasts regarding car usage and the restoration of central and east Europe's manufacturing base are met - emissions would still be well in compliance with annex I of the Kyoto protocol, which lists the reductions required of the candidate countries.

This cannot be said about the current members of the European Union and other rich, industrialized polities. Lawmakers in the former communist bloc are aware of it. Quoted by Radio Free Europe/Radio Liberty, the Russian Federation Council Science, Culture, Education, Health, and Ecology Committee Chairman Viktor Shudergov told the news agency Rosbalt in October 2002:

"We must calculate and anticipate the maximum possible improvement for our own industry so that in a few years we don't find ourselves purchasing (pollution) quotas. Russia is currently the world's major supplier of oxygen in the atmosphere. Other countries are using Russia's biological resources to develop their industries. The USA has every possibility to reduce its own emissions but refuses to do so. It would have been more useful if the main source of ecological pollution, the United States, had participated."

Central and east Europeans have a few things going for them as far as the environment goes. Public transport is more developed in the countries in transition than in the rest of the continent. Industry - rebuilt from scratch - invariably comes equipped to minimize pollution. Private cars are less ubiquitous than in Western Europe. Vast swathes of countryside remain virtually untouched, serving as "green lungs" and carbon sinks.

If, as the European Commission envisions, a community-wide regime of emissions-trading is established, the countries east of the Oder-Neisse line could well benefit as net sellers of unused quotas. According to Ziarul Financiar, a Romanian financial newspaper, in 2001, the government of Romania negotiated the sale of some $20 million in carbon dioxide emission rights to Japan.

A similar deal - this time for c. $4 million - was struck with the Swiss. The money was used to refurbish the decrepit central heating systems in a few townships. The interesting twist is that the very enhancement of the energy efficiency of the antiquated pipelines freed for sale portions of the emissions quota.

It is telling that Romania was unable or unwilling to sell its emissions to the United Kingdom, Denmark, or the Netherlands, all three of which host functional emissions-trading pilot projects. The trading rules are so complex - certain sectors and gases are excluded and fiendishly intricate auctions regulate the initial allocation of quotas - that many potential buyers and sellers prefer to abstain.

Estonia circumvented the nascent exchanges altogether. It convinced the Dutch, Finns, Germans, and Swedes to invest in reducing carbon dioxide emissions in Estonia. The reductions, according to the Baltic News Service, will be applied to the quotas of the investing nations.

Still, the political leadership of most countries in transition understands that it has at least to be seen to be supportive of the Kyoto process. Russia announced in the World Summit on Sustainable Development in Johannesburg in September 2002 its intention to ratify the protocol by the end of 2004, as it did. A year later (2003), it also hosted the International Conference on Climate Change. Its then Prime Minister Mikhail Kasyanov boasted of a one third reduction in emissions in recent years.

Environment ministries - a novel fixture - have proliferated throughout the region and, backed by the international community, have become assertive. The Croat minister of environment, for instance, warned his own government in March, in his first national report on local climate changes, of international sanctions due to a considerable increase in the emissions of noxious gases since 1990.

According to the Regional Environmental Center for Central and Eastern Europe, many countries in the region - including three New Independent States, Ukraine, Bulgaria, and the Czech Republic - have completed national climate change action plans. Hungary, Kazakhstan and Russia are preparing theirs. The BBC says that Slovenia is working on a program of its own, though in compliance with the Kyoto requirements.

Less scrupulous politicians regard the environment as another way to extract funds from Western governments and multilateral lending institutions. Especially active are the European Bank for Reconstruction and Development (EBRD) and the World Bank. The former approved $12 million to Vetropak Straza, Croatia's only glass factory. The money will be invested in a new technology with less harmful emissions.

Together with Citibank, the EBRD is committed to financing the $470 million conversion of the Bulgarian thermal power plants, Maritsa 2 and 3 to more efficient and less polluting coal burning. The Bank is collaborating with the Dutch to establish a carbon credits market exclusive to its client states - the countries of central and eastern Europe and the Balkan.

Pollution-phobic European countries - mainly in Scandinavia - work with the World Bank and match its funds in specific environmental undertakings. Thus, the Danish Agency of Environment has financed 13 projects in Bulgaria last year, part of $18 million it has granted that country alone since 1995. It is now assisting Bulgaria in its application for world Bank funds to counter the effects of past pollution.

L

Land Reform

The Western press casts him in the role of an African Saddam Hussein. Neighboring leaders supported his policies, but then succumbed to diplomacy and world opinion and, with a few notable exceptions, shunned him. The opposition and its mouthpieces accuse him - justly - of brutal disregard for human, civil, and political rights and of undermining the rule of law. All he wants, insists Comrade - his official party title - Robert Mugabe of Zimbabwe is to right an ancient wrong by returning land, expropriated by white settlers, to its rightful black owners.

Most of the beneficiaries, being real or alleged "war veterans", happen to support his party, the Zimbabwe African National Union-Patriotic Front, or ZANU-PF, and its profligate largesse:

"We must deliver the land unencumbered by impediments to its rightful owners. It is theirs by birth; it is theirs by natural and legal right. It is theirs by struggle. Indeed their(s) by legacy," he thundered in a speech he made to the Central Committee of his party in March 2001 in response to mounting multi-annual pressures from war veteran associations.

It was Margaret Thatcher of Falklands fame who, after two decades of fierce fighting, capitulated to rebels, headed by Mugabe. The Iron Lady handed to them, in the Lancaster House agreement, an independent Zimbabwe - literally, "Great Stone House". The racist Rhodesia was no more. But the agreement enshrined the property rights of white farmers until 1990 and has, thus, sown the seeds of the current chaos.

Many nostalgic white settlers in Zimbabwe - mostly descendents of British invaders at the end of the 19th century - still believe in their cultural - if not genetic - superiority. Their forefathers bought indigenous land from commercial outfits supported by the British Crown. The blacks - their plots and livestock confiscated - were resettled in barren "communal areas", akin to Native-American reserves in the USA minus the gambling concessions.

Starting in 1893, successive uprisings were bloodily suppressed by the colonizers and the British government. A particularly virulent strain of apartheid was introduced. By 1914, notes Steve Lawton in "British Colonialism, Zimbabwe's Land Reform and Settler Resistance", 3 percent of the population controlled 75 percent of the land. The blacks were "harshly restricted to a mere 23 per cent of the worst land in designated Reserves. There were only 28,000 white settlers to nearly one million Africans in Zimbabwe at this time."

Land ownership hasn't changed much since. The 1930 "Land Apportionment Act" perpetuated the glaring inequality. At independence, according to "Zimbabwe's Agricultural Revolution" edited by Mandivamba Rukuni and Carl Eicher and published in 1994 by the University of Zimbabwe Publications, 6000 white commercial farms occupied 45 percent of all agricultural land - compared to only 5 percent tilled by 8500 black farmers. Another 70,000 black families futilely cultivated the infertile remaining half of the soil.

As black population exploded, poverty and repression combined to give rise to anti-white guerilla movements. The rest is history. The first post-independence land reform and resettlement program lasted 17 years, until 1997. It targeted refugees, internally displaced people, and squatters and its aims were, as Petrunella Chaminuka, a researcher at SAPES Trust Agrarian Reform Programme in Zimbabwe, summarizes a 1990 government discussion paper in the "Workers' Weekly":

"To redress past grievances over land alienation, to alleviate population pressure in the communal areas and to achieve national stability and progress. The programme was designed to enhance smallholder food and cash crop production, achieve food self-sufficiency and improve equity in income distribution."

Land reform was an act of anti-colonialist, ideologically-motivated defiance. The first lots went to landless - and utterly unskilled - blacks. Surprisingly, theirs was a success story. They cultivated the land ably and production increased. Certified farmers and agronomists, though, had to wait their turn until the National Land Policy of 1990 which allowed for compulsory land purchases by the government. There was no master plan of resettlement and infrastructure deficiencies combined with plot fragmentation to render many new farms economically unviable.

As ready inventory dried up, the price of land soared. Droughts compounded this sorry state and by the late 1980's yields were down and squatting resurged. Unemployment forced people back into rural areas. Egged on by multilateral lenders, white farmers, and Western commercial interests, the government further exacerbated the situation by allocating enormous tracts of land to horticulture, ostrich farming, crocodile farming, ranching and tourism thus further depleting the anyhow meager stock of arable acreage.

International outcry against compulsory acquisitions or targeting of c. 1600 farms forced the Zimbabwean government and its donors to come up in 1997-9 with a second land reform and resettlement programme and the Inception Phase Framework Plan. Contrary to disinformation in the Western media, white farmers and NGO's were regularly consulted in the preparation of both documents.

In what proved to be a prophetic statement, the aptly named Barbara Kafka of the World Bank, quoted by IPS, gave this warning in the September 1998 donor conference:

"We are delighted that the government has called this conference as a key step in our working together to make sure that Zimbabwe reaps the results it deserves from its land reform programme ... Nevertheless, we must not be naive. The downside risks are high. There is abundant international experience to show that poorly executed land reform can carry high social and economic costs ... For instance, a programme that does not respect property rights or does not provide sufficient support to new settlers, is underfunded or is excessively bureaucratic and costly, or simply results in large numbers of displaced farm workers, can have very negative outcomes in terms of investment, production, jobs and social stability."

This second phase broke down in mutual recriminations.

The government made an election issue out of the much-heralded reform and the donors delivered far less than they promised. Acutely aware of this friction, white farmers declined to offer land for sale.

Even as lawless invasions of private property recommenced in earnest, the government initiated the Fast Track Land Reform Plan in mid-2000. It envisioned the purchase of between 5-8 million of hectares of agricultural land, the resettlement of the rural indigent, the provision of infrastructure, technical advice and inputs by both civil and military authorities and the involvement of all "stakeholders" - especially white commercial farmers - in an on-going dialog in the framework of the Zimbabwe Joint Resettlement Initiative.

But the Plan fast deteriorated into strong-arm, threat-laden, and litigious confiscation of white property. Following a setback in the polls - its proposed constitution was rejected - ZANU-PF aided and abetted in the disorderly - and, sometimes, lethal - requisitioning of farms by a mob of war veterans, mock veterans, petty criminals, the rural dispossessed, party hacks, and even middle class urbanites. Ironically, the very anarchic nature of the process deterred genuine and the long term settlers.

About 2000 farms were thus impounded by the end of last year. The government refused to compensate farmers for the land seized insisting that such reparations should be paid by Britain. It did, however, provide pitiful sums for infrastructure added to the land by the white settlers.

As pandemic corruption, lawlessness, and mismanagement brought the country to the brink of insolvency and famine, Mugabe tainted with anti-Western diatribe his merited crusade for reversing past injustices. He lashed at the IMF and the World bank, at Britain and the USA, at white farmers and foreign capital. Xenophobia - no less that patriotism - is the refuge of the scoundrel in Africa.

In 1997, Britain's New Labor government ceased funding the acquisition of land from white farmers. Donors demanded matching funds from destitute Zimbabwe. By 1999, the entire West - spearheaded by the IMF - disengaged. Zimbabwe was severed from the global financial system.

This was followed by sanctions threatened by the EU and partly imposed the USA and the Commonwealth. Sanctions were also urged by prescriptive think tanks, such as the International Crisis Group, and even by corporate and banking groups, such as Britain's Abbey National.

Yet, discarding land reform together with Mugabe would be unwise. The problems - some of which are ignored even by the Zimbabwean authorities - are real. A negligible white minority owns vast swathes of forcibly obtained prime arable land in a predominantly black country.

A comprehensive - and just - land reform would cater to farm hands as well. They are mostly black - about one fifth of the population, counting their dependants. They live in shantytown-like facilities on the farms with little access to potable water, sanitation, electricity, phones, or other amenities. They were not even entitled to resettlement until recently.

According to "Rural poverty: Commercial farm workers and Land Reform in Zimbabwe", a paper presented at the SARPN conference on Land Reform and Poverty Alleviation in Southern Africa, in June 2001, only about one third of the most destitute black farm workforce have been imported as casual and seasonal workers from neighboring countries.

The rest, contrary to government propaganda, are indigenous. Yet, protestations to the contrary notwithstanding, the government, preoccupied with relieving growing tensions in the communal areas and rewarding its own supporters and cronies, refuses to incorporate farm hands fully in its Fast Track Resettlement Program. They are being accused of causing previous resettlement programs to fail.

The problems facing Zimbabwe's agricultural sector are reminiscent of the situation in Mozambique, Namibia, Malawi, Swaziland, Lesotho, and South Africa. Namibia has already threatened to emulate Zimbabwe. Sam Nujoma, the country's president, rebuked the market mechanism as "too slow, cumbersome and very costly". An understandable statement coming from the head of a government which, according to Namibian news agency, NAMPA, turned down 151 farms in 2001 for lack of funds.

"Land Reform in Zimbabwe: Constraints and Prospects", edited by T.A.S. Bowyer-Bower and Colin Stoneman, notes that development, growth, and poverty alleviation in the continent are directly linked to the ownership and cultivation of land - often the sole means of production. That no regional approach to this pressing issue has arisen attests to the quality of the self-centred, thuggish, and venal African leadership.

Politically-motivated land reform will lead to the emergence of the next generations of the deprived and the discriminated against. Resettlement has to be both fair and seen to be fair. It has to be based on unambiguous criteria and transparent and even-handed procedures. It has to backed by sufficient agricultural inputs and machinery, financial and technical assistance, access to markets, and basic infrastructure.

The proximity of services and institutions - from schools to courts - is critical. Above all, land reform has to look after people displaced in the process - commercial farmers and their workers - and thus enjoy near universal support or acquiescence. Legal title and tenure have to be established and recorded to allow the new settlers to obtain credits and invest in buildings, machinery, and infrastructure.

Alas, as both Human Rights Watch and the UNDP concluded in their detailed reports, none of these requirements is observed in Zimbabwe. Hence the recurrent failures and the blood-spattered chaos they have produced. Is Mugabe to blame? Surely. Is he the prime mover of this debacle? Not by a long shot. He merely encapsulates and leverages pernicious social forces in his country and in the continent. Until the root problems of Africa are tackled with courage and integrity Mugabe and his type of "reform" will prevail.

Lebanon, Economy of

In April 2003, a day after he won a parliamentary vote of confidence, 58-year old Rafiq Hariri, Lebanon's multi-billionaire prime minister, reluctantly formed a new, overtly pro-Syrian government with 30 ministers, only 11 of whom are new faces. It was to have been his last. He was murdered in February 2005.

Lebanese Information Minister Michel Samaha was quoted by regional news agencies as saying at the time Hariri's last government was proclaimed:

"The president indicated that the new government comes at a very sensitive time regionally. (It comes) in the shadow of pressures and accusations, which Israel is behind, targeting Syria and Lebanon to give up ... their principled stand that calls for resistance to occupation ... We must deal with...the importance of internal solidarity and solidarity with our Syrian brothers so we face as one the challenges directed at us."

Syria, in other words, is merely securing its Lebanese flank, faced with mounting tensions and an increasingly unhappy United States. By 2003, Hariri had formed 5 governments and had been serving as premier for 9 out of the last 11 years. Like Italy's Silvio Berlusconi, Hariri owned various media, including the Future television channel, a radio station and a newspaper. His tentacular grip extended to banking, real estate, oil and manufacturing.

Hariri was credited with the reconstruction of Lebanon's infrastructure, reduced to rubble by 15 years of rabid civil war that ended in 1990. The conflict and its aftermath have plunged Lebanon into a massive usurious public debt amounting to 180 percent of its gross domestic product, or $31 billion. Lebanon spends half its budget - about $3 billion - on interest payments.

Threatened with a default, international donors pledged yet another $4.4 billion in soft loans in November 2002. The USA, Britain, Germany and Spain refused to pitch in without the seal of approval of the International Monetary Fund, withheld until the beginning of the following year. By end-2002, Lebanese banks have been "convinced" to purchase $4 billion of interest free two-year government bonds. This slashed the country's debt service by $400 million a year.

Following the Paris-II donor conference, gross foreign exchange reserves surged to more than $10 billion. Gross capital inflow - at $3.2 billion - was enough to cover the trade deficit and yield a balance of payments surplus of $2 billion. Add to this $45 billion in total bank deposits - seven tenths of which are held in foreign currency - and the Lebanese pound's strength against the US dollar is explained. The price of Lebanese Eurobonds jumped 20 percent in the six months between October 2002 and April 2003.

In its latest financial statements, Banque Audi, a local outfit, pegged 2002 GDP growth at a miserly 1.5 percent. Exports increased by 15 percent to slightly more than $1 billion - though the Chamber of Commerce and the Ministry of Industry and Oil deem these figures wholly inflated. Construction still moves and shakes the economy with the number of square meters covered by permits up by one eighth - as is the number of international landings and departures. But activity in the Port of Beirut dropped, albeit marginally.

Lebanon is notorious for the glacial pace of its reforms. Market liberalization is peremptory. The country's 37 year old import monopolies are yet to be scrapped. Much-needed privatization is stalled. The electricity utility and two mobile phone operators alone can fetch up to $5 billion.

Two austerity budgets in a row - and the introduction of a value added tax in February 2002 - did nothing to revive the flaccid economy. The tax administration and the judiciary are infamous hotbeds of venality and bloated inaptitude. Both the banking system and the business community are risk-averse and interest rates are still too high, despite recent reductions.

Still, left to its own devices, the country can gradually regain its position as the banking and commercial hub of the Middle East. With a deep rooted mercantile culture, a well-equipped coast line, a polyglot, highly educated and high income population, private media and connections to all the nations of the region due to its multi-ethic composition - Lebanon is a natural economic anchor as well as the role model for a democratic, liberal and pluralistic Arab world. It is also the natural export route for Middle Eastern oil.

Alas, this is but a pipe dream. Lebanon is largely a puppet state, remote controlled by members of the Syrian secret services and some of its politicians. Anti-Syrian lawmakers and businessmen are harassed on a regular basis, often under the pretext of a security agreement between the two countries. In a notorious case, a television station owned by Gabriel Murr, a Christian candidate, was silenced in September 2002 on flimsy legal grounds.

Syria's pernicious influence is all-pervasive. The Central Boycott Office in Damascus - set up by the Arab League in 1951 to blacklist all firms with operations or subsidiaries in Israel - moved to renew its activities. Lebanon is one of its members. Such trade restrictions will do nothing to lure sorely needed foreign direct investment to its battered economy. But it can hardly be expected to resist Syrian pressure to comply.

As recent demonstrations prove, many denizens feel that Syria should emulate Israel and unilaterally withdraw from Lebanon its 20,000 troops and agents - an "occupying force" according to American Secretaries of State, Colin Powell and Condolenzza Rice. Others are still wary of their southern trigger-happy neighbor and regard Syrian presence as a kind of insurance policy. As recently as September 2002, Israel again threatened war over the diversion of water from the Wazzani, a border tributary of the Hasbani river.

The Hizbullah - a militant, well-armed, trained, Iranian-sponsored, anti-Israeli and anti-American militia cum political party in the south - would be only too happy to partake in future skirmishes. It receives $100 million annually from Iran and Syria in cash and in materiel. In a patently suicidal interview on CBS television's 60 Minutes, Hassan Nasrallah, the leader of the Shiite Muslim militant group proffered this thinly veiled threat:

"American policies in the region encourage this kind of retaliation, whether we agree with it or not ... I believe the continuation of American policy will make enemies of all Arabs and Muslims - 1,400,000,000 Muslims around the world. Lots of groups will surface, not necessarily al-Qaida. And they'll be impossible to bring to justice."

The war in Iraq, though mercifully shorter than feared, is an added burden. In April 2003, Mustapha Nabli, the World Bank's Middle East Chief Economist, warned of collapsing tourism (a mainstay of the Lebanese economy), surging oil prices (Lebanon is a consumer, though Syria a producer), faltering trade in with Iraq (a crucial import destination and source of subsidized crude) and dwindling foreign direct investment. Central Bank first vice-governor and former economy minister Nasser Saidi believes that the conflict shaves 1 to 2 GDP percentage points off Lebanon's growth annually.

Lebanon's economy is heavily dependent on expat remittances. According to the Saradar Investment House quoted by the Lebanese Daily Star, these equal one seventh of its GDP and have been growing by a whopping one quarter every year. This, on average, is five times both the amount and growth rate of foreign direct investment in the country.

The entire banking system relies on these familial flows. Growth in remittances outweighed the increase in foreign currency deposits by two to one and amounted to more than triple the leap in non-resident foreign currency deposits. But a global slump - and an Arab recession - may send many Lebanese emigrants packing and render this fount of foreign exchange desiccated.

Desperate to extricate itself from the Middle East's surrealistic quagmire, Lebanon is looking to the European

Union. In June 2002 it joined the Euro-Mediterranean Partnership by signing an Association Agreement. It is thus eligible for free trade in industrial goods by 2010 and for cuts in tariffs and quotas till then. Lebanon runs a $3 billion trade deficit with the EU.

Nasser Saidi openly exhorts Arabs to resist American hegemony by teaming up with the Europeans. He reminds the EU that the Middle East is the origin of one third of its energy needs. He is all for the much proposed Euro-Mediterranean Investment Bank in conjunction with GAFTA the Greater Arab Free Trade Area and a World Bank-like EuroMed Investment guarantee Agency (EMIGA).

Saidi is representative of the philosophy of Lebanese civil servants and businessmen. But whether the EU is listening is another matter altogether. Patching up bruised relations with the USA may prove to be a higher priority and one that necessitates the sacrifice of Syria and its appendage, the nominally independent state of Lebanon.

Leisure and Work

In his book, "A Farewell to Alms" (Princeton University Press, 2007), Gregory Clark, an economic historian at the University of California, Davis, suggests that downward social mobility in England caused the Industrial Revolution in the early years of the 19th century. As the offspring of peasants died off of hunger and disease, the numerous and cosseted descendants of the British upper middle classes took over their jobs.

These newcomers infused their work and family life with the values that made their luckier forefathers wealthy and prominent. Above all, they introduced into their new environment Max Weber's Protestant work ethic: leisure is idleness, toil is good, workaholism is the best. As Clark put it:

"Thrift, prudence, negotiation and hard work were becoming values for communities that previously had been spendthrift, impulsive, violent and leisure loving."

Such religious veneration of hard labor resulted in a remarkable increase in productivity that allowed Britain (and, later, its emulators the world over) to escape the Malthusian Trap. Production began to outstrip population growth.

But the pendulum seems to have swung back. Leisure is again both fashionable and desirable.

The official working week in France has being reduced to 35 hours a week (though the French are now tinkering with it). In most countries in the world, it is limited to 45 hours a week. The trend during the last century seems to be unequivocal: less work, more play.

Yet, what may be true for blue collar workers or state employees - is not necessarily so for white collar members of the liberal professions. It is not rare for these people - lawyers, accountants, consultants, managers, academics - to put in 80 hour weeks.

The phenomenon is so widespread and its social consequences so damaging that it has acquired the unflattering nickname workaholism, a combination of the words "work" and "alcoholism". Family life is disrupted, intellectual horizons narrow, the consequences to the workaholic's health are severe: fat, lack of exercise, stress - all take their lethal toll. Classified as "alpha" types, workaholics suffer three times as many heart attacks as their peers.

But what are the social and economic roots of this phenomenon?

Put succinctly, it is the outcome of the blurring of boundaries between work and leisure. This distinction between time dedicated to labour and time spent in the pursuit of one's hobbies - was so clear for thousands of years that its gradual disappearance is one of the most important and profound social changes in human history.

A host of other shifts in the character of work and domestic environments of humans converged to produce this momentous change. Arguably the most important was the increase in labour mobility and the fluid nature of the very concept of work and the workplace.

The transitions from agriculture to industry, then to services, and now to the knowledge society, increased the mobility of the workforce. A farmer is the least mobile. His means of production are fixed, his produce mostly consumed locally - especially in places which lack proper refrigeration, food preservation, and transportation.

A marginal group of people became nomad-traders. This group exploded in size with the advent of the industrial revolution. True, the bulk of the workforce was still immobile and affixed to the production floor. But raw materials and finished products travelled long distances to faraway markets. Professional services were needed and the professional manager, the lawyer, the accountant, the consultant, the trader, the broker - all emerged as both parasites feeding off the production processes and the indispensable oil on its cogs.

The protagonists of the services society were no longer geographically dependent. They rendered their services to a host of geographically distributed "employers" in a variety of ways. This trend accelerated today, with the advent of the information and knowledge revolution.

Knowledge is not geography-dependent. It is easily transferable across boundaries. It is cheaply reproduced. Its ephemeral quality gives it non-temporal and non-spatial qualities. The locations of the participants in the economic interactions of this new age are transparent and immaterial.

These trends converged with increased mobility of people, goods and data (voice, visual, textual and other). The twin revolutions of transportation and telecommunications really reduced the world to a global village. Phenomena like commuting to work and multinationals were first made possible.

Facsimile messages, electronic mail, other forms of digital data, the Internet - broke not only physical barriers but also temporal ones. Today, virtual offices are not only spatially virtual - but also temporally so. This means that workers can collaborate not only across continents but also across time zones. They can leave their work for someone else to continue in an electronic mailbox, for instance.

These technological advances precipitated the transmutation of the very concepts of "work" and "workplace". The three Aristotelian dramatic unities no longer applied. Work could be performed in different places, not simultaneously, by workers who worked part time whenever it suited them best.

Flextime and work from home replaced commuting (much more so in the Anglo-Saxon countries, but they have always been the harbingers of change). This fitted squarely into the social fragmentation which characterizes today's world: the disintegration of previously cohesive social structures, such as the nuclear (not to mention the extended) family.

All this was neatly wrapped in the ideology of individualism, presented as a private case of capitalism and liberalism. People were encouraged to feel and behave as distinct, autonomous units. The perception of individuals as islands replaced the former perception of humans as cells in an organism.

This trend was coupled with - and enhanced by - unprecedented successive multi-annual rises in productivity and increases in world trade. New management techniques, improved production technologies, innovative inventory control methods, automatization, robotization, plant modernization, telecommunications (which facilitates more efficient transfers of information), even new design concepts - all helped bring this about.

But productivity gains made humans redundant. No amount of retraining could cope with the incredible rate of technological change. The more technologically advanced the country - the higher its structural unemployment (i.e., the level of unemployment attributable to changes in the very structure of the market).

In Western Europe, it shot up from 5-6% of the workforce to 9% in one decade. One way to manage this flood of ejected humans was to cut the workweek. Another was to support a large population of unemployed. The third, more tacit, way was to legitimize leisure time. Whereas the Jewish and Protestant work ethics condemned idleness in the past - the current ethos encouraged people to contribute to the economy through "self realization", to pursue their hobbies and non-work related interests, and to express the entire range of their personality and potential.

This served to blur the historical differences between work and leisure. They are both commended now. Work, like leisure, became less and less structured and rigid. It is often pursued from home. The territorial separation between "work-place" and "home turf" was essentially eliminated.

The emotional leap was only a question of time. Historically, people went to work because they had to. What they did after work was designated as "pleasure". Now, both work and leisure were pleasurable - or torturous - or both. Some people began to enjoy their work so much that it fulfilled the functions normally reserved to leisure time. They are the workaholics. Others continued to hate work - but felt disorientated in the new, leisure-like environment. They were not taught to deal with too much free time, a lack of framework, no clear instructions what to do, when, with whom and to what end.

Socialization processes and socialization agents (the State, parents, educators, employers) were not geared - nor did they regard it as their responsibility - to train the population to cope with free time and with the baffling and dazzling variety of options on offer.

We can classify economies and markets using the work-leisure axis. Those that maintain the old distinction between (hated) work and (liberating) leisure - are doomed to perish or, at best, radically lag behind. This is because they will not have developed a class of workaholics big enough to move the economy ahead.

It takes workaholics to create, maintain and expand capitalism. As opposed to common opinion, people, mostly, do not do business because they are interested in money (the classic profit motive). They do what they do because they like the Game of Business, its twists and turns, the brainstorming, the battle of brains, subjugating markets, the ups and downs, the excitement. All this has nothing to do with money. It has everything to do with psychology. True, money serves to measure success - but it is an abstract meter, akin to monopoly money. It is proof shrewdness, wit, foresight, stamina, and insight.

Workaholics identify business with pleasure. They are hedonistic and narcissistic. They are entrepreneurial. They are the managers and the businessmen and the scientists and the journalists. They are the movers, the shakers, the pushers, the energy.

Without workaholics, we would have ended up with "social" economies, with strong disincentives to work. In these economies of "collective ownership" people go to work because they have to. Their main preoccupation is how to avoid it and to sabotage the workplace. They harbour negative feelings. Slowly, they wither and die (professionally) - because no one can live long in hatred and deceit. Joy is an essential ingredient of survival.

And this is the true meaning of capitalism: the abolition of the artificial distinction between work and leisure and the pursuit of both with the same zeal and satisfaction. Above all, the (increasing) liberty to do it whenever, wherever, with whomever you choose.

Unless and until Homo East Europeansis changes his state of mind - there will be no real transition. Because transition happens in the human mind much before it takes form in reality. It is no use to dictate, to legislate, to finance, to cajole, or to bribe. It was Marx (a devout non-capitalist) who noted the causative connexion between reality (being) and consciousness. How right was he. Witness the prosperous USA and compare it to the miserable failure that was communism.

From an Interview I Granted

Question: In your article, Workaholism, Leisure and Pleasure, you describe how the line between leisure and work has blurred over time. What has allowed this to happen? What effect does this blurring have on the struggle to achieve a work-life balance?

Answer: The distinction between work and leisure times is a novelty. Even 70 years ago, people still worked 16 hours a day and, many of them, put in 7 days a week. More than 80% of the world's population still live this way. To the majority of people in the developing countries, work was and is life. They would perceive the contrast between "work" and "life" to be both artificial and perplexing. Sure, they dedicate time to their families and communities. But there is little leisure left to read, nurture one's hobbies, introspect, or attend classes.

Leisure time emerged as a social phenomenon in the twentieth century and mainly in the industrialized, rich, countries.

Workaholism - the blurring of boundaries between leisure time and time dedicated to work - is, therefore, simply harking back to the recent past. It is the inevitable outcome of a confluence of a few developments:

(1) **Labour mobility** increased. A farmer is attached to his land. His means of production are fixed. His markets are largely local. An industrial worker is attached to his factory. His means of production are fixed. Workers in the services or, more so, in the knowledge industries are attached only to their laptops. They are much more itinerant. They render their services to a host of geographically distributed "employers" in a variety of ways.

(2) The advent of the **information and knowledge revolutions** lessened the worker's dependence on a "brick and mortar" workplace and a "flesh and blood" employer. Cyberspace replaces real space and temporary or contractual work are preferred to tenure and corporate "loyalty".

Knowledge is not geography-dependent. It is portable and cheaply reproduced. The geographical locations of the participants in the economic interactions of this new age are transparent and immaterial.

(3) The **mobility of goods and data** (voice, visual, textual and other) increased exponentially. The twin revolutions of transportation and telecommunications reduced the world to a global village. Phenomena like commuting to work and globe-straddling multinationals were first made possible. The car, the airplane, facsimile messages, electronic mail, other forms of digital data, the Internet - demolished many physical and temporal barriers. Workers today often collaborate in virtual offices across continents and time zones. Flextime and work from home replaced commuting. The very concepts of "workplace" and "work" were rendered fluid, if not obsolete.

(4) The **dissolution of the classic workplace** is part of a larger and all-pervasive disintegration of other social structures, such as the nuclear family. Thus, while the choice of work-related venues and pursuits increased - the number of social alternatives to work declined.

The extended and nuclear family was denuded of most of its traditional functions. Most communities are tenuous and in constant flux. Work is the only refuge from an incoherent, fractious, and dysfunctional world. Society is anomic and work has become a route of escapism.

(5) The **ideology of individualism** is increasingly presented as a private case of capitalism and liberalism. People are encouraged to feel and behave as distinct, autonomous units. The metaphor of individuals as islands substituted for the perception of humans as cells in an organism. Malignant individualism replaced communitarianism. Pathological narcissism replaced self-love and empathy.

(6) The last few decades witnessed unprecedented successive **rises in productivity and an expansion of world trade**. New management techniques, improved production technologies, innovative inventory control methods, automatization, robotization, plant modernization, telecommunications (which facilitates more efficient transfers of information), even new design concepts - all helped bring workaholism about by placing economic values in the forefront. The Protestant work ethic ran amok. Instead of working in order to live - people began living in order to work.

Workaholics are rewarded with faster promotion and higher income. Workaholism is often - mistakenly - identified with entrepreneurship, ambition, and efficiency. Yet, really it is merely an addiction.

The absurd is that workaholism is a direct result of the culture of leisure.

As workers are made redundant by technology-driven productivity gains - they are encouraged to engage in leisure activities. Leisure substitutes for work. The historical demarcation between work and leisure is lost. Both are commended for their contribution to the economy. Work, like leisure, is less and less structured and rigid. Both work and leisure are often pursued from home and are often experienced as pleasurable.

The territorial separation between "work-place" and "home turf" is essentially eliminated.

Some people enjoy their work so much that it fulfils the functions normally reserved to leisure time. They are the workaholics. Others continue to hate work - but feel disorientated in the new leisure-rich environment. They are not taught to deal with too much free and unstructured time, with a lack of clearly delineated framework, without clear instructions as to what to do, when, with whom, and to what end.

The state, parents, educators, employers - all failed to train the population to cope with free time and with choice. Both types - the workaholic and the "normal" person baffled by too much leisure - end up sacrificing their leisure time to their work-related activities.

Alas, it takes workaholics to create, maintain and expand capitalism. People don't work or conduct business only because they are after the money. They enjoy their work or their business. They find pleasure in it. And this is the true meaning of capitalism: the abolition of the artificial distinction between work and leisure and the pursuit of both with the same zeal and satisfaction. Above all, the (increasing) liberty to do so whenever, wherever, with whomever you choose.

Libraries

"In this digital age, the custodians of published works are at the center of a global copyright controversy that casts them as villains simply for doing their job: letting people borrow books for free."
(ZDNet quoted by "Publisher's Lunch on July 13, 2001)

It is amazing that the traditional archivists of human knowledge - the libraries - failed so spectacularly to ride the tiger of the Internet, that epitome and apex of knowledge creation and distribution. At first, libraries, the inertial repositories of printed matter, were overwhelmed by the rapid pace of technology and by the ephemeral and anarchic content it spawned. They were reduced to providing access to dull card catalogues and unimaginative collections of web links. The more daring added online exhibits and digitized collections. A typical library web site is still comprised of static representations of the library's physical assets and a few quasi-interactive services.

This tendency - by both publishers and libraries - to inadequately and inappropriately pour old wine into new vessels is what caused the recent furor over e-books.

The lending of e-books to patrons appears to be a natural extension of the classical role of libraries: physical book lending. Libraries sought also to extend their archival functions to e-books. But librarians failed to grasp the essential and substantive differences between the two formats. E-books can be easily, stealthily, and cheaply copied, for instance. The source of the e-book - scanned printed titles, or converted digital files - is immaterial and irrelevant. The minute a title becomes an e-book, copyright violations are a real and present danger. Moreover, e-books are not a tangible product. "Lending" an e-book - is tantamount to copying an e-book. In other words, e-books are not books at all. They are software products. Libraries have pioneered digital collections (as they have other information technologies throughout history) and are still the main promoters of e-publishing. But now they are at risk of becoming piracy portals.

Solutions are, appropriately, being borrowed from the software industry. NetLibrary has lately granted multiple user licences to a university library system. Such licences allow for unlimited access and are priced according to the number of the library's patrons, or the number of its reading devices and terminals. Another possibility is to implement the shareware model - a trial period followed by a purchase option or an expiration, a-la Rosetta's expiring e-book.

Distributor Baker & Taylor have unveiled at the recent ALA a prototype e-book distribution system jointly developed by ibooks and Digital Owl. It will be sold to libraries by B&T's Informata division and Reciprocal.

The annual subscription for use of the digital library comprises "a catalog of digital content, brandable pages and web based tools for each participating library to customize for their patrons. Patrons of participating libraries will then be able to browse digital content online, or download and check out the content they are most interested in. Content may be checked out for an extended period of time set by each library, including checking out eBooks from home." Still, it seems that B&T's approach is heavily influenced by software licencing ("one copy one use").

But, there is an underlying, fundamental incompatibility between the Internet and the library. They are competitors. One vitiates the other. Free Internet access and e-book reading devices in libraries notwithstanding - the Internet, unless harnessed and integrated by libraries, threatens their very existence by depriving them of patrons. Libraries, in turn, threaten the budding software industry we, misleadingly, call "e-publishing".

There are major operational and philosophical differences between physical and virtual libraries. The former are based on the tried and proven technology of print. The latter on the chaos we know as cyberspace and on user-averse technologies developed by geeks and nerds, rather than by marketers, users, and librarians.

Physical libraries enjoy great advantages, not the least being their habit-forming head start (2,500 years of first mover advantage). Libraries are hubs of social interaction and entertainment (the way cinemas used to be). Libraries have catered to users' reference needs in reference centres for centuries (and, lately, through Selective Dissemination of Information, or SDI). The war is by no means decided. "Progress" may yet consist of the assimilation of hi-tech gadgets by lo-tech libraries. It may turn out to be convergence at its best, as librarians become computer savvy - and computer types create knowledge and disseminate it.

Liquidity

Large parts of the world today suffer from a severe liquidity crisis. The famed globalization of the capital markets seems to confine itself, ever more, to the richer parts, the more liquid exchanges, the more affluent geopolitical neighbourhoods. The fad of "emerging economies" has all but died out. Try telling the Macedonians about global capital markets: last year, the whole world invested 8 million USD in their poor country. Breadwinners earn 300 DM a month on average. Officially, in excess of one third of the workforce is unemployed. Small wonder that people do not pay their bills, employers do not pay salaries, the banking system has a marked tendency to crash every now and then and the average real default rate is 50%.

Illiquidity erodes the trust between the economic players. Such trust is a precondition to the existence of a thriving, modern economy. We all postpone the gratification of our desires: we save now and consume later, for instance or we sell goods or services and get paid a month later. Such postponement of gratification is at the heart of the economic machine of the new age. It cannot be achieved, however, if the players do not trust each other to fulfil their promises (to pay, for example). Alternatively, the state can instate an efficient court system, aided by active law enforcement agencies. Keeping promises can be imposed to counter the natural tendency to ignore them.

The countries in transition lack both: liquidity necessary to keep one's monetary word and the legal system to force him to do so if he reneges. Small wonder that solutions are actively being sought by all involved: the business community, the state, the courts and even by consumers.

In this article, we will describe a few of the global trends. The trends are global, the reaction is world-wide because the problem is global. Bouncing checks have become a household reality in places as rich as Israel, for instance. The mounting crisis in Southeast Asia foreshadows bankruptcies and delinquencies on a chilling scale.

The simplest method is to revert to a cash economy. Payments are accepted only in cash. This, naturally, slows the velocity of money-like products and diminishes their preponderance, obstructing the expansion of economic activity. An even more malignant variant is the barter economy. Goods and services are swapped on a no-cash basis. It is money that generates new value added (by facilitating the introduction of new technology, to mention but one function). In the absence of money, the economy stagnates, degenerates and, finally, collapses because of massive mismatches of supply and demand aggregates and of the types of goods and services on offer and demanded. Still, this system has the advantages of keeping the economic patient alive even following a massive liquidity haemorrhage. In the absence of barter economy, the economy might have ground to a complete halt and deteriorated to subsistence agriculture. But barter is like chemotherapy: it is good for a limited period of time and the side effects are, at times, worse than the disease.

In many countries (Georgia, to mention one) defaults are prevented by demanding prepayment for projected consumption. Let us take the consumption of electricity as an example: many heavy users and numerous households do not pay their bills at all. To disconnect the electricity is an effective punitive measure but it costs the electricity company a lot of money. The solution? Programmable Electronic Meters. The consumers buys a smart card (very similar to phone-cards). The card allows the buyer to use a certain amount of prepaid electricity and is rechargeable. The consumer pays in advance, electricity is not wasted, the electricity company is happy, the tariffs go down for all the users. Prepayment does have a contracting effect on the demand and usage of electricity - but this is welcome. It just means that people use electricity more efficiently.

A totally different tack is the verification approach. The person making the payment carries with him a card which confirms that he is creditworthy and will honour his obligations. Otherwise, the card also serves as an insurance policy: an entity, not connected to the transaction, guarantees the payment for a fee. This entity is financially viable and strong enough to be fully trusted by the recipient of the payment.

This market in credit guarantees is more developed in the USA (where credit cards have overtaken cash and personal checks as a mode of payment) than in Western Europe. But even in Europe there are credit card equivalents which are very widespread: the Eurocheck card, for instance, is really a credit card, though it usually comes with physical checks and guarantees only a limited amount. One must differentiate the functions of a debit card (with direct and immediate billing of a bank account following a transaction) from those of a credit card. The latter allows for the billing of the account to take place in a given day during the month following the month in which the transaction was effected or converts the payment into a series of instalments (within the credit limits of the cardholder as approved by his bank). But in both cases, the guarantee is there and is the most predominant feature of the system. Such cards seem like a perfect solution but they are not: the commissions charged by the card issuers are outrageous. Between 2 and 10 percent of the payment made go to the pockets of the card issuers. Cards get stolen, forged, lost, abused by their owners, expire. But with the advent of new technologies all these problems should be solved. Electronic POS (point of sale) cash registers, connected through networks of communication, check the card and verify its data: is it valid, is it presented by the lawful owner, was it stolen or lost, is the purchase within the limits of the approved credit and so on. Then, the billing proceeds automatically. Such devices will virtually eliminate fraud. The credit card companies will guarantee the payments which will be subject to residual crime.

Another fast developing solution is the smart card. These are cards similar to phone cards and they can be charged with money in the bank or through automatic teller machines. These cards (in wide use in Belgium, Austria, Germany and many other countries) contain an amount of money which is deducted from the cardholders account. The account is billed for every recharge. The card is the electronic (and smart) equivalent of cash and it can be read (=debited) by special teller machines in numerous businesses. When payment is made, the money stored in the card is reduced and the recipient of the payment stores the payment on magnetic media for later delivery to his bank (and crediting of his account).

A more primitive version exists in many countries in Eastern Europe: depositors receive checks exactly corresponding to the amount of money deposited in their account. These checks are as safe as the banks that issued them because they are fully convertible to cash. They are, really, paper "smart cards".

Credit cards and (more cheaply) smart cards are a way to restore confidence to a shattered, illiquid economy. Macedonia should consider them both seriously and encourage them through the appropriate legislation and assistance of the state. For Macedonia, the choice is to be liquid or, God forbid, to economically self-liquidate.

Macedonia, Economy of

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VAKNIN

I have often accused Trajko Slaveski, Macedonia's Minister of Finance, of mismanaging the economy. But, you got to hand it to him: he has a great sense of humor. On Saturday, August 16, 2008, he visited Bitola and made these announcements, hereby copied faithfully from MIA and Nova Makedonija:

"Инфлацијата во земјава е под контрола, изјави викендов министерот за финансии Трајко Славески во Битола, одговарајќи на новинарски прашања.
- Инфлацијата во јуни во земјава падна за еден процент, а што е поинтересно, во САД на пример таа порасна за еден процент. Последниве четири месеци имаме многу ниски месечни стапки. Од почетокот до крајот на годината стапката на инфлација ќе биде 3,2 отсто, а проекцијата беше таа да изнесува околу 5,5 проценти, што значи дека инфлацијата во Република Македонија е под контрола - истакна Славески, кој додаде дека во моментов во државниот буџет има суфицит, односно повеќе приходи од расходи.
Во врска со економскиот пораст во земјава и различните процени на Меѓународниот монетарен фонд (ММФ) и македонската влада, Славески рече

дека до крајот на годината се очекува порастот на бруто-домашниот производ да ја надмине проектираната стапка со ММФ и таа, според процени на Владата, да биде над шест проценти.
- Потребен е уште еден месец за да ги добиеме конечните показатели за порастот на бруто-домашниот производ во вториот квартал. Првиот квартал беше 5,1 проценти. Неофицијално, според последните анализи на податоците, во вториот квартал, до 30 јуни, бруто-домашниот производ ќе биде со нешто повисока стапка и очекуваме до крајот на годината да ја надминеме проектираната стапка со ММФ, која според нашите проекции ќе биде над 6 отсто - појасни министерот."

The Minister later responded to my request for clarification (to his credit, he always does). Apparently, he was misquoted. What he did say is that cumulative inflation being 3.2% in January-July, it looked as though the target of 5.5-6% annual inflation in 2008 is well on its way to being met.

It's uncanny how the government of Macedonia - alone in the whole world - gets all its predictions right, courtesy of the ever-pliant Bureau of Statistics here.

Moreover, the Minister, aware of the abysmal ignorance of both journalists and citizenry, manipulates public opinion by comparing oranges to apples: inflation in the USA is not the government's doing. It is the fault of the Central Bank there (the Federal Reserve). Inflation in Macedonia, on the other hand, is, in large part, an outcome of the government's outpouring of populist generosity. Its unbridled and irresponsible spending led to a wage spiral in the private sector, for instance. It also

failed to take steps to counter inflation imported from abroad through the prices of oil, electricity, raw materials, finished goods, and luxury items.
Consequently, Macedonia's trade deficit is among the highest in the world (and in history) and jeopardizes the country's macroeconomic stability.

As for the impressive growth in GDP - it is far less impressive when we realize that the economies of all the countries in the region have grown more or less by the same percentage. The British have a saying: "The incoming tide lifts all boats". When the economy grows (unexceptionally), the government takes credit. When something goes wrong with the economy, it is never their fault, the global economy is to blame.

More to the point, the growth in GDP, like much else in Macedonia is, to a certain extent, a mirage. It is fuelled by rampant construction, government outlays gone amok, and remittances from Macedonian Gastarbeiters. The real sector is no doubt expanding, but is far from making a sizable or lasting contribution in terms of gross factors of production.

Finally, the Minister brags that the government's budget is in surplus. Let me get this straight: the government takes 42% of GDP in taxes and then spends some of it on churches and basketball halls and media campaigns and it thinks that this gross misallocation of scarce economic resources deserves praise. With its all-pervasive economic presence, the government has transformed itself into Macedonia's biggest employer and advertiser. The private sector is crowded and cowed. There is no economy to speak of. Foreign direct investment (FDI) - touted as the panacea to the country's economic problems only two years ago - is now no longer the top priority, maybe because Macedonia last year has again been ranked as the least attractive in the region. A pretty picture this is.

DONCEV

Sam you don't spend much time on small talk - straight to the point. But before I respond to the many issues you have raised, let me just say for the record what an absolute pleasure it is for me to be engaged in this dialogue with you. I seem to recall that the last guy who had an open dialogue with you ended up as Prime Minister of Macedonia. Judging from the tone of your opening remarks though, it would seem that at least as far as you're concerned Macedonia passed the crossroads of ten years ago only to hit a dead end!

The economy has certainly been mismanaged, but I don't think Trajko Slaveski is entirely to blame in this case. He is not in an enviable position. The previous two Ministers of Finance (Popovksi and Gruevski) were both in a much stronger position in the sense that they had no higher political authority who was considered as an authority in economics. Now by this I am in no way making a judgment on the actual competence of Popovski and Gruevski as Ministers of Finance or ignoring the fact that they too had political masters, but it is fair to say that they both had a much freer hand to manage (or indeed mismanage the economy) than what Slaveski has today.

Slaveski is not in a strong position as Minister in the sense that he has Zoran Stavreski above him (who is stronger politically and considers himself as a higher authority in economics than Slaveski) and of course you have Prime Minister Gruevski of whom many in his

Government will tell you is the most brilliant economist in Europe. So Slaveski I am sure is conforming to the economic wishes of Stavrevski and Gruevski even in cases where he may disagree. In analyzing the performance of Macedonia's economy over the last two years we have to take into account the political dynamics between this troika, which has significant influence on the actual economic policy decisions that have been taken.

You know the old saying that there are lies, damned lies and statistics! The Macedonian Bureau of Statistics and Trajko Slaveski can quote whatever figure on inflation they want, but the one thing they cannot manipulate are the prices people pay for their goods and services. The Macedonian consumer knows very well the prices he is paying for basic goods such as bread, milk, eggs, meat, rice and cooking oil, compared to the prices two years ago. Indeed the prices of almost all goods and services have gone up to various degrees, and in almost all cases they have been well into double digits. Add to this the expected astronomical rise in the prices of electricity and heating. Measured properly, Macedonia's inflation rate for 2008 would be at least 12%.

Three observations I want to make here. First, at various stages of this year, different Ministers have quoted different rates of inflation ranging from the above mentioned 6% by Slaveski to 10% by Stavreski. It seems they can't even agree on the rate among themselves. Second, we have often heard the excuse throughout the year that inflation is high but it's imported. Macedonia has a fixed rate of exchange pegged to the Euro. This effectively means we import all our goods and services at a constant Euro rate. Thus by definition the inflationary effect from increased prices of imports cannot be higher in

Macedonia than that in the Euro zone. The 2008 Euro zone overall inflation rate is only 4%. Third, for the first time in the last ten years, we now have negative real interest rates (interest rates minus inflation rate) of at least 3%. The savings and wealth of Macedonia's citizens is being eroded every day. As people realize this effect, they shift their savings to consumption which in Macedonia's case also leads to a direct increase in the trade deficit.

Therefore, I concur with you that inflation in Macedonia is in large part, an outcome of the government's outpouring of populist generosity, and unbridled and irresponsible spending leading to a wage/price spiral. Over twelve months ago, I had the unfortunate experience to watch an interview on a television show which claims to represent the voice of the Macedonian people. Clearly amazed by the fact that the government had just announced significant increases to the public administration wages and the pensions of the senior citizens, the interviewer asked Gruevski if he was in fact the "Wizard of Oz"? If only it were so easy. If the history of economics shows one thing, it is that every time wages in a country are increased, and the increase is not as a result of increased worker productivity, inflation always follows!

I want to really expand on your final point. I think there is such a misconception among society at large (and in this regard I think the media in general have much to answer for) as to what the Budget actually represents. First of all, when you say that the government takes 42% of GDP in taxes, two things must be made clear. First, on average, 42% of the yearly income of every citizen goes to the government by way of all the direct and indirect taxes which exist in Macedonia. All these taxes are collected from the Private Sector in the economy. Second, it follows by definition that should the government choose to reduce its share of GDP to say 30% (by reducing the overall tax burden by 12%) the 12% reduction of the Government sector will result in a 12% increase in the Private Sector. The converse is true if the Government chooses to increase its share of GDP by raising the overall tax burden. This is in fact the "crowding out" effect you refer to. This is why it becomes almost laughable when Macedonian media report front page news that we have the lowest taxes in Europe.

From a macro economic point of view, the hundreds or thousands of individual taxes are only important insofar as they determine the overall tax burden on the Private Sector. (Of course individual taxes analyzed on a stand alone basis play an important role on the micro economic level of activity).

It thus becomes a real choice for society (through its elected leaders): Do we want a society which allocates a larger or smaller portion of the GDP of the country in the hands of the Government? And once that choice has been made, it then begs the second choice as to how we actually allocate the funds within the Budget itself? Do we spend it on churches, basketball halls and media campaigns as you say, or do we choose to build roads, schools and hospitals with the same funds? In this context, the self serving media campaigns of this Government (amounting to tens of millions of Euros) are in my opinion one of its
biggest sins.

A pretty picture indeed!

Alas, something happened on the tortured way from 1998 to 2008. Macedonians have become so downtrodden and destitute that they now knowingly choose to live in fantasy rather than face their dismal reality. It is a state of mass psychosis, a delusional hysteria, fostered by an endless stream of Big Brother advertisements and inane hype. People refuse to wake up and resent the few truth-speaking messengers left to the point of branding them "traitors".

And what is the truth?

(1) Macedonia's macroeconomy hasn't been in worse shape since 1996 and (2) This government has failed in literally all its efforts: geopolitical, political, and economic.

Admittedly, there have been some improvements in what Stavreski keeps calling "business climate": the introduction of streamlined taxation; the decrease in red tape and regulation (through the mechanism of "regulatory guillotine"); the (partial) implementation of a one-stop-shop process of company registration; and the reform of various business-related institutions (such as the Customs and the Cadastre). But the microeconomic sphere is subordinate to the macroeconomic climate. In an unstable environment of high inflation, for instance, business cannot thrive.

Zoran Stavreski is my biggest disappointment. While Nikola Gruevski is an outstanding and gifted manager, he is hardly an economist. Not so Stavreski, who used to be a conscientious and well-informed monetary expert. Yet, probably tempted by power and fame, he has transformed himself from a first-rate economist to a third-rate politician.

The government's new strategy: never admit to failure. Declare victory and retreat with dignity intact. Thus, they pretend that Macedonia's economic malaise is actually a sign of its growing economic health and an inevitable outcome of the government's sagacious and farsighted policies. The record-shattering trade deficit? Nothing to worry about: it is a mere reflection of growing foreign interest in Macedonia's industry. Inexorably rising inflation? A normal by-product of the meteoric growth of Macedonia's economy. Unemployment? Give it a decade or two and it, too, shall be conquered. Macedonia's failure to join NATO and the EU? Will only serve to attract foreign direct investors in the next four years up to accession.

Those who disagree with them are accused of getting paid either by the shady opposition or by Macedonia's enemies.

The government's attempts to re-write and revolutionize the economic sciences is probably a sign of desperation. But, the people at its helm also tend to believe and vehemently defend the veracity of their own propaganda claims. This is where the real danger lies. Gruevski, Stavreski, and Slaveski are not confabulators and con-men. They are self-deluded ideologues, trapped by their own verbosity.

Three cases in point: FDI (Foreign Direct Investment), labor productivity, and the trade deficit.

First, FDI. The government tells us that close to 240 million euros flowed into the country in the first 5 months of the year. This is the same as all of 2007.
Yet, close to 80% of this amount are in the form of acquisitions: foreign companies (mainly banks) buying Macedonian firms (mainly banks). This is meaningless FDI that has little effect on the domestic economy (though it does enhance the net worth of certain individual shareholders).

Moreover, economic studies demonstrate conclusively that foreign banks tend to do business with foreigners, not with local firms and that the profits they repatriate (the foreign exchange they take out of the country) exceed their initial investment.

But, what about the remaining 20%? We are still talking about 50 million euros!

Most of this money is invested in construction of objects such as shopping malls. What do shopping malls contribute to the economy? Zilch. Shopping centers are non-productive. They don't increase exports. They barely increase employment (except temporarily, during the construction phase). They do elevate the trade deficit (by importing goods) and inflation (by encouraging consumption). This is the wrong kind of investment.

How much new foreign money was invested in greenfield industry and manufacturing? A negligible amount. During the election campaign of 2008, the entire government embarked on a flying circus of sorts, signing up foreign companies and touting their achievements to a retinue of obsequious (and happy to travel free of charge) journalists.

What happened with these deals? Nothing. They were not real. Macedonia had signed numerous memoranda-of-understanding and memoranda-of-intent, but very few firm contracts. Bunardzik is still an empty lot.

Now, to labor productivity. In his by-now infamous column in Dnevnik, on August 29, Stavreski claimed that labor productivity in Macedonia, by some measure, has gone sharply up. Well, wrong again: it hasn't. Neither has the competitiveness of Macedonia's products improved. The prices paid for Macedonia's exports are going up, thus creating the optical illusion that exports are rising.

The average salary in Macedonia is c. 250 euros per month and the cost to the employer - what with wage taxes and contributions to the pension and health funds thrown in - is c. 420 euros. That translates to c. 5000 euros a year.

According to the IMF, Macedonia's GDP this year would be c. 8 billion USD (or 5 billion euros). The World Bank and the CIA largely agree with this estimate. That's 2500 euros per every Macedonian, man, woman, and child (=GDP per capita).

Of course, only 20% of Macedonia's population are employed, so GDP per employee is c. 15,000 euros (excluding the 10% of those who do not get paid).

How does it compare to other countries?

Start with the region.

Albania's and Bosnia-Herzegovina's GDP per capita are equal to Macedonia's, but rising fast with impressive flows of FDI. Bulgaria's and Serbia's are 40% higher. Croatia's is three times Macedonia's. But, since the rate of employment in Croatia is double that of Macedonia, a Croat worker produces only 1.5 times as much GDP as a Macedonian one. Every Greek, Czech, and Slovene worker is four times as productive as a Macedonian worker (these countries' GDP per capita is 8 times Macedonia's) while the Romanians are almost twice as plentiful and the Russian workers beat the Macedonians 1.7:1 (Russia's GDP per capita is 3 times Macedonia's).

Of course, such a comparison is unfair. The Czech average salary is 722 euros. We should, therefore divide the GDP per capita by the cost of labor. This is known as GDP unit labor cost.

Even then, Macedonian workers are spectacularly unproductive. The Macedonian costs 5000 euros a year and produces 15,000 euros of GDP annually. The Serb costs pretty much the same (c. 5300 euros a year), but produces 20,000 euros of GDP every 12 months. The Czechs, Greeks, and Slovene employees do even better: they each cost between 9000 euros (Czech Republic) and 20,000 euros (Greece) a year, but give in return 60,000 euros of GDP!

This disparity is one of the reasons why Macedonia is not an attractive destination for foreign direct investors. Salaries here are actually way too high. Judging by this meager output, to render it attractive, the average wage in

Macedonia should not exceed 50 euros a month, all included.

Are Macedonian workers lazier or more stupid than their counterparts elsewhere? Not so. Labor productivity does depend on the existence of a work ethic (longer hours and more effort and initiative). But, more importantly, it reflects the workers' level of education and skills, the age and quality of machinery and other capital goods and equipment used in the production process, the availability of knowledge and technology, and the proliferation of better management. Macedonia needs to work hard in all these spheres merely to catch up with the rest of the region, let alone the world.

The government can do a lot to render Macedonia a more attractive proposition as far as labor unit cost goes. It can reduce wage-related taxes and contributions drastically, or even waive them altogether for new employees. It took one halting step in this direction and leveraged it to the hilt for public relations purposes. This propensity to govern-by-gesture, to emphasize cosmetics over substance will be the undoing of the economy, I fear.

Finally, the trade deficit. It is a prime example of how populism (of previous governments as well as the incumbent one) trumped and trumps common economic sense.

There is only one path to reduce Macedonia's threatening trade deficit: to discourage imports. There are many ways to reduce imports. For starters, the government should correctly price items like electricity and fuel, which it is attempting to do. Subsidies need to be limited only to the neediest 10% of the population. Everyone else should pay much higher, realistic, global market prices.

Consider passenger cars - a major and recurrent components of Macedonia's burgeoning trade deficit. The government should make it very expensive to buy a new car and very attractive to keep a used one. Instead, the Ministry of Finance, eager to please the population and with an eye on the ratings of the governing coalition, spews out nonsense to justify its irresponsible acts. "New cars consume less fuel and need fewer spare parts", they say. True. But, a new car costs 10,000 euros, paid for with scarce hard currency. The savings that are the results of higher fuel efficiency do not amount, over the life of the car, to 10,000 euros.

Had this government been leading rather than following the opinion polls, it would have embarked on a campaign to encourage the use of public transport; would have cut the costs of owning and maintaining a used car; would have slapped punitive taxes and charges on buyers and owners of new passenger cars; and would have used remedies available to it under the WTO to impose import quotas and other duties, tariffs, and non-tariff (e.g., environmental) limitations on luxury, gas-guzzling vehicles.

Macedonians consume imported vegetables, imported chocolate, imported meat and dairy products; they buy imported "white electronics" and "black electronics"; they vacation outside the country, some of them in order to boast about it to their friends. A craze of conspicuous consumption has gripped this impoverished country that has no economy to speak of. Macedonians are living over and above their means and over and above their economic contribution to society. This will end badly: with a banking crisis, hyper-inflation, and massive indebtedness of both this profligate state and its gullible citizens, who want so much to dream and to fantasize.

DONCEV

I accept your assessment that Macedonians in general have become downtrodden and destitute. The words transition, reforms, EU and NATO have become a cognizant part of everyday life over the last fifteen years. Our lack of success in each of these fields has had a significant demoralizing effect on the nation as a whole. It seems at times that we are living through a never ending story whose plot is always the same, but the actors periodically change. However, I don't think that the Macedonian people knowingly choose to live in fantasy rather than face their dismal reality. I believe it is a failure of the leadership of the country and not of the people. One of my Harvard professors defined real leadership as "getting people to confront reality and change values, habits, practices and priorities to deal with the real threat or the real opportunity the people face". The converse of this he defined as counterfeit leadership which "provides false solutions and allows the group to bypass reality". I believe that the Macedonian people, deep down, are aware of the reality, but in the absence of real leadership that leads people to confront reality, they are left with no choice but to conform and fit in as best they can and thus bypass reality. And at no time have we had greater counterfeit leadership than by the existing populist government.

The Government's failures in its political and geopolitical efforts in particular are of course a subject for debate in themselves, but they have certainly played a significant role in increasing the political risk that potential foreign investors associate with Macedonia. This in turn greatly diminishes Macedonia as a destination for foreign investment.

Personally, I don't think the much touted improvements to the "business climate" have been anything more than window dressing. The much heralded so called "flat tax" is a gross misrepresentation of the truth. I have spoken out about this in Parliament and the media and to anyone who cares to listen, but for the record let me say it again. Macedonia does not have a flat tax! The tax rates are not the lowest in Europe! But this has not stopped the Government from paying expensive advertisements in foreign newspapers which proclaim the opposite.

Of course, any serious foreign investor who does basic level of due diligence on business in Macedonia quickly finds out that the tax rates are not what they were led to believe. In a debate in Parliament last December, I made an elaborate presentation which proves that Macedonia does not have flat tax. In fact the overall tax rate on wages varies from 38 to 40 percent on the gross wage, or, since every one in Macedonia is accustomed to the net wage concept, the overall taxes represent an add on of between 60 to 70 percent to net wages. The manner in calculating the overall taxes payable on wages is unbelievably complicated and antiquated.

So, the Government comes along and merely reduces one of the six components of calculating taxes on wages to 10% and then heralds with great fanfare that Macedonia now has a flat tax with the lowest rates in Europe. In his response to my speech, Trajko Slaveski said, and get this, that I was confusing personal income tax with contributions (to the pension fund, health fund, employment fund, etc). Now I should have said to him at the time, but I chose to be diplomatic then, that the Government can call these taxes a "contribution to Trajko Slaveski's Christmas cake" if it likes, but nothing changes the fact that they are taxes which business has to pay for every employee it has on its payroll. But this is the type of mentality we are dealing with here.

With regards to the trade deficit I have four additional observations. First it never ceases to amaze me how successive Governments in recent years have been quick to point out the virtues of Macedonia's increase in its exports. Prime Minister Vlado Buckovski started this trend in 2005 and it culminated in, as you say, in Zoran Stavreski's "by-now infamous column" in Dnevnik, on August 29, when he proudly proclaimed that exports have increased by 38% in 2008 (ohh and by the way imports also increased by 55% at the same time). The major reason why exports have increased dramatically over the last four years is because the price value of the exports have increased and not because of material increase in the quantity exported. The world has gone through a commodities boom over the last seven years culminating in record prices for commodities such as nickel, zinc, lead, and iron ore. At the same time oil had more than tripled when it climaxed at $147 per barrel in mid 2008. But because our commodity exports are in large part import dependant, the value of our imports has also increased parallel to the value of the exports. But the actual value added to Macedonia's economy has remained roughly the same.

A couple of examples will illustrate this point. OKTA imports oil and exports refined petroleum. The import value of oil reflected in Macedonia's Balance of Trade account has tripled over the last four years. At the same time the value of the refined petroleum exported has also more than tripled. Or take FENI INDUSTRIES or MAKSTEEL. They too produce import dependant exports. The value of their exports has increased several fold over the last few years, but so too has the value of their imports. But once again, the value added to the Macedonian economy has not been much different.

Second, the only reason why the absurdly large trade deficit has not yet resulted in a total meltdown of Macedonia's economy is because remittances from the Macedonian Diaspora and temporary Gastarbeiters have been steadily increasing over the last ten years. This is hardly something to be proud about and in no way represents a sustainable way to keep a country's economy going, but it has been the country's only saving grace to now. Bear in mind, total remittances in 2007 amounted to 1.4 billion dollars, or close to 20% of the country's GDP. This is mind boggling! In 2008 they are likely to be less than last year but will again be in excess of 1 billion dollars.

Thirdly, it is a truly amazing phenomenon how each successive government over the ten years has in a parrot like fashion repeatedly stated that it is their objective to have a fixed and stable rate of exchange. Thus we have had a fixed rate of exchange pegged to the Euro (and its Deutschemark predecessor) of approximately 61 Denars to the Euro. Any attempt to even debate the issue is usually linked to the period of 1990 to 1995 when Macedonia went through a period of hyper inflation and

repeated devaluation of its currency. Of course every time the government prints money, hyperinflation and devaluation will follow. But an exchange rate policy that takes into account the economy's competitive environment and is designed to maximize exports and reduce imports should not
in any way be confused to the phenomenon which occurred in the early part of the last decade.

Finally, the growing balance of trade deficit over the last several years (and the last two years in particular) has been exasperated by the rapid growth of credit over the same period. As people's perception of the stability of the Macedonian banking sector has improved and as the memories of the late 80's early 90's begin to fade (when citizens lost vast amounts of their saving when the Yugoslav banking sector collapsed), the citizens of Macedonia have began to place more and more of their savings (which they previously held as Euros "under the mattress") on deposit with the Banks.

Normally this would be a fantastic opportunity for the economy if it was geared for investment. Unfortunately it is geared toward consumption, and as a result there has been an explosion in the growth of credit over the last few years. A large number of families with no savings of their own have taken out loans. This trend is visible even in farming villages.

This credit formation process has led to a credit fuelled consumption as people take out loans to finance current expenditure. Since the economy is incapable of meeting the increased consumption demand internally (paradoxically of course, owing to the lack of prior investments in the economy's productive capacity) the increased consumption demand has resulted in the ballooning of the balance of trade deficit.

We have painted a grim picture. Some may think it's malicious, some may think it's too pessimistic, some may refute it. The easiest thing to do is to ignore it. But ignorance does not change reality. How our leaders choose to lead the people to confront this reality will also determine the policy measures taken to remedy the situation with an aim to genuinely improve the economic condition of all citizens in Macedonia. You have given a fairly grim prognosis of how you think this will all end - with a banking crisis, hyper-inflation, and massive indebtedness of both the profligate state and its citizens.

I should like to hope that we will sooner, rather than later, get leadership at the helm of the country that will not be as concerned with its rating as it is with the wellbeing of the country's citizens. Confronting reality requires in some instances policies that are far from populist. Some policies will actually cause more pain in the short term. But close to twenty years of "transition and reform" have already passed and we are witnessing its fruits today first hand.

Something is rotten in the State of Denmark - but not hopeless!

Western pressures, mainly the EU's and NATO's, yielded an agreement between Macedonian and Albanian political parties regarding the future of Macedonia. But such an agreement is bound to be rejected by both Macedonians and Albanians who already deeply distrust both their own politicians and the West. In the medium term this may lead to vigilantism and sporadic fighting and atrocities by paramilitary groups.

The strong anti-Western sentiment is unlikely to deter foreign direct investment by Greek firms. But it is likely to give U.S. and Western European investors pause. Manufacturing contracts awarded by foreigners to the Macedonian textile industry have been cancelled. A major investment in a shopping mall has been frozen. Capital flight - at this stage mainly in the form of Macedonian export firms avoiding the repatriation of their export proceeds - is taking hold.

Macedonia's central bank, the NBRM, has used more than $100 million of its pre-crisis $700 million in reserves to defend the currency, which has depreciated by 10 percent against all major currencies since February.

There is no panic buying, but hard currency is hard to come by. The Macedonian banks have rationed foreign exchange sales and the numerous exchange offices are only buyers. The spreads between the sale and purchase prices of foreign exchange have widened considerably. Still, the demand is not driven by households, but by the economy's corporate behemoths, such as its oil refinery, Okta, and its largest bank, Stopanska Banka.

As both exports and imports have fallen as much as 20 percent, Macedonia's financing gap in its balance of payments has grown from nil to $65 million (about 2 percent of gross domestic product). Even this figure is based on optimistic scenarios regarding GDP growth (+2.5 percent) and inflation (4 percent). Should the country deteriorate in to civil war, negative growth will be the likely outcome.

Four weeks of negotiations with the IMF regarding Macedonia's future arrangement were broken when the visiting mission was recalled to Washington due to safety considerations. Talks are to resume in mid July. The parties are very close to an agreement, but it still can be jeopardized by an escalation in the war.

The country's reformist Minister of Finance, Nikola Gruevski, is hoping to obtain the funds to close the financing gap in a donor conference at the end of July. But with Macedonia now being gradually cast by the West as the intransigent and belligerent party, this hope may prove to be unfounded.

In the conference of EU ministers of foreign affairs in Luxembourg on June 24, Macedonia was explicitly threatened with the withholding of EU aid unless it ceases all military operations against Albanian insurgents. The United States is also lukewarm.

Still, Macedonia's economy is holding together surprisingly well. Its currency is pretty stable. Its foreign exchange reserves equal 3 months of imports. Foreign investment is flowing in. The budget deficit is likely to be about 6.5 percent of GDP following a 0.5 percent financial transactions tax levied as of July 1 and projected to yield about 2 percent of GDP in added revenues. The overall tax burden is a reasonable 37 percent, and all manner of taxes - from the personal income tax to the corporate profits tax - have actually been reduced lately, concurrent with the introduction of a 19 percent Value Added Tax. The revenue side of the budget is hurting, but the government has a cushion of about 9 billion Macedonian Denars ($180 million) deposited with the central bank and about 700 million deutschemarks ($320 million) - the proceeds from the sale of the local telecoms company to Hungary's MATAV. Moreover, tax collection in western Macedonia - the fighting zone - has anyhow always been insubstantial.

The absurdity is that the economy may actually revive owing to the heavy, expansionary, military outlays by both the Macedonian security forces and NATO. But this is far outweighed by the economic disruption caused by 60,000 refugees and 30,000 internally displaced persons, which costs the government about $6 per capita per day. It is a burden the government cannot carry for long without sharing it with the international community.

Macedonia has always been an economic dependency. Even in the clunky Yugoslav Federation, Macedonia (one of Yugoslavia's republics) subsisted on transfers from Belgrade, sometimes amounting to 40% of its GDP. Similarly, international aid and credits often made up 10% of GDP in Macedonia's first decade of independence (1991-2001).

Macedonia is on its way to yet another (and much postponed) donor conference. Donor conferences are charades. They consist of photo opportunities for donor and recipient politicians signing agreements sealed long beforehand. But even as charades go, the existence of an IMF arrangement with the needy country was hitherto considered a sine qua non.

Yet, Macedonia has no such arrangement. It is under IMF "staff monitoring". This means that it may apply and even qualify for stand-by loans - but also that its finances are in disorder. The victim of seriatim external shocks (transition, reluctant independence, embargoes, wars, and, lately, a civil war) - Macedonia's economy is in disarray. Social tensions are rising both due to a long overdue restructuring of Macedonia's obsolete industry and to the shameless corruption that permeates every government organ and state-owned enterprise.

In the last two years, Macedonia has re-written most of its economic laws. It has started to implement anti-money laundering measures. It has dismantled the venal payment system and privatized it to the banks. It has rationalized its tax system and introduced VAT. It has shut down or sold most of the industrial loss-makers. It has sold Macedonia's largest commercial bank to the Greeks and its telecom to MATAV. It has applied to join the WTO and plans to join CEFTA. It is in the throes of modernizing its capital markets. It deserves the $228 million it would like to get (and the $173 million promised).

The money is supposed to plug Macedonia's financing gap - and, thus, be out of the reach of avaricious politicians. Yet, money is a fungible commodity and Macedonia has squandered a lot of the international aid and credit it has received - not least by installing in power one kleptocracy after another.

Only $36 million out of $120 million disbursed for the construction of a railway line were traced in September 2001. No one was able to tell what happened to the rest. In another celebrated case, the former Minister of Defense, Paunovski, absconded with 13 million DM of the Ministry's funds. Having been accused of as much on state television by the Prime Minister - he retorted by threatening to expose the latter's alleged corruption in the privatization of the nation's only oil refinery, Okta. Paunovski resigned but was never persecuted. An audit team dispatched by the Ministry of Finance meekly went nowhere.

Macedonia deserves any help it can get. But flooding it with poorly supervised and poorly monitored funds only serves to enrich its politicians. Many Macedonians believe that this, precisely, is the intention of the West and that the donor conference is a massive backhander. The receipt of the funds was explicitly tied to political and constitutional concessions - and never conditioned on structural reforms. The IMF's departing (and often bravely and unusually outspoken) Chief of Mission, Biswajit Banerjee, has distanced himself from the conference.

Yet, even the most avid disciplinarians understand that Macedonia might collapse without these funds. It has an enormous trade deficit (close to $600 million - or 15% of its GDP), the result of an overvalued currency. It cannot rectify this by devaluing the denar because inflation is rearing its ugly head again. The monetary pillar of Macedonia's policy of economic stabilization far outweighs its fiscal pillar.

Moreover, in a year of early elections (the latest date bandied about is June 30) - budget discipline is likely to suffer. For a few scary months last year, Macedonia's budget deficit reached 9% of GDP (it later settled around 5-6%, saved by a reluctantly introduced "war tax" levied on all financial transactions). Tax collection is tottering as more than 26,000 firms (the majority of all active companies) have become insolvent. Macedonia has almost double the average private sector credit default rate among countries in transition.

Macedonia is asking for $65 million to plug the gap in its balance of payments, another $63 to reverse the effects of the civil war (which many observers fear is about to start again), $40 million for reconstruction, and $23 to cover expenses associated with the implementation of the Ohrid Framework Agreement. Some of this money has been already (and irresponsibly) advanced by the EU (mainly by the Netherlands). The World Bank will help with funds to ameliorate the social effects of the industrial devastation wrought by the transition (the latest loss-maker to be shuttered this week is "Jugohrom"). The EBRD and the IFC plan to establish a microcredit bank.

Macedonia can use all the help it can get. But effective help is predicated on circumventing Macedonia's hopelessly crooked politicians and bankers and on the strict and micromanaged enforcement of good governance clauses. Alas, the donors are so eager to prevent another conflagration that they are ignoring these important caveats. In doing so, they foster further instability. The lesson learned by Macedonia's unscrupulous decision makers may well be that conflict, war, and terrorism pay handsomely.

In the near past, Macedonia seemed to have been bent on breaking its own record of surrealism. While politicians in other countries in transition from communism and socialism strive to be noticed for not stealing, their Macedonian counterparts, without a single exception, aim to steal without being noticed.

The previous VMRO-DPMNE government (1999-2002), in which Gruevski served as Minister of Finance, plundered the country shamelessly. The local papers accused then outgoing prime minister, Ljubco Georgievski - a virtual pauper when he attained power - of owning land and a residential building in the capital's most expensive neighborhood. The erstwhile Minister of Defense, Ljuben Paunovski, was recently sentenced to 42 months in prison for his pecuniary shenanigans during his tenure. Another leading figure, the former Minister of interior, Ljube Boskovski, is in the dock in the Hague on war crime charges.

Inevitably, VMRO-DPMNE lost power to the SDSM in the heated elections of 2002 and then fractured as its new leader, Gruevski, purged the old guard and installed his own cohorts everywhere.

Then prime minister designate, Branko Crvnkovski (the country's current President whose legitimacy is contested by the Gruevski government), vowed to learn from his party's (SDSM) past mistakes when they venally ruled the land until 1998. In a sudden and politically-motivated resurrection, the high court began scrutinizing the "Okta" deal: the opaque sale of the country's loss-making refinery to the Greeks in 1999. Heads will roll, promised both the election victors (the SDSM) and their Western sponsors. Nothing happened.

The country's current Governor of the Central bank and then minister of finance, Petar Goshev, a former socialist high-level functionary known for his integrity, announced that his top priority would be to eradicate corruption by instituting structural and legal reforms. His newfound socialist partners - he headed a center-right outfit - found this bizarre ardor unpalatable and promptly kicked him out of office.

Four years later, with Georgievski relegated to the political wasteland, Crvnkovski ensconced in the presidential suite, and his successor, Buckovski a resounding failure, Gruevski's ascent in 2006 was all but secure. It was the SDSM's turn to crumble acrimoniously amid a virulent contest for its leadership. It has never recovered and Macedonia has had no viable opposition ever since.

Macedonia's post-electoral euphoria faded, in July 2006, into arduous coalition-building negotiations replete with arm-twisting by the worried representatives of the "international community".

The country's new VMRO-DPMNE Prime Minister, Nikola Gruevski (36), excluded from his government the party that won the majority of Albanian votes because of its roots in the much-hated Albanian NLA, National Liberation Army, the instigator of the 2001 near-civil-war. Albanian factions clashed in a chilling reminder of the country's inter-ethnic fragility.

To add to Macedonia's precarious standing, its greenhorn Minister of Foreign Affairs, Antonio Milososki, engaged in intermittent - and utterly avoidable - spats with its neighbor and biggest foreign investor, Greece, virtually guarantee delayed accession to both NATO and the European Union, the much ballyhooed strategic goals of the current administration. Milososki adopted a similarly belligerent and ill-informed stance against Bulgaria, another flanking polity and the newest member of the coveted European club.

Where the government claims great strides is in its uncompromising stance against all forms of malfeasance and delinquency in both the public and the private sectors. From the army to various municipalities, scandals erupt daily in an atmosphere often bordering on a frenzied, media saturated, witch-hunt.

Gruevski is alleged to have rejected a bribe of 3 million euros (c. 4 million USD) offered to him by a Serb firm. His government embarked on highly publicized campaigns against illegal construction (the "urban mafia") and other festering nests of corruption.

Alas, Gruevski himself appointed members of his family and innumerable political hacks to senior government positions in a series of blatant acts of nepotism and cronyism decried by the European Union and other watchdogs. Consequently, with one exception (Zoran Stavreski, the talented vice-premier), the government in all echelons is largely made up of utterly inexperienced operators. Plus ca change.

Politics, venality, and terrorism are the sole venues of social mobility in this tiny, landlocked, country of 2 million impoverished people. Immediately following their insurgency, the former terrorists of the Albanian National Liberation - courtesy of Western pressure and the Albanian voters - occupied crucial ministries with lucrative opportunities of patronage of which they are rumored to have availed themselves abundantly.

Comic relief is often provided by bumbling NGOs, such as the International Crisis Group. In 2001, its representative in Macedonia, Edward Joseph, went to Prilep to conduct an impromptu investigation of the thriving cigarette smuggling trade. Posing to the cameras he declared that only the local leaf-rolling plant was not involved in this pernicious line of work.

Macedonia is a hub of expats and consultants in the Balkans. Ante Markovic, an Austria-based former Yugoslav prime minister, who served as an oft-criticized economic advisor to the government until he was dumped, sued Macedonia for $1 million. In 2001-3, the youthful former minister of finance, Nikola Gruevski, was asked by USAID, on behalf of the Serbian-Montenegrin government, to serve as its consultant on matters of reform of the financial system. The author of this article acted as Economic Advisor to Georgievski's government and, later, to Gruevski himself.

But to no avail. The country is a shambles. In the wake of a civil war, the official unemployment rate is 31-35 percent. Close to 70,000 people work in the bloated central and local administrations. The trade deficit is an unparalleled 17 percent of GDP. In 2001, the budget deficit climbed to 5 percent, though it was since halved.

"The Heritage Foundation" has consistently ranked Macedonia 95-97 out of 155 countries in terms of economic freedom. The country is "mostly unfree" it correctly concludes in its reports, though it cites sometimes erroneous data. A moderate level of trade protectionism, low tax rates, moderate inflation, a moderate burden of the government, moderate barriers to capital flows and foreign investment, and moderate interference in the economy are offset by a dysfunctional banking system, intervention in wages and prices, low level of protection of property, a high level of regulation, and a very high level of activity of the black market.

Owing to the IMF's misguided emphasis on exchange rate stability, the currency is inanely overvalued. The manufacturing sector has all but evaporated. Industrial production declined by a vertiginous 20 percent in August 2002 compared to the average the year before - or by 11 percent year on year. The trend has not been reversed since.

Macedonian steel is exempt from the latest bout of American protectionism, but not so its textile industry. Europe is fending off the country's agricultural products. People make their meager and desultory living catering to the needs of an ever-expanding international presence or dabbling in illicit activities. Piracy of intellectual property, for instance, is thought to yield c. 1 percent of GDP.

Close to half the population is under the poverty line. The number of welfare cases increased by 70 percent between 1994 and 2002. Generous and incessant multilateral and bilateral credits sustain the faltering economy (and line politicians' ever-deepening pockets). The country is alternately buffeted by floods and droughts. There has been only one day of rain in all of January 2007.

In a much-touted donor conference after the 2001 skirmishes, the pledges amounted to a whopping 15 percent of GDP. Then governor of the central bank, Ljube Trpski (currently detained for his role in a murky affair involving the country's foreign exchange reserves), cheerfully predicted that these handouts will cover the gaping hole in the balance of payments.

Macedonia also received 7.5 percent of the gold reserves of the former federated Yugoslavia of which it was a component. At between $700 million and one billion USD net, foreign exchange reserves are at an all-time high. Macedonia has recently decided to prepay its $104 million debt to the Paris Club creditors.

Both the IMF and the World Bank, who did their best to obstruct the previous VMRO-DPMNE government in its last few months in power, promised a speedy return to business as usual. An hitherto elusive standby arrangement is likely to be concluded by the end of the year. World Bank funds, frozen in material breach of its written contracts with the state, will flow again. The EU promised development funds if the new government acts in a "European spirit" - i.e., obeys the diktats of Brussels.

The incoming administration is likely to enjoy a period of grace with both the trade unions and international creditors. Strikes and demonstrations by dispossessed miners and underpaid railways workers have waned. But Macedonia joined the WTO in 2002 and will thus be forced to open even more to devastating competition. Labor unrest is likely to re-erupt soon.

Foreign investment in the country mysteriously wanes and waxes - some of it laundered money reinvested in legitimate businesses. The government is doing a great job of building up the image of Macedonia as an FDI (Foreign Direct Investment) destination. But public relations and perceptions management must be followed by palpable actions and the new government is woefully short on concrete steps. It talks the talk but hitherto does not walk the walk.

The government's attempts to attract foreign investors by introducing lower taxes may backfire: studies clearly evince that multinationals worry less about taxation and more about functioning institutions, a commodity that Macedonia is irreparably short of. Moreover, vanishingly lower taxes signal desperation and Macedonia indeed sounds more desperate than confident. No one wants to buy the country's leading bank, long on offer. Only one contender (Mobilkom Austria) entered a bid for Macedonia's third operator cellular network licence.

On a few occasions, domestic firms, using international fronts, have bid for local factories, such as the textile plant "Astibo". The national payment card project has been guzzled by two banks incestuously close to the outgoing ruling party, VMRO-DPMNE.

But there are real investments, too. The capital's central heating utility was purchased by a unidentified French energy outfit, announced the general manager. The utility's shares were listed in the Athens stock exchange. The Macedonian construction firm "Granit" will build a $59 million highway in Ukraine, with which Macedonia enjoyed an unusually cordial relationship, to American chagrin. Johnson Controls and others are eying a string of free trade zones and infrastructure projects (dams, roads, railways, oil pipeline). A much hyped Vardar Silicone Valley is in the works.

The contentious census in the first two weeks of November 2002, a part of the "Ohrid Framework Agreement" which ended the internecine fighting the year before, was conducted fairly. The count showed that Albanians make c. one quarter of the population rather than one third, as most Albanians spuriously insisted.

But, with Kosovo's independence looming across the border, the restive Albanians are likely to coerce the enfeebled Macedonia into translating this numerical reality into political and economic clout. The Macedonians are likely to resist. The West will intervene. Macedonia is facing a hot spring and a sizzling summer in 2007.

Macedonian steel is exempt from the latest bout of American protectionism, but not so its textile industry. Europe is fending off the country's agricultural products. People make their meager and desultory living catering to the needs of an ever-expanding international presence or dabbling in illicit activities. Piracy of intellectual property, for instance, is thought to yield c. 1 percent of GDP.

Close to half the population is under the poverty line. The number of welfare cases increased by 70 percent between 1994 and the present. Generous and incessant multilateral and bilateral credits sustain the faltering economy, recently buffeted by floods.

In a much-ballyhooed donor conference, the pledges amounted to a whopping 15 percent of GDP. The governor of the central bank, Ljube Trpski, cheerfully predicted that these handouts will cover the gaping hole in the balance of payments. Macedonia also stands to receive 7.5 percent of the gold reserves of the former Yugoslavia of which it was a component. At c. $700 million net, foreign exchange reserves are at an all-time high.

Both the IMF and the World Bank - who did their best to obstruct the previous government in its last few months in power - promised a speedy return to business as usual. An hitherto elusive standby arrangement is likely to be concluded by the end of the year. World Bank funds, frozen in material breach of its written contracts with the state, will flow again. The EU promised development funds if the new government acts in a "European spirit" - i.e., obeys the diktats of Brussels.

The incoming administration is likely to enjoy a 100 days of grace with both the trade unions and international creditors. Strikes and demonstrations by dispossessed miners and underpaid railways workers have waned. But Macedonia joined the WTO last month and will be forced to open even more to devastating competition. Labor unrest is likely to re-erupt soon.

Foreign investment in the country has mysteriously increased - some of it laundered money reinvested in legitimate businesses.

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Macedonia is now preparing for a contentious census in the first two weeks of November. It is part of the "Ohrid Framework Agreement" which ended the internecine fighting last year. If fairly conducted, the count is likely to show that Albanians make c. one third of the population rather than one quarter, as most Macedonians spuriously insist.

The restive Albanians are likely to coerce enfeebled Macedonia into translating this numerical reality into political and economic clout. The Macedonians are likely to resist. The West will intervene. Macedonia is facing a hot spring and a sizzling summer.

1. How Big is the Macedonian Market?

a. 2 million consumers
b. 10 million consumers
c. 20 million consumers
d. 60 million consumers

Most People answer…

2 million consumers

WRONG!!!

Through its well developed and growing system of symmetrical and asymmetrical array of free trade agreements – Macedonia gives you direct access to well over 600 million consumers in the region – from Turkey to Slovenia.

2. What is Macedonia's Biggest Market?

a. Former republics of Yugoslavia and especially the Federal Republic of Yugoslavia
b. The European Union and especially Germany and Greece

c. Turkey and the Arab World
d. Central Europe

Most People answer…

The former republics of Yugoslavia and especially the Federal Republic of Yugoslavia.

WRONG!!!

Macedonia's biggest market by far – almost 60% of its trading volume, both exports and imports – is the European Union. Its position is comparable to the Czech Republic in that more than 75% of its international trade is conducted with either the European Union or with the USA.

3. Macedonia's GDP Per Capita is…

a. 700 US dollars
b. 1,100 US dollars
c. 300 DM
d. Almost 2,000 US dollars

Most people answer…

About 700 US dollars.

WRONG!!!

Even in 1998, Macedonia's GDP per capita was 1,865 US dollars per capita. Adjusted to purchasing power (PPP) and taking into consideration the informal sector of the economy – Macedonia's GDP per capita is probably c. 5,000 US dollars per annum.

By comparison – the Czech Republic non-PPP adjusted GDP per capita in 1998 was also 5,000 US dollars.

4. Macedonia's Level of Corruption is…

a. Exceedingly high
b. Very high
c. Like South Europe
d. Like Africa

Most people answer…

Very high.

WRONG!!!

According to Transparency International, Macedonia's level of corruption is MEDIUM (66th place out of 99 countries in its 1999 report), below many countries and even below some members of the European Union. It has one of the lowest rates of violent crime and property crimes in the world – though, unfortunately, property crimes and drug-related crimes are on the rise as modernization proceeds apace.

5. The Level of Wages in Macedonia is…

a. Very high, comparable to the European Union
b. Very low, comparable to Africa
c. Comparable to other countries in transition
d. Comparable to other developing countries

Most people answer…

Comparable to other developing countries.

WRONG!!!

Macedonia's workforce – one of the most well educated in the countries in transition – is much cheaper in RELATIVE terms than the workforce in other countries in transition. The average salary in Macedonia is comparable to most other countries in transition and is around 400 euros a month. BUT, the productivity of the Macedonian worker, as measured by GDP per worker is much higher. Macedonia produces (without the informal sector of the economy) c. 3.5 billion euros a year with c. 350,000 active workers. This is c. 10,000 euros per worker. The salary paid to a Macedonian worker constitutes, therefore, 20% of his product.

6. Macedonia is…

a. Investor friendly
b. Investor averse
c. So-so, not different to other countries in transition
d. Investor indifferent

Most people answer…

Investor averse.

WRONG!!!

Investors ignored Macedonia mainly if not only because of geopolitical external shocks. Despite this, Macedonia succeeded to attract almost 200 million US dollars in 1997-8 only. Another 200 million were invested in 1999, the year of Kosovo and the refugee crisis. Macedonia is the first to have legislated a law for free economic zones and it has an impressive array of tax and investment incentives in place. By implementing a one-stop shop concept, it is doing its utmost to isolate the prospective investor from red tape and potential official corruption. It is gradually but steadily injecting added transparency into the investment and procurement processes. And it is transforming itself into a free trade hub and the axis of a regional free trade zone in conjunction with its neighbours with which it is now on historically unprecedented friendly terms.

7. Property Rights in Macedonia are…

a. Non existent
b. Poorly developed and protected
c. Like in all other countries in transition
d. Adequately developed and protected

Most people answer…

Poorly developed and protected.

RIGHT!!!

Despite the fact that Macedonia has a fine legislative infrastructure, its courts and its bureaucrats, its banking system, its collateral system and its property registrars are all poorly developed and dysfunctional to varying degrees.

This is a top priority of the last few administrations. Legislation is adapted, law enforcement agents – especially judges – are educated, mortgage registration, collateral registration, company registrars – all is being revamped. The aim is to provide investors with maximal protection of their rights and property.

Today the main problem is not securing property rights or due process. The main problem is the DELAY, the TIME LAG and the BACKLOG in doing so. This is an improvement over the past – but it is still a sorry state.

Still, Macedonia being the small and informal country that it is, the office of every minister and every civil servant is open to investors, who are provided with unparalleled access to the highest level of government.

Moreover: Macedonia never had problems of currency convertibility, repatriation of profits or investments or default. Its debt is medium by international standards (60% of GDP, most of it long term and to multilateral and international financial institutions). It has 9 months of imports in foreign currency reserves. Its debts are trading at 75% of their face value – better than most developing countries, a sign of international confidence in its obligations. It has recently become only the second country in the world to prepay its Paris Club debts.

8. Macedonia's Infrastructure is…

a. Decrepit and inadequate
b. Like in other poor countries
c. Sufficient but not well maintained
d. Excellent

Most people answer…

Like in poor countries.

WRONG!!!

Don't forget that Macedonia was a part of one of the most sophisticated markets in the world – the Former Yugoslav Federation. Its infrastructure is insufficient and often badly maintained – but not uniformly so. Some types of infrastructure are highly developed, even by European standards. For instance, there are more than 100,000 mobile phone subscribers in a workforce of less than 750,000 people. Macedonia has one of the most developed wireless networks in Europe – it far surpasses the systems of Central Europe. It is rich in electronic media. The Internet is gaining ground though penetration is still low. It has a few German-quality autobahns – connecting Macedonia to its neighbours and, in a few years, to every country in Europe, West and East.

9. Macedonia is Isolated and in a War Zone

No American multiple choice here.

Yes, Macedonia is situated in a turbulent area.

But it is also an area bigger and more naturally endowed than Central Europe.

And - with the exception of the skirmishes with a segment of its Albanian minority in 2001 - Macedonia has never been involved in any war activities.

It has always been an island of stability and smooth democratic transition.

It hasn't been isolated for years now. Its neighbour Greece is one of its greatest trading partners and investors. Its other neighbour Bulgaria has signed with it a series of economic collaboration agreements, including a free trade agreement.

With the advent of the reconstruction of the Balkans, Macedonia is a uniquely positioned multi-ethnic society, with Albanians and Macedonians in its government. Trusted by all its neighbours, it is bound to become a pivotal player in the stability and growth of this part of the world.

10. Macedonia's Orientation is Not Clear

It has always been the same:

- Prosperity
- Growth
- Opportunities
- Achievements
- Happiness

All these come today bundled with democracy and one model or another of free market economy.

Macedonia has adopted both enthusiastically.

It is a pro-Western, pro-European country aspiring to become a member of the Euro-Atlantic structures. Hopefully, it will.

Macedonia, Foreign Investments in

PART ONE
Foreign Investments in the Region

Dialog between **Nikola Gruevski** (later, Minister of Finance and Prime Minister of Macedonia and **Sam Vaknin**, later Economic Advisor to the Government of Macedonia)

Nikola: The Republic of Macedonia is at the bottom of the ladder, as far as foreign investments are considered, among the countries in transition. It is not a coincidence. The general judgement of all the relevant economic institutions and experts in and out of Macedonia is that there is a need for foreign commercial investments at this time. This dialogue is the commencement of an attempt to analyse the reasons for the absence of foreign investments and to act to change the present situation.

I think that we should above all focus on foreign capital in the form of indirect and direct investments from commercial institutions in the world. That is a priority as far as the needs of Macedonia are concerned. The Receipt of credits (as foreign capital from the EBRD, The World Bank, the IMF and other similar institutions) should not be a subject of these comments.

Moreover, the purpose of our discussions should be to inform the public regarding the situation and the developments in Eastern and Central Europe, which skipped Macedonia.

Sam: I think both your distinctions are very important. Macedonia has grown addicted to a the drug of multilateral financial aid in the forms of grants and credits. The money is used either to finance unproductive consumption or is invested in extravagant infrastructure projects. Macedonia is running a lethal trade and balance of payments deficits covered by donations and other forms of ""ad" capital. No wonder that commercial avoids Macedonia. Moreover, the public is not informed. The facts are available – but the public is not educated to understand them. Thank you for selecting me to be your partner in this exciting dialogue.

Nikola: As an opening comment I would mention the globalization as a world process and the dimensions of this process from Macedonia's point of view.

Last year witnessed the merger of Union Banque Suisse (UBS) with Swiss Bank Co. (SBC). The new bank is now the second biggest bank in the world with a total capital of 687 billion dollars. As of last year, the biggest world-class aircraft manufacturers, Boeing and DC have become one company. It was probably the biggest merger of 1997. The British insurance companies "Commercial Union" and "General Accident" have integrated to the tune of 15 billion pounds. They will form one of the biggest insurers in Europe. Every month brings along mergers and acquisitions between smaller or bigger companies worldwide. This is a trend. Globalization is a world trend.

Sam: Always has been. Research shows that the world used to be much more globalized than it is today until the outbreak of the Great Depression during the 1930s. We are just resuming an old trend which was interrupted...

Nikola: General Motors has 25 times, and NTT has 52 times the sales figures of the entire Republic of Macedonia, respectively. Decisions are made within the premises of the multinationals and not by ministers. Anyone who stands up in their way is bound to be destroyed. This is a part of the same large trend called globalization, a process that enormously helped the development of transport, telecommunication and other segments of technology, but at the same time tremendously deepened the polarization of countries, as never before. Within 10 years, telephones might look like a wrist watch, a small button or a brooch. According to The London Times dated 17th November 1997, the technologies have finally converged so that there will no longer be a difference between telephones, computers, TV sets, calculators or other home entertainment electronic appliances. The developed technology will be cheap and incredibly user friendly. The developments in telecommunications have caused the world to have 13 billion micro-processors, and 5,7 billion people. Today, there is more computer exchange of information every working day, than all the verbal communications going back to Adam and Eve.

My concern is: ***How is it possible for any Macedonian company to be competitive against other companies, each with 300.000 workers, the most up to date technology, the most efficient cost structure, the most capable and trained staff and managers? It seems to me that there is only one chance. The bridges between Macedonian firms and the biggest world companies can be established only if the latter come to Macedonia, only if they inject the Macedonian companies with capital, new technology and new markets. It is the only way to join Macedonia with the modern part of the world. Of course, that process has a "price", but in the long run, Macedonia will gain much more then that. Macedonia must to prepare STRATEGY how to join in the modern world.***

Sam: I share your belief in the purifying and strengthening powers of foreign investors, especially if we are talking about well-equipped, well-managed and well-capitalized multinationals. However, I would like to put things in perspective. Accumulated experience in the world shows that foreign investment does improve considerably the professional, technological and marketing skills of those companies that it invests in. Additionally, foreign owned companies are responsible for the greater part of the exports in their "adopted" countries. But it is equally important to apply market pressures to domestic firms through opening up to competition. Local companies, owned by locals, must adapt or die – and the sooner, the better, the less pain. Foreign investors tend to form their own sector and to isolate themselves from the local economy. Even their contribution to employment (especially of skilled people) and to the local economy through purchases is minimal. Another risk is that multinationals will look upon Macedonia as a source of cheap labour and raw materials, a colony in the guise of sovereignty. Some of them will even try to dictate anti-free market measures to the host government. Audi tried to do it to Macedonia and now the Korean auto-makers are trying to do this to the Ukraine. The government should use the entry of foreign investors – with their active participation – to cajole, threaten, force and weigh upon the local industries to get leaner and meaner. In the long run, this is the main contribution of foreign investment: the transformation of the domestic sectors.

Nikola: Business Central Europe, the leading regional business magazine, in the 1997/8 Annual published information regarding foreign investments in the 27 countries in transition in Central and Eastern Europe. Macedonia is on the last position with 30 million $

(although the December takeover of Makstil is not taken into account here). The data for the other countries are:

- Albania $298 million (1996 figures); Armenia - $44 million (1996); Azerbaijan - $987 million; Belorussia - $110 million; Bulgaria - $1,2 billion (6/97); Croatia - $827 million (6/97); Czech Republic - $7,3 billion (6/97); Estonia - $800 million (6/97); Hungary (6/97) - $16,2 billion; Kazakhstan - (96) $6,3 billion; Kirgizstan - (96) $276 million; Latvia - (6/97) $860 million; Lithuania - (6/97) $ 762 million; Moldavia - (96) $167 million; Poland - (6/97) $16,3 billion; Romania - (6/97) $2.4 billion; Russia (6/97) - $7,3 billion, Slovakia - (6/97) $1 billion; Slovenia - (5/97) $1,7 billion; Tadjikistan - (96) $47 million; Turkmenistan (96) - $544 million; Ukraine - (9/97) $1,6 billion; Uzbekistan - (96) $320 million; Yugoslavia (97) - $1 billion.

The magazine cites the following as sources for the data: EBRD, EIU, IMF, OECD, WIIW.

In the past 5-6 years, the world's most famous banks opened branch offices in almost every state in Central and Eastern Europe. Except in Macedonia.

Citibank, Creditanstalt, ING-Barings, Deutsche Bank, Bank Austria, Bayerische Vereinesbank and others opened branch offices in the Czech Republic. Citibank, ABN Amro, Unicbank and others in Hungary. Citibank, ABN Amro in Romania. Volks Banken Creditenstalt, CSOB and others in Slovakia. In Slovenia, Bank Austria, Societe Generale, Volks Banken and others have opened shop. Chase Manhattan in Uzbekistan, ING Bank, Raifeisen Bank, Dresdner Bank, Societe Generale, Xios Bank, National Bank of Greece and Ionian Bank in

Bulgaria and so on. In Bulgaria, for example, there are a lot of joint ventures with foreign banks, as well: Post Bank (Bulgarian Japanese Bank/Nomura) Bulgarian-American Credit Bank, First Investment Bank (Bulgarian and EBRD capital), OBB (Bulgarian, American and EBRD capital), Bayerische Bulgarische Handelsbank (Bulgarian-German capital), Euro Bank (Bulgarian-Czech capital) and so on. Even in Albania branch offices of some foreign (western) banks were opened. The Bank of Albania was the first joint venture bank in Albania (an Italian Albanian Bank) and was established in 1992. There is one other joint venture bank with the Albanian State, foreign private participation (The Albanian Islamic Bank), the only wholly private foreign bank (Dardinia Bank) and the National Bank of Greece.

Except opening branch offices, the banks invested and bought up many local banks in most countries in transition. The above-mentioned magazine comments: It was an unusual year for the miserable banks in the region". After 8 years in transition the question is whether the Central European governments will or won't give up the control over the sector, which they think is the central economic power. The big shift was in 1997. They realized that they have no choice, had they not sold the banks, the banks would have been ruined. But, whether this danger is generally recognized is an open question. The results of a poll conducted among a group of readers of "The Annual" show that people still have a tendency to think that "big is best", regardless of the basic health of the bank.

Sam: There are 23 universal (all-purpose) banks in Macedonia. This is not a healthy situation. The illiquid, tiny, isolated economy of Macedonia cannot support such a large number of financial mediators. The results are poor returns on equity, low quality loan portfolios (assets of the bank), monstrous default rates and, as a result, atmospheric real interest rates and reticence of the bank to fulfil their basic function: to finance economic activities. No reliable credit rating and risk assessment tools have been developed, no reliable, computerized, central registrars of collaterals. Property rights are not protected by inefficient and baffled courts and by legislators who lack all economic expertise and experience. In addition, the Central Bank, terrified by the ghosts of hyperinflation, is implementing an unduly restrictive monetary policy. Money supply, credit acceleration, secondary money formation are all at abysmal level. On top of this, the banks themselves are not modernized, under-computerized, lack professional expertise and management, offer no innovative financial products and services, are not customer oriented, notoriously slow and inefficient. Why should foreign banks enter such a fray? It took Erste Bank almost two years to conclude a deal to purchase a minority stake in Macedonia's largest bank, Stopanska Banka, which control close to 50% of the banking system in the country. This was a major vote of no-confidence, preceded by dire reports issued by the Central Bank and by the World Bank.

Nikola: Hungary was the first state in the region that recognized the danger of a fragile banking system. Hungary suffered a series of bank collapses, but after that the Hungarians learned the lesson of the fiasco and put the other state banks on a strict diet to make them fit for sale. The Czech Republic and Slovakia resisted the sale of their main banks longer. But the bad debt problems made the Czech Republic change its opinion last year, and it sold one of its 4 biggest banks, IPB, to the Japanese (Nomura). The other 3 will most likely be sold to strategic investors by the end of 1998. An American financier said something about the Czech banks to be remembered: "Your banks are like ugly brides. You should be happy if you find a husband for them who only has syphilis." Slovakia endured similar problems.

But, besides banks, large manufacturers of world class are present in every other Eastern and Central European State. I'll mention only a few of them: in The Czech Republic: Tesco (UK), VW (Skoda) - Germany, Unilever (England and Denmark), and in Poland ABB Fiat, Procter and Gamble, in Hungary: IBM General Motors, Unilever, Suzuki..., in Slovakia: VW, Whirpool, Heineken...

There are many companies of this kind in Romania, Russia, Bulgaria, Croatia and in other countries. Except in Macedonia. On the Deloitte & Touche list of the biggest companies in Central Europe there are two from SR Yugoslavia, four from Slovenia, and none from Macedonia.

Sam: There was a lost chance to introduce industrial multinationals to Macedonia during the privatization process. Macedonia had – and still has – many relatively large companies, which could have been of great interest to foreign investors. Pivara, Makpetrol, Ohis, Alkaloid, not to mention the infrastructure firms (such as PTT and ESM). When foreign investors witnessed the transfer of these prize assets (mostly) to their managers – they decided that if you cannot beat the system, join it. So, they established joint ventures with local firms. Pivara has such a collaboration with McDonald's and with a German beer manufacturer, for instance and Ohis has many industrial alliances. Foreigners started buying up bankrupt Macedonian firms. The privatization process has transferred circa 1200 companies to incapable, under-funded hands. The new owners do not know how to run a manufacturing firm in the global marketplace. They are being forced to apply to foreign investors now – unfortunately, at prices much worse than could have been obtained before their mismanagement. I am much more optimistic than you, in this respect. I think that we will see a wave of foreign takeovers and joint ventures starting this year.

PART TWO

Nikola: Other things happened in Eastern Europe, but not in Macedonia in 1997, both in business and in finances.

- In February 1997 Isuzu from Japan confirmed that it will build a $250 million USD machine factory in Tuchy in southern Poland.
- In April, the Moscow county assumed the control over the AZLK manufacturer of Moskovich cars, and one of Russia's biggest tax bonds.
- In May, The Hungarian company OZD (railroad manufacturer) was sold to the German firm Aicher.
- In June, Serbia sold 49% of the state telecom to the Italian Stet and the Greek OTE for $900 million. The Swedish forest group AssiDoman took control over the Czech paper company Sepop.

- In July, Poland issued 72 million shares in the copper manufacturer KGHM, with an estimated value of over $1 billion. 51% were set aside for sale to financial investors and to the workers. The American car manufacturer Ford invested $9.5 million in 51% of a car state factory in Belorussia. A Consortium led by the Russian Uneximbank bought 25% of the state telecom company Svyazinvest. The tender was publicly regarded as fair, but was attacked by other Russian bankers. Unexim also "hooked" Norilsk Nickel, the world's biggest nickel manufacturer, in which the company owned a stake.

- In September, the Polish textile company Prochnik bought a 60% stake from 6 rivals, in that time divided among quite a few national investment funds. This was the first consolidation after the programme for mass privatization. Poland agreed to sell its telecom monopoly TPSA. In 1998 20% of the shares will be sold on the domestic and foreign stock exchanges. A strategic investor will be introduced in 2003. The Polish consortium led by Elektrim won the right to build and operate a highway from Lodz to the German border. The South Korean firm Daewoo concluded an agreement for joint investment with the Ukrainian car manufacturer Avtorar. They will immediately invest $300 million plus $1,3 billion after 6 years.

- In October, the Italian Fiat returned to Russia after 30 years, by associating with itself with GAZ – a car manufacturer – and committing itself to a $850 million deal for building a factory for Fiat.

- In November, the Swedish Volvo bought Ikarus – a Hungarian manufacturer of buses - through a tender. The English - Holland Shell aligned itself with the Russian Gazprom and Lukoil to buy the state oil company Rosneft. British Petroleum paid $572 million to buy 10% of the Russian oil giant Sidanco, from its shareholder Unexim. The French Renault declared that it would invest $350 million in a joint investment with the problematic car manufacturer Moskovich - formerly AZLK. The Romanian manufacturer Dacia concluded a deal with the South Korean Hyundai, for manufacturing its 1999 Accent model.

This trend continued well into 1998.

In January alone, Pepsi Co. completed the purchase of the remaining shares in the Polish manufacturer of sweets and sandwiches Wedel. Pepsi Co. already manages 83,3% of the company. Poland decided to raise the legal ceiling of foreign ownership of the local radio networks to 49%, instead of the previous limit of 31%. The changes were forced upon it because Poland has committed itself, in the accession talks, to the liberalization of foreign ownership limits, in line with the EU.

The Holland brewery Heineken launched a tender to increase its share in the polish brewery Zywiec to 75%, at a price of $125 million. The Holland giant already invested $50 million in the factory, and increased its share from 25% to 32%. Heineken announced that it would like to keep the company on the stock market, and has no intention to increase the capital further.

The Slovakian manufacturer of steel VSZ finally succeeded to take over the problematic Hungarian cast iron manufacturer DAM, after the Hungarian government agreed to a nominal value of $1 if the Slovaks take over its debts of $13 million. Besides that, VSZ sold its 20% to a Czech steel mill.

The American Ford Motor Group declared that there will be a joint investment with Russky Dizel, an engineering group based near St. Petersburg, for the production of $150 million, and annual production of 25 000 automobiles is planned.

In the financial world of Eastern and Central Europe, the following events transpired, among others:

- In January, the Dutch bank ABN Amro bought 80% of the Hungarian Magyar Bank for $89 million, plus $137 million in new capital.

- In February, the Russian energy firm Gazprom forced Hong Kong Regent Pacific to liquidate a 200 million dollar fund. The purpose was to exploit the difference between the low domestic and high foreign value per share of Gazprom.

- In March, the Polish BIG bank paid 84 million dollars to the state, for a special share of 32% in Gdanski Bank, in which BIG already had 31%. An Irish company increased its share in the Polish bank Wielkopolski Bank Kredytowy to 60.2%. The Austrian Futures & Options Exchange started to offer derivatives to investors in Hungary. The well connected Polish bank Kredit Bank bought the shares of the central bank in the Polish Investment Bank and in Prosper Bank.

- In June, the government of Poland sold Bank Handlowy – the former bank for foreign trade – to a mixed bag of strategic and financial investors for $1 billion. In Slovenia, Nova Ljubljanska and Nova Kreditna Banka Maribor were put out of reclamation. They were being prepared for privatization in 1998.

- In July, the Japanese Nomura agreed to buy 50% of Investicni a Postovni Bank in the Czech Republic. An Irish insurance company and Kredietbank from Belgium paid $90 million for 48% of K&H, the fourth biggest bank in Hungary.

- In September, the German Commerzbank increased its share in the Polish BRE Bank from 28% to 48,8% by buying new shares. The Austrian Giro Credit bought 88,7% of Merobank, a Hungarian bank owned by the state , for 24,3 million dollars.

- In October, Bank Austria/Creditanstalt bought 13% of the Polish PBK Bank for approximately $60 million. A similar share went to the local Kredit Bank and to the Warta Insurance group.

- In November, in spite of the disturbances in the global markets, the Hungarian telecommunications giant Mata successfully sailed into New York and Budapest. A consortium led by the local insurance company Atlasz paid $32 million for 62% of PK Bank - the last Hungarian state bank. The

Romanian government announced that the postal bank Banc Post will be put on the block at the beginning of 1998.

Again, this trend continued, unperturbed well into the first few months of this year.

Investicni a Postovni Bank (IPB) was finally sold to the Japanese NOMURA SECURITIES. The Japanese paid a small amount of 2,9 billion CZKs ($81 million) for the 36% that were supposed to belong to the government, but they agreed to inject an additional 12 billion CZK into it. Nomura and similar funds now control 70% of IPB.

The Polish minister of finance, Balcerowicz, announced that 35% of PKO, the biggest commercial bank will be sold to strategic investors in the third quarter of this year. Also, a listing on the stock exchange will follow in March or April.

Russia issued licences to four western banks for opening branch offices. The German Deutche Bank and Commerz Bank, as well as the American JP Morgan and Bank of America were the most successful candidates from a total of twenty applicants.

Last year Poland had a 7% growth rate. From 1990 to the present, foreign investments in Poland totalled more than 20 billion dollars. The USA has invested 4 billion dollars, Germany 2,1 billion dollars and so on. Among the top foreign investors in Poland, Fiat is in the first place with 1,1 billion dollars, and Daewoo Motors on the second with 1 billion dollars in investments.

These bits of information are only a part of what happened in Eastern and Central Europe in 1997. Where is Macedonia in all of this? How much fresh capital was missed in this period? How many new jobs, new ideas and new markets Macedonia did not obtain, and could have? Why?

FOREIGN INVESTMENTS (2)

Foreign Investments in Macedonia

Sam: It may come as a surprise to many, but foreign investors are as interested in psychology as they are in economics. The first things they enquire about have nothing to do with GDP per capita, the rate of inflation and its forecasts, domestic interest rates, the living standards, the available infrastructure, the banking system and other, "hard core" questions. To start with, they are interested to know other things: are property rights protected by the State and by the courts? Is the right legislation in place? What is the crime rate and how pervasive is it? Are people industrious or lazy, corrupt or honest, liars or truthful, educated or ignorant? Is it easy to do business there – or does the bureaucracy stifle everything? Are officials and politicians interested mainly in their own welfare or in that of their country's? These are "soft" issues, which matter much more to the foreign investor in the longer term. It is here that Macedonia failed in projecting to the world an image of a country friendly to business in general – and to foreign business, in particular. Investors don't even know that Macedonia exists, let alone its many advantages.

Nikola: An analysis of the situation of the Macedonian national economy shows the following:

1. Over 80% of the equipment in Macedonia is considered obsolete, meaning that it is no longer in use in West Europe. 10 to 15% of the equipment is so called medium level, and only 5 to 10% is high technology, completely imported.

2. The depression level is high, 53%, while the write-off level is approximately 71%.

3. The structure of the fixed capital is inadequate. Over 60% is in construction operations, compared to a worldwide average of 45%.

4. The distribution in the sector in inadequate, which is very dangerous because it needs a long period to change.

5. The capital assets have a low economic value (the market value is often 50% under the accounting value).

6. The part of the inflow of gross investments in the domestic (social) product in the past years was under 18%, in contrast to 1971 and 1972 when the investment rate reached 40%. Economic investments, being the most important segment, increased from 8% in 1992 to 15% in 1994. After two years of receding, in 1997 they reached 12% (although it was determined to be 16%).

7. The economic distribution of the investments is very negative. Of the total investment, 17-20% went to infrastructure, and only 46,5% were commercial investments - the engine driving the economy.

8. ***The restructuring of property failed with regards to the organizational and technological aspects.***

9. Last year the number of new enterprises and projects decreased.

10. The savings rate is very low, and it is assumed that the population has funds of 600 million to 1,2 billion US dollars; this item (population) is negligible in the western countries with developed financial infrastructure.

Sam: There is nothing inherently wrong with a low rate of savings, especially in illiquid economies in crisis and transition. The engine of consumption is as important as the engine of investments. But this is true when savings are IMPORTED – in the form of foreign investments – from abroad. Macedonia is doubly cursed: it has a low (official) savings rate (though, in reality, thank the black economy, it is much higher) coupled with the absence o9f commercial foreign investment. Add to this the roaring deficits and the picture that emerges is that of a bleeding economic body. The trade deficit is mostly used to finance consumption and infrastructure projects. Nothing productive and profitable is engendered by it. People prefer to buy Volkswagen cars than plant machinery. The result is a stock of capital assets which is depleted and decrepit – not only in industry. Have a look at the universities, for instance. This is a vicious circle: a problematic economy fosters uncertainty. Uncertain people do not commit themselves to long-term investments. They prefer to consume or to speculate. The result is even a more problematic economy. The low domestic savings rate is linked to the abysmal investment rate. Even when money does come in, the management class and the political-economic decision makers do not know what to do with it. The safest bet is to invest in infrastructure and in construction. It is much easier and more familiar to construct a house than to manage a microchip factory. Lack of management skills, of modern, flexible, organization, of technology means that even the available resources are misallocated, that the productivity rate is bound to deteriorate. Learning from foreigners is an excellent solution, which Macedonia has yet to adopt. But Macedonians find it highly embarrassing to admit that there is something, which they need to learn. When in need of help and advice they feel inferior and humiliated. I can tell you this from my experience as a foreign consultant here.

Nikola: Looking from both from the historical and from the present point of view, and according to many others, also from a prospective point of view, the Balkan is one of the less stable regions in the world. This is why there is no inspiration for capital investment and foreign ownership. When you mention Macedonia to anyone in the world, they do not think individually of Macedonia, but as a part of a region, known around the world for its unpleasant events. The fact that Macedonia, at the moment, is not at war or anything similar, is a small consolation when you look at the history of the state and the region, or at the relations with the neighbors, or at specific recent actual scenarios of terrorist groups from around the world, where Macedonia is included as a possible object of destabilization or worse. Take, as an example, the publication that was issued in 1996 by the London branch office of Bankers Trust International PLC - one of the biggest broker investment institutions in the world with its head offices in America, a research on the markets of the ex-Yugoslav republics. The conclusion of the publication was that Greece will prevent the EU from effectively assisting Macedonia, until the problem of the disputed name is solved. A probable scenario is mentioned in which the Macedonian territory could be a subject to a dispute between Greece and Turkey (both members of NATO), as well as Serbia, Bulgaria and Albania. Even in the recent study of Merrill Lynch, despite the optimistic estimates, there still exists a small reservation regarding the political future of Macedonia. The Kosovo events caused inestimable damage to Macedonia in as much as foreign investments are concerned. The fact that the highest Macedonian political officials, in interviews to the media, are indirectly or directly saying that Kosovo can destabilize Macedonia, is as damaging as what happens on Kosovo. If the prime officials of the state are openly discussing the possibility of ethnic conflict in Macedonia in their statements, a conflict that could be contracted from the neighboring countries, if they are asking for foreign defense forces from the UN and NATO to be stationed on the territory of Macedonia, I wonder why should the potential foreign investors think otherwise?

I think that the first conclusion on this subject is that, basically, the region where Macedonia is located is one of the last where the firms that are involved with international transfers of capital would invest. But that does not mean that the level of foreign investments in Macedonia is a result only of this, and that the situation could not be far better. This a only a starting point.

Sam: I couldn't agree more with your concluding remarks. The regional instability and its chequered history is maybe 10% of the explanation, in my view. Slovenia was part of Yugoslavia, even involved in fighting, initially. Still, it cleverly distanced itself from its former co-federates and identified itself with Europe. The result was prosperity for Slovenia in the middle of the worst ethnic war in the last 50 years. Similarly, Bulgaria and Albania are in the same region as Macedonia and so are Croatia, Romania. All these countries (Albania until recently) enjoyed large inflows of foreign investments despite their regional affiliation. In Russia and India, governments collapse monthly. In Russia, Georgia, foreign businessmen are even often murdered. In all of them, foreign investment is booming. Money seems to be an incentive stronger than life. But foreign investors must be convinced that money is here to be made. They haven't been, hitherto.

Nikola: I think that the following should be also mentioned:

First, ***in the last seven years, the least foreign capital entered Macedonia than any other country in transition. This is not because somebody in the world hates Macedonia***.

Second, ***certain situations in Macedonia look different from a distance***. This is because of (in some cases) the low level of information available about Macedonia in the Western developed countries (they should not be blamed for this), and the common unrealistic interpretation and comments about events in Macedonia, aired by local authorities under the influence of the daily political arguments.

To see how Macedonia looks like to the world, one should read foreign professional magazines (or surf the internet), or even better, leave the country and get in touch with investors, who invest in emerging markets, among others.

They are in for an unpleasant surprise. A year may pass in thorough perusal of foreign financial magazines, before the name of Macedonia pops up, not to mention a detailed analysis. I met many multinational companies which have developed special departments for research and investment in the so called emerging markets (Macedonia's natural place). During the first contact I encountered with the following reactions:

1. Besides a rough geographical location (sometimes even that is uncertain), and the knowledge that Macedonia is in a way connected to Alexander the Great, regarding everything else there is very little, and often no information whatsoever about anything in Macedonia, including its economy and its companies.

2. Often Macedonia is being confused with Greece or the question arises which Macedonia is concerned.

3. Surprise that no one from Macedonia has ever visited them. At the same time, they are pleased to hear something about a totally unknown and unexplored market.

Sam: Type the word "Macedonia" in a few word-processors and you will get a "spelling mistake" sign. I was once asked at the Prague international airport whether Macedonia was … part of Belgrade. This is entirely the fault of the Macedonian authorities. No coherent and serious promotion, public relations and investment relations campaigns were ever undertaken. More than 80 new nations were added to the world in the last two decades. In an age of information glut, sovereignty inflation and fierce competition on economic resources –

to be unknown is to be dead, politically as well as financially. In the long term, the survival of Macedonia depends not on meaningless treaties and conventions. It depends on its ability to attract foreign capital and thus to bind its neighbours and the West to it. Money is a strong incentive to refrain from instability and wars. The bitterest enemies become the best friends once they have common economic interests (see the example of France and Germany). Macedonia should immediately develop a multi-year plan for fostering and encouraging recognition among its allies and foes alike. The international media should be used and economic interests should get involved. But to leave the situation as is is nothing short of detrimental.

Nikola: The image of Macedonia is an image of a landlocked country, with poor neighbourly relations. The stationing of foreign forces on its the territory raises the question why is international protection needed? The dispute with Greece, besides the negative implications for the Macedonian economy, (though it was good to finally be noticed) did not help the situation. The existing tension with the ethnic Albanian minority in the country also creates an image of an unstable country.

In the projections for 1998, the government of Macedonia persistently states that it will do anything to increase the foreign direct investments in Macedonia. But it never mentions the indirect and portfolio (through the stock market) foreign investments. Whether these two concepts are mutually inclusive , or mutually exclusive, is not clear.

PART THREE

Nikola: ***And while one is having a problem with insufficient capital, others have a problem investing the surplus of capital, a problem of high liquidity.***

For example, the Nomura company, as one of the most powerful investment banks in the world, with shareholders' capital of over 15 billion dollars, with 63 international offices in 26 countries, approximately 3 million client accounts and over 400 billion dollars in managed client funds, last year, "as a joke", bought 4000 pubs in England. It holds the first place in Central Europe (excepting Russia) as a leading provider of financing. Since 1995, in their capacity as lead managers, they invested 2,7 billion dollars in this region (source: Euromoney Bondware). JP Morgan are right behind them, judging by the same criteria, with 2,2 billion dollars, Daiwa Securities with $1,9 billion, Credit Swiss First Boston $1,6 billion, Merrill Lynch with 1,4 $billion. Nomura was the lead manager of the first public offering of bonds of the National Bank of Slovakia in 1994, to the tune of 25 billion yens. At the same year Nomura bought the municipal bonds of the city of Prague for 250 million US dollars, invested 24 million dollars in corporate bonds in Slovakia, invested 4 billion in Latvia, 15 billion in bonds of the National Bank of Hungary, 60 million $ in international bonds issued by Lithuania. In 1996, besides the issue of municipal bonds of the city of Tallinn, in Latvia (60 million DM), Nomura invested 50 billion yens in Romania, 70 million $ in corporate bonds in the Czech Republic, and in 1997 they invested 500 million $ in bonds of the City of Moscow, 70 million $ in Slovakia, 450 million dollars in international bonds in Ukraine. In

1998 hitherto, they concluded new investments in The Czech Republic (the takeover of IPB Bank), and negotiations in Ukraine and Slovakia are in their final stages. The same company invested 91,2 million $ in Pliva-Croatia, 31,1 million $ in VTS-Slovenia, 24,7 million USD in SKB Bank in Slovenia, and in July 1997 453,3 million $ were invested by it in KGHM Polland Miedrz SA.

Creditanstalt appeared 7 times as a lead manager and 3 times as a co-manager in stock offerings in this region, Credit Suisse First Boston did so 6 times, and 3 times as co-manager, Schroders 4 times and twice, respectively, Dresdner Kleinwort Benson 5 times in both categories, Merrill Lynch 4 times, HSBC 4 times, and Salomon Brothers and UBS 3 times. These data are for 95, 96 and up to July 1997 (source Euromoney Bondware analyzed by number of issues). Last year Romania was a real investment hit and after the stabilization of the economy in Bulgaria, there is a great interest again in new investments there. There are many other similar data from which can be concluded that the big multinationals have much enhanced liquidity, and are looking to emerging markets to invest it in. They have so much money, that they are prepared to invest in risky countries, much more risky than Macedonia, naturally against much higher yields than in low risk countries, or countries with no risk at all.

Sam: Only in the USA in the last two years 2 trillion USD of new wealth were created by investing in stocks. The same pictures repeats itself all over the world. Stock exchanges the world over have set new records and generated fabulous amounts of new wealth. Contributions to pension funds, money pouring in to mutual funds, the globalization of the capital markets and the resulting capital mobility – all created a deluge of money frantically in search of yields. The more mature markets in the West offer less luring returns because of the lower risks that you have mentioned and because of correspondingly lower projected growth rates. New legislation permitted- even encouraged – the international diversification of these funds. Once legally allowed, the dam was opened and a gush of almost 400 billion USD in investments swept over the emerging economies. Some of these investments soured and there are periods of remorse. Sometimes, investors even completely withdraw from a specific market (as they have done in the Czech Republic in 1997). But these are temporary fluctuations. The phenomenon is here to stay: investors and money managers hedge their investments by spreading them across political boundaries. High growth rates attract them. The availability of political risk insurance calms their nerves. It is a golden era for those countries who know how to tempt the right suitors. Macedonia, unfortunately, is not one of them.

Nikola: When we discussing portfolio investments (indirect investments), we must mention that all the serious multinational companies have special departments or separate firms, specializing in investing in the so called Emerging Markets. In these departments, 50, 100 or more account managers and investment officers have an annual amount of money they should invest in some of the countries in East and Central Europe, South and Middle America, Southeast Asia, Russia and the CIS (NIS – New Independent States) and eventually Africa, depending on the strategy of the company. The amount can be between one half and two or more billion German marks. The companies have established in-house research and development (analysis) sections within the departments (or their special firms) which tackle the emerging markets. The professionals, that are working in these departments, are usually divided by regions. For example: Romania, Bulgaria and Croatia, or the Czech Republic, Poland and Hungary or Russia and the NIS. Alternatively, they are grouped according to the type of the securities that they deal with: East and Central European bonds, or shares issued in the same region, or other more complex financial instruments. These departments are obliged to observe everything that happens on their markets, the ones actually invested in or in which there are plans to invest. On the basis on this information, they should provide instructions to the fund and portfolio managers of the company. The latter, after reaching a final decision, issue directives to the dealers of the company to sell or to buy the exact number and type of securities. The dealers of the company are associated with local brokers and the operation is thus completed.

In every meeting that I had with these firms, I concluded that they are (literally) bombarded daily with information, data, brochures, analyses, telephone messages, faxes and e-mail. All of this is sent to them by governments, state agencies and authorities, brokerage houses, by banks and by other private or governmental institutions and individuals, from all the countries, but one: guess which.

It seems that there is a double barrier to information: data from Macedonia never reaches potential financiers from the West , and information from the West doesn't reach the citizens and legal entities in Macedonia. Without exaggeration, I can say that Macedonia is in an

information vacuum, when it comes to financial events and opportunities that the world offers.

Sam: I think that the second type of vacuum is less threatening. Today, anyone who is really interested and is willing to devote the time and resources, can hook up to the world at a minimal cost. Professional magazines, the Internet, foreign radio and television stations. The problem is that I see so little interest. People are much more interested in politics, in football or in Cassandra than they are in economics. It may be because matters economic are perceived to be the "government's headache". The government did little to expose the citizens to the realities of the market economy. Most people here replaced "socialism" with "IMF-ism" or with "governmentalism". They await a miracle cure, a solution from above. The psychological barrier to learning that I mentioned before, the twisted superiority-inferiority complex ("no one can teach us anything that we already do not know") – are a major hindrance. I reviewed your economic textbooks and spoke at length to may students of economics. You lack a lot of knowledge. You teach out-dated doctrines to uninterested students. This will not work. You must open up and accept the fact that you need help: urgently and a lot of it.

The first kind of information barrier is much more serious. That Macedonia is absent from the information cum investments race is suicide.

Nikola: That is why many things that are normal and regular, in the financial world, (stock exchange, shares, capital markets, investment banking), seem very distant to most people in Macedonia. Actually, Macedonia is very far from all this. It is not like the public imagines when it sees on the local television an old replay of a chaotic and messy stock market. On the contrary, everything is in perfect order, and that is not something that only a few people can understand.

All of this can be compared to basketball. 7 or 8 years ago nobody in Macedonia knew what was happening in the NBA league, but today, after regular TV broadcasts and commentary, the bulk of the populace feels the league to be its own. Many know the names, success stories, the good and the bad side of every team in the most lofty basketball league. If anyone were to inform the public about the events in the world's capital markets, as well they do regarding the events in basketball, the picture would have been different. Many of the citizens would have put this knowledge to good use, especially in view of the emergence of the capital markets in Macedonia. Unfortunately, not only has the domestic public been until now in a so called informational vacuum, but the passiveness of Macedonia with regards to this question, obstructed the ideas or opportunities of the investment multinationals to invest their capital in Macedonia. This caused great damage to the country, and it is a missed opportunity.

Sam: From the very beginning it was clear that no one knew what is a stock exchange and what to do with it, once it was established. It was perceived more as a nuisance than as a tool for the formation and allocation of domestic and foreign wealth. The privatization was conducted completely outside it, new shareowners were not allowed to trade their shares there, the government did not finance its needs through it. It was relegated to the margins, devoid of liquidity and basically useless as a corporate financing arena. This was a major strategic mistake, which would require many years to reverse. The stock exchange could have become a source of cheap credits and equity capital to the struggling, illiquid, domestic economy. It could have competed with the local, inefficient, banks. It could have attracted portfolio investments and even domestic "undeclared" capital. All this could have been achieved had the right number of companies been listed, had the supply been varied and of good quality. But a stock exchange does not go well with cronyism.

Nikola: However, nothing will help Macedonia in its plan for self-promotion, if it does not help itself. Macedonia must lead an aggressive policy in this respect. Bearing in mind that the private institutions, which are participants in the capital market, are still not fully developed and formed to carry this project alone, the state should take over. The state must be a generator in the process of promoting itself, and later, when the conditions will change for the better, the state can gradually leave the "scene" to a certain minimal level, relegating its role to the private institutions.

Foreign capital is important for faster development as well as for a prompt exit from the economic crises and isolation. Foreign capital is also important in preparing the country to EU entry. Until and unless it finds interest in Macedonia, the probability of entering EU are very small. At the moment, this is better, because if Macedonia were to enter the EU now or in the near future, it would have become an even bigger base for the supply of raw materials to that community than it is now. Macedonia must deeply enmesh itself in the process of globalization, and to ask for the acquirements from it. In that game every side has its own "mathematics". The rich can get richer, and the poor can get less poor. This option is possible, but if one is not careful, the poorer can get even more so.

The second lesson is, that multinationals are looking at emerging markets, and have extra funds to invest. What share of it can Macedonia attract depends on:

1. How aggressive will Macedonia be in its propaganda;
2. How much "substance" it has to offer, and
3. The conditions offered by it.

Since these companies invested in Malaysia, Vietnam, Bulgaria, Albania, Romania, Kazakhstan or Afghanistan - there is no reason that they should not invest in Macedonia, which was bypassed until now, and with a reason.

FOREIGN INVESTMENTS (3)

Promoting the Macedonian Market

Sam: The world has gone through a major cycle of physical colonization in the last five centuries. European countries conquered, by military means, large swathes of land with rich raw materials and mineral resources. They clashed with each other often and the outcomes of these clashes were eternalized in the form of international borders. Whole continents were subjected to this mercantilist behaviour. Raw materials and cheap labour were "sold" at ridiculous prices by the colony to the colonizer – and expensive finished goods and services were imported by it. This led to economic depletion and social unrest which resulted in two world wars and in the de-colonization of the world. But a second cycle started in 1989, with the fall of the Berlin Wall. This time no physical presence is required. Money and other symbols (information and know-how, technology and science, cultural imports) do the job. Again, the Western powers colonize parts of the world for the same reasons: cheap raw materials, cheap labour, new markets. Yet, this time, they do it more subtly: through credits, joint ventures, film festivals and television serials. A reaction is already developing. I, personally, believe that the countries of Central and Eastern Europe will rebel (mainly against the EU), once they understand what is being done to them. A world of regions and ethnic groups will supplant the world of nation-states. All over the world, political units are disintegrating to smaller and smaller ones. Macedonia should be aware of these trends and should not fall in the trap of the new form of colonialism without extracting a hefty price. But it would be able to demand this price only if it will become an interesting place, economically and financially. This is the most basic mistake of the Macedonian national strategy: It strives to join the EU as soon as possible – without going through the pains of real reform, the creation of a real market economy and the sacrifice of special interests of powerful groups.

Nikola: ***In the meanwhile, the Western countries understood the East European market to include all the ex communist countries in Eastern and Central Europe except Macedonia (and SR Yugoslavia and Albania to a certain degree). Forgotten, on the financial chart of the world the name Macedonia almost doesn't appear, more often marked only with five letters (FYROM).***

In the prestigious SBC-Warburg-Dillon-Read the present director of equity investments, the executive director of the head office covering equity investments in the European emerging markets, and another person from the so called "emerging markets" discussed the Macedonian capital market. While mentioning the state telecommunications company in Macedonia, I was asked: "Can you dial a foreign country from Macedonia, or the people can dial only between them, inside the country?"

This question was asked when the Macedonian government was announcing the privatization of the state telecommunications company, probably not loudly enough.

Similar questions were asked regarding other fields and concerning concrete and potential opportunities related to investment in Macedonia. My conclusion was that their knowledge about the State, in general and about the Macedonian national economy, in particular, was equal to the knowledge that the average Macedonian has about Tanzania. The above mentioned company has invested billions in: The Czech Republic, Uzbekistan, Poland, Russia, Romania, Bulgaria, Ukraine etc. except in Macedonia. I could notice the same thing in almost every similar multinational. Most of these companies, with no exaggeration, have so much money that they could buy, without any problem, all the companies in Macedonia. For example, the seven funds of Flemings manage, between them, 64,99 billion pounds (June 30 1997), equivalent to 188 billion German marks.

In the plan for attracting foreign capital, the government must, besides the agency for the promotion of Macedonia, appoint a person in the government (for example a minister without portfolio, with a special and unique assignment - attracting foreign commercial

investments to Macedonia). This person must have high authority and the confidence of the prime minister to whom he should also report. His aim will be to generate concrete suggestions, decisions, activities and laws "to be passed" by the legislature. He should encounter no obstacles in the government, despite the resistance of certain ministers, under the influence of external interest groups or as a result of direct pressures applied by these groups or through lobbying. All of this is assuming that the minister has both the will and the determination to persist to the end of the battle to make Macedonia attractive for foreign capital, regardless of the internal pressures and influences. Maybe in this game, the prime minister, as a politician, for a short period of time, might lose some support, but for the longer period, he stands to gain much more, above all from the voters - the citizens of the country, that will undoubtedly feel the positive changes brought on by the politics.

Sam: This solution, a "Czar" of investments or of privatization has been tried elsewhere, with little success. Very few politicians – anywhere, not only in Macedonia, give up so easily on lucrative state enterprises. They can reward their cronies by providing them with jobs, profitable contracts and other benefits, material and intangible. To open the country to foreign investments – means to lose economic control. A lot of people make money from imports, for instance. Will they be happy if local produce replaces imports? A lot of wealth is transferred from the state to select individuals and enterprises in the forms of concessions, monopolies, favourable tax and customs tariffs and "customized" public tenders. Foreign investors will not put up with this. They are a noisy lot. They refuse to play the game. They say what they think and are afraid of no one. Do local politicians really want this kind of trouble? Until a clear separation is made – backed by criminal sanctions and penalties – between money and politics, between businesses affected by decision making and the decision makers, the incentives to introduce foreign capital to Macedonia are few and far between. Foreign investments will come, with or without government involvement. It is the negative involvement of the state that must first be eliminated. Its positive assistance is less important by far.

Nikola: Should one Western firm enter the Macedonian market by purchasing only 10% to 20% or more of the ten best companies in Macedonia, that would mean that the foreign company will not only bring fresh capital to expand the domestic companies, but through its own representatives on the Boards of Directors of these local companies, the Western firm will bring new ideas, solutions, product mixes, quality, new investments, exports and new markets. The Western firm could then connect the domestic companies to new individuals and companies in the Western world of finances. The objective of any firm that would purchase securities in Macedonia would be to make the companies and country invested in much more competitive and attractive. After a period of time, they could sell the securities, in order to realize a profit, and thus to invest in another or in the same country with the same purpose.

To start with , if the foreign companies conclude that there is no chance to sell the securities that they would buy, they are not likely to buy them because nobody wants to buy something that later can not be sold at a profit of 20 - 30% or more.

Macedonia is one of the risky countries. Eventual investment of foreign capital in the form of portfolio investments would come after forming a judgment that high profits would be made from speculative investments. There is no other reason why would anyone invest in Macedonia and not in, for example, England where the risk is much lower. The Macedonian companies and the Macedonian market can compete only by offering higher yields through capital gains, dividends or interest payments, and especially the former. Because the capacities in Macedonia are under-utilized, and the level of development is low, higher positive earnings are possible.

I would like to return to the suggestion, that the government should initially take upon itself to attract foreign capital. The minister that I mentioned earlier should suggest a programme with pre-determined deadlines, and submit a report to the government on compliance with it. He should be directly engaged in:

1. Attracting portfolio investments (selling smaller and/or bigger parts of several our companies to western investors, through the stock exchange). In this case we are talking about indirect investments (through the stock exchange) of large, prestigious, investment banks, brokerage firms, funds etc.

2. Attracting direct investments (sale of control nuclei of factories and other companies in Macedonia to foreign investors, and with a prior agreement signed with the government and with the Agency of privatization). These deals – in the absence of a law regarding takeovers - would formally be effected through the stock exchange.

In this context, we are talking about direct investments where multinational renowned manufacturers of a certain products would buy factories in Macedonia, in their field of manufacturing.

3. Joint investment in new projects.

4. Finding buyers - underwriters of eventual issues of Macedonian Eurobonds.

5. Attracting foreign capital to the field of tourism.

The assignment under point 5 could be eliminated from the jurisdiction of the above mentioned person /and assigned to other person/s, to avoid overburdening him.

It would be best to leave the mission of contacting direct creditors (IMF, WB, EBRD, etc.) of the state to another person(s).

Sam: I think that if such a person will have the backing that you mentioned: from the Prime Minister, by a special law, from the legislature – he might even succeed. All this, subject to the sea change in the political atmosphere. Attracting foreign Direct and Indirect Investment must be declared a national priority and a state of emergency must ensue. This person must be a widely known, appreciated and liked figure, well connected and with the legal authority to cut through red tape, circumvent regulatory procedures, go around commissions, committees and bureaucrats. On the other hand, he must not be given too much power, lest he abuses it. Stringent checks and balances must be implemented to prevent corruption.

PART FOUR

The person that this project would be entrusted to, must have enormous knowledge in the field of international finances and must exceptionally well know the problems and needs of Macedonia.

Under the coordination of the specially assigned person by the government (he should be a member of the cabinet) and with the Agency for the Promotion of Macedonia, in the first phase that should last not longer than 6 months, the activities must be taken in 3 directions:

Permanent and regular contact with the direct participants in the capital markets of Macedonia: the managers of the companies, the stock exchange, banks and brokerage firms and big investors. The objective of these contacts is to deeply, and from various points of view, to tackle the essence of the problems, and to avoid any vacuum on the vertical axis of contacts between the government and any other participant on the capital markets.

To prepare several studies regarding Macedonia, in general and certain companies, in particular, where the possibilities and the conditions that this market is offering and is planning to offer are realistically presented. The big financiers in the world should be "bombarded" with these publications. All the positive aspects of investment in this market and, concretely, in certain projects must be mentioned in them. It must also be mentioned that these reports are intended only to attract the interest of the foreign companies in certain projects. This should be followed by engaging a local legal counsel in the second phase, and usually by sending representatives to Macedonia, to consummate the third phase of engaging a broker, and carrying out the deal. After the money is invested (and possible even before that), the research and development departments of the Western companies will start to independently prepare reviews, reports and other printed material regarding Macedonia, in order to realize a profit from the deal, and to interest other multinationals to invest in the Macedonian market. This means that the country must initiate the project and accelerate it. So far, only a couple of companies have prepared reports about Macedonia. One of them is Bankers Trust where in November 1997, I was told that for the time being this famous multinational company has no intention to invest in Macedonia. Recently Merrill Lynch issued a research report concerning Macedonia, but they also have no intention to invest in Macedonia at least till the year 2000. This is what the director of Merrill Lynch Frankfurt, Mr. Wolfgang Eickmann, sincerely told me, in reply to my questions a year ago. But there are many other large multinational companies, that are interested to invest in Macedonia. Unfortunately because of many reasons, and above all, because of lack of information, the small scope of the market and bad legal regulations they don't do so.

Sam: My experience has been similar. The "biggies" – Merril Lynch and the like – are not likely to invest in Macedonia until it is a much more developed market, internally. The size is simply too small. It is not cost efficient to dedicate research manpower and other resources to a market where the number of transactions is likely to be very small. But smaller financial institutions –

and there are hundreds – might be interested. The World Bank lists more that 20 private, small, mostly equity, funds that are interested to invest here. But these funds are under-staffed, do not have serious research departments (if at all), are short on budgets. They are flooded by waves of business plans, brochures, offers and requests. Their attention must be attracted. The first factor in attracting attention is the identity of the market that the proposal is coming from. A business plan from Slovenia will get much more attention than its twin from Macedonia. Admittedly, the fundamentals of the two markets are very different – but there is also a heavy problem of image and market awareness. I myself was told by an IFC official that the Macedonians are a "Kaffana nation". The Macedonians are perceived to be lazy, unreliable, unknowledgeable, not decisive, fickle, unaware of the most basic concepts of time, obligation, contract and loyalty. The lack of disclosure in financial statements, the inefficient courts, the corruption, the bad working habits, the high unemployment – all accentuate this flawed image. No one, until now, made a serious effort to courageously confront this image, dismantle it and offer an alternative. No one markets Macedonia, its people, its culture, its markets, its industries. No one has bothered to learn the mentality of the money providers, their language, their worldview, their hopes and fears.

Nikola: ***It would be useful if the government of Macedonia, besides the specially appointed person, and the specialized Agency for the Promotion of Macedonia, also engages:***

- ***Companies – consultants, at least in London, New York and Frankfurt , that would be remunerated through a flat rate combined with a***

percentage of every realized deal; Besides using the services of the Law and Economy Faculties in Skopje, the government should engage independent financial consultants, in Macedonia and abroad;

- ***The embassies of Macedonia in the big financial centers should have new appointees besides the existing staff: qualitative representative of Macedonia with expert help from economists associated with this project.***

Sam: I wholeheartedly support these two recommendations. Not because I am a foreign consultant, who lives in Macedonia. I render my services to the government (when they are required), my lectures and my articles free of charge. I think that Macedonia should be instructed as to how to market itself – it is doing such a bad job now, that nothing can be worse. Moreover, Macedonians seem not to believe in their own country. They keep telling me how deficient and defunct it is and how much they would have like to leave it and to go to greener, Western, pastures. Whenever I express optimism, they put me down, or even accuse me of some political collusion. Sometimes, you look to me like a nation of pessimists, waiting for the worst to happen with a masochistic joy. This is not the way to promote a country. Let others do the work for you until your mood improves. Agree to be taught, only the truly wise know that they do not know.

Nikola: The Agency for the Promotion of Macedonia, that was recently established, must not transform itself from its promotional and marketing roles into some kind of a mediator, that would add to the bureaucracy of this sphere.

The impression is that the external problems could be solved much faster than the internal ones, because of, as one high-level financial expert and politician in Macedonia stated: "the hostility of the domestic managers of the companies towards the foreign capital", which more or less is the generator of every other problem in Macedonia with regards to the attraction of foreign investments. This situation will sooner or later change, but the conditions and the environment will no longer be the same. The favorable conditions for foreign investments have its timing, just like everything else.

The lagging behind the technical-technological developments and the enormous insufficiency of capital in Macedonia, will very quickly lead to the so called "third degree" privatization. Most people that are generating today the negative situations in Macedonia will be disposed to sell in panic the already privatized companies, realizing that even the low price with which they managed to buy the company is already too high, because of the stagnation in its development. We will not even dare to estimate the damage to the Macedonian national economy. We will see to what extent will the current long-term stagnation in development make the Macedonian products less competitive, and to what extent it will affect the (un)employment. The entire lack of foreign investments is indirectly or directly damaging the budget and the trade balance of Macedonia.

Sam: I have been warning for a year regarding this forthcoming forced privatization. Years were lost. Any competitive edge that Macedonia might have had has been completely eroded. World markets have been lost to competitors. The nation has lost the wealth that could have been generated to it through the orderly sale of the privatized firms. Now, the bulk of these firms, still badly managed, under-funded, without export markets, new ideas, new technology and new management – will collapse. Unemployment will surge. Foreign investors will come in (if they will know what is happening!) and pick up the shards cheaply. The process has already started and agro-businesses are offered for a pittance by both Agencies (Privatization and Rehabilitation of the Banks).

Nikola: ***There is a saying: " you can take something away from somebody by force, but not give something to him (by force)…"***

If Macedonia wants to be successful at attracting foreign investments, it should demonstrate that it has investment possibilities. This can be accomplished by permanent travels of a representative of the government, by attracting foreign delegations, by collaborating with representatives of the industry and commerce. The promotion of Macedonia in business and financial newspapers and magazines in the world must be frequent. Advertising in other kinds of magazines (for example: magazines of air-carriers) should not be excluded.

FOREIGN INVESTMENTS (4)

Legal Environment

The legal environment is the starting point of serious intentions for attracting large amounts of foreign investments. There is a need for customized laws and/or for the introduction of changes to existing laws, which will give the capital market in Macedonia at least approximately equal conditions with the same in other countries in transition, not to mention more favorable ones.

You can get the impression that the legal environment in Macedonia regarding foreign capital, is made to prevent foreign investments from entering. This is the case with certain regulations under the Law for Business Associations, the Law for Foreign Exchange Transactions, tax laws and other laws.

First of all there is no law for foreign investments as a "lex specialis". It is a big lacuna in the legislation in Macedonia. Of course it would mean discrimination against domestic companies, but we must know that if we want foreign investment, the discrimination is unavoidable. Even now there are a few discriminatory articles in the laws of Macedonia (e.g., tax laws), but obviously it is not enough. All East European countries gave strong stimuli (and this means discrimination) to foreign investors. This is our fate.

But Macedonia is an opposite case. In Macedonia, more laws contain discrimination against foreign investors or non-standard legal conditions for investment.

The Macedonian courts must accord faster treatment to all the matters involving a foreign company or a foreign investor.

Sam: Laws are complex things. They are like organisms. They evolve, prosper, die, inherit and bequeath. The legislation in Macedonia is no worse than in other countries. In certain respects it is better. It has been copied – almost verbatim – from the laws of more advanced countries (like Germany). Though it contains a lot of inapplicable provisions – largely, it should have been sufficient. The problem, therefore, is not with the laws. The problems lie in extra-legal matters. To start with, people have no respect for economic laws. They violate them openly, all the time. Then, special interest groups collude with politicians to generate laws suitable for their own, highly idiosyncratic needs, or to change existing laws accordingly, or to prevent potentially harmful legislation, or openly and flagrantly violate them with immunity. The laws that are enforced are subject to the court system. Notoriously over-burdened, inefficient, slow and confused (it is not rare to get conflicting interpretations to the same text by different judges) – the courts are considered by foreign investors to be the problem, not its solution. This means the extra-legal (criminal and private) enforcement systems are likely to develop and this deters investors even further. A court decision is nothing much without an efficient, largely non-corrupt police to enforce it. Special incentives (taxes, grants), special industrial zones and trade zones, off shore banking – all are very important. The ability to operate without too much bureaucracy (permits, red tape) – is also very important. Geopolitical stability counts. But, above all, the investor is concerned about his property and his ability to "repatriate" it in case of trouble. Will he be able to buy the necessary amount of foreign exchange? Will he be able to transfer all of it freely in one day? Is the collateral given to him by his local partner / borrower secure and properly registered? Will his rights as a minority shareholder be fully upheld? Can he get reasonably quick justice from the courts? Can he enforce court decisions in his favour? The answers to all these questions are, unfortunately, still negative.

In the past, I proposed to establish a special court (within the existing court system) for foreign investors. This court will be obliged by law to render a decision and judgement in six months time. Otherwise, it will have all the authority and responsibility of a regular court. This single act may be more important than reams of paper imprinted with the right verbiage of non-applicable laws.

Nikola: ***I will try to review the more important bits of legislation now. The first is the Law for Business Associations (in the following text LBA):***

The most significant change in every legal act that the government must take, if it seriously plans to begin a project of this kind, is to delete paragraph 2 article 290 in LBA. This paragraph gives an opportunity to the managing organs of private enterprises to condition the transfer of shares issued by the company. Instead of that there should be: "the transfer of the shares is free and the managing organs of the associations have no right in any way to condition the transfer of shares, when the buyer and the seller of the shares made a transfer - buying and selling of capital shares- in accordance to the existing legal regulations."

Besides this, in the section dealing with the penal aspects of the same law, there should be serious punishment for the company and for the managing organs in case of a violation of this regulation. The deviations from this regulation should be regulated in details with a law. For example, for performing a transaction with bank shares above a certain percentage, a prior consent is needed from the NBRM. If this consent (permit) is not provided, the managing organs have the right and the obligation to condition the transaction.

The Securities Commission of the Republic of Macedonia asked for an opinion from SEC of the USA, and received the following answer:

"Regarding the provisions of the Macedonian Law for Business Associations concerning the questions mentioned above, we think that the Macedonian provisions are too general and can create confusion and misuse. The regulations do not deal with the permitted limitations, and a conclusion can be reached that they are giving carte blanche to the association or to the managing board. The regulations do not elaborate on the types of notification of limitations which is necessary if they should be applied against another person, especially the persons that according to the American concept would appear as bona fide buyers. Also, the regulations create an unacceptable opportunity to transfer the ownership of the shares to another person, without the consent of the owner, in order to take away significant property rights. (Capital no. 10, the magazine of the SEC of the Republic of Macedonia).

The creators of the Macedonian stock exchange, Mr. Andy Wilson and Barry J. Bird from the consultancy ISC (the first is the former Executive Director of the London Stock Exchange), also estimated that this article is the main reason for the absence of foreign capital in Macedonia in the form of portfolio investments, and for the stagnation in the development of the stock exchange in Skopje.

"It is very difficult to imagine a good reason why an association whose shares are publicly traded, prohibits the legitimate shareholders to sell their shares, except if their intention is not to allow the members of the Board of Directors to buy shares at prices suitable for them."

Most of the stock companies in Macedonia have this regulation in their statute. Most of them even predicted that their administrative organs will determine the price of the shares, which will be sold to the members of the Board.

If the companies whose shares are traded in public must grant permits for any transfer of their shares, than there is a very serious risk that nobody will care to invest in them. This refers, particularly, to foreign investors who don't think that it is reasonable to ask for a prior approval from the business associations to sell their own shares. Members of the board of directors, who want to buy other shares, need to do so in competition with the public, and not to have privileges at the expense of other shareholders. Due to this provision in the Law for Investment Funds in Macedonia it will be very difficult to trade shares. Now the probability that the Investment Funds in Macedonia (whose development is likely to encounter other problems), will not function properly is very high, and that will have inevitable negative results on the saving and on the Macedonian economy.

One of the arguments for including this article in the Law for Business Associations is that this will help the stock companies in preventing unwanted actions. However, it is not a way to achieve that goal; it could be stopped with regulations and a behavior codex in the case of taking over and associating.

Sam: When it comes to introducing new partners into their businesses – especially foreign partners – the Macedonian managers become very defensive. They refrain from disclosing or voluntarily divulging information. They instruct their accountants to hide more than to tell. They assure the workers (most of them uneducated) that they are doing all this so as to prevent mass layoffs. They are waving the scarecrow of the mean, brutal, profit seeking, capitalist, who has no concepts of social solidarity or humanity. This article – and others like it – reflects the mentality, it does not create it. It is a bunker, fortress mentality. People, on all levels, are afraid to face the inevitable shocks of mass redundancies (as industry grows more efficient, technology replaces labour intensive functions and the economy moves up scale). All the major companies that I met and worked with regarded the stock exchange as a threat, not as a source of financing. Today, the managers maintain a monopoly of information. The financial reports are tax driven and do not reflect reality. Inn this kind of environment it is easy to benefit privately. Throwing the company open to all manner of non-collaborating foreigners with their strange notions of equity, justice and transparency – is not good for business.

Nikola: My experience with potential Western investors, shows that to talk about more serious portfolio investments under these conditions is almost impossible and not serious.

This is because of the possibility, given to the Board of Directors of the companies to manipulate the ownership structure. To foreign investors, the possibility that the future of their investment will depend on the good will of a company's administrative organ is unacceptable, not serious, and deters them from investing. There are precedents (for example in Russia). In 1946, the communist government of the " new social order" took away the property of the citizens, "by law". From the legal point of view, everything was fine. Today, in some ex-communist countries, there are still attempts to limit the freedom of the use and disposition of private property.

This problem concerns both foreign investors and thousands of small shareholders in the country.

The most alarming thing in Macedonia regarding this question, is that, until now, not one serious force or lobby appear, that concretely and seriously addressed this issue. Potential candidates include: political parties, journalists, powerful non-governmental organizations, trade unions, the political opposition, the professors' lobby, the management lobby etc.

Sam: this supports my previous thesis, that everyone is content with these calm waters, no matter how infested they are…

Nikola: The government of Macedonia, according to unofficial sources, will be required by the International Financial Institution to delete this article, as a condition for further investments.

This article is a result of the ineffective law of privatization in Macedonia. This fact (the inefficacy of the whole process) is less and less disputed in Macedonia both by those who authored the law and by those who were responsible to implement it.

Once the primary and secondary cycles of privatization in Macedonian ended (and the shares were concentrated at the management levels) - the third cycle of privatization will begin. Then, the defenders of this law will ask for changes in it, because of the impossibility - without foreign capital - to keep up with the industrial development of competitive companies in the countries in the area and worldwide. Unfortunately, many opportunities will been missed by then, and the citizens of the middle and poorer classes of Macedonia are likely to feel the brunt. 90 per cent of the nation belongs to middle and poor class of citizens. There is low probability that this law will be changed till the next parliament elections in Macedonia, so as to avoid conflict between the government and the management lobby. The resolution of this question depends on the pre-election government calculus, on pressure applied by international financial institutions. In the best case it will be changed just before or after the elections. In worst case, only after completion of the privatization process in Macedonia in the year 2001.

When we discuss the Law for Business Associations, ***it seems that there is a need for a clear distinction between the open and closed types of stock companies, also known as public and private companies of the Anglo-Saxons type of legislation.*** The first ones should have much more facilities and faculties than the second ones.

Sam: Just so that the wrong impression is not created, such provisions are to be found in laws in many countries, both developing and developed. In the Russian Joint Stock Companies (JSC) Act of 1/1996 it is expressly stated that a shareholder (in a closed company) will not be allowed to sell his shares, or transfer (assign) them to another –

unless such a move has been approved by ALL the other shareholders. Shareholders, even in public companies (if the Statute says so) have preemptive (first refusal) rights to buy the shares of other shareholders who wish to sell their holdings. The situation is not much different in the Czech Republic and in Slovenia, to mention but two examples. Actually, even in German legislation we can find traces of this attitude. The USA and the UK are exceptions, in this sense, and not the rule. Even today, limitations apply to the free transferability of shares following a flotation (Initial and Subsequent Public Offerings).

PART FIVE

Nikola: A second big problem for the entry of foreign capital, is that in the current Foreign Exchange Working Law (Official newspaper of RM No 30/93) a specific possibility for the entry of foreign currency into Macedonia for the purposes of buying securities is not foreseen.

In article 90, item 3 of the above mentioned Law, it is predicated that a domestic party, on the basis of a foreign exchange deposit of a foreign depositor, may keep foreign exchange on a foreign exchange account in an authorized bank for working abroad, if said party has contracted to keep the foreign exchange in the foreign exchange account, or to use it for purposes consolidated in the deposit agreement.

In 1993, when this law was passed, there was no stock exchange in Macedonia, but after its inauguration, and after the passing of a law which stated that any trade in securities must be conducted through the stock exchange (article 186 of the Law for Issuing and Trading Securities), no one in Macedonia found a reason (nor wanted to find one) to amend this Law.

A lot of illogical situations regarding foreign capital are to be found in the chapter dealing with the purchase of securities and titled "Frozen Savings", - facts which are contrary to the statements of Macedonia that there is a great need and great wish to attract foreign capital.

These problems are regulated with the ***Manual for the Means and Procedures for using the Deposits of Foreign Exchange which belongs to the citizens for buying shares and portions of Companies with Social Capital (Official newspaper of RM No 7/95).***

This manual constituted a permit to use the deposited foreign currencies which belonged to the citizens, for the purposes of buying shares and portions of companies in transformation. This was allowed only to domestic or foreign individuals who are buying shares or portions of these companies. Because the serious foreign investors are legal entities (although exceptions do occur), in practice this Manual meant that insiders in the companies (called: "The Management Team", the establishment) who were in control of the management could buy the company at a 35%-45% discount, through the so called "frozen foreign exchange" and buy stock companies according to the Law. If any foreign company wanted to buy the same company through the Agency for Privatization it would have had to pay in cash without such a discount. This deprived the legal companies of their right to have received an equal discount of 40% of the price they should have paid for the Macedonian non-privatized social enterprises. And this is when Agency for Privatization and the government of Macedonia were proclaiming that they would gladly sell to a foreign investor, but such an investor is nowhere to be found.

Sam: I do not need to protect my reputation as a severe critic of the way that the privatization was handled. I just, again, would like to put things in perspective. The same gimmicks – and worse – were employed by virtually all the nomenclatures throughout the former socialist block. National wealth was plundered not only in Macedonia. Foreign exchange restrictions which applied to purchase and sale of securities were in existence as late as 1990 in Israel and even in the USA some form of them existed until 1971. I suggest not to be too harsh on yourselves. Cronyism, nepotism, corruption, legal stupidity – are human traits, not confined to Macedonia. They are typical of all the corners of the Earth inhabited by humans. To my mind, the question is not what has been done wrong – because it cannot be reversed. Any reversal now will damage Macedonia more than any status quo. The future should interest us. The big guys finished their lunch, let us enjoy the crumbs. There is no point in going home hungry. This is why I appreciate your practical suggestions: the elimination of these parts in the laws that make foreign investments prohibitive and dangerous. Let us hope that the incentive – that evidently existed – to keep them on the books has waned.

Nikola: I did not mention the domestic legal entities on purpose, because the largest part of the sale (privatization) of the social enterprises in Macedonia, was made to domestic physical persons (management teams and employees).

The stock exchange in Skopje is less and less transparent. You can see the reports of the trade from time to time in only one Macedonian newspaper.

The domestic investors can be informed about the operation on the stock exchange only if they call the brokers and probably the stock market on the phone. That is not a problem of the newspapers, but of the stock exchange. The foreign investors can follow the happenings on Telerate and sometimes on Reuters (without information regarding the prices of the shares that can be bought with frozen foreign currency) and the lack of a stock market index is discouraging them.

There are other possibilities for changing some existing systems in Macedonia: ***changing the concept of the stock exchange, that is introducing computer trading and/or new members of the stock exchange, dealers, or specialists who will offer prices for selling and buying at every moment (Law for Issuing and Trading Securities)***. This would improve the liquidity of the stock exchange, and would allow to create a kind of an index (better than none). This is a subject that should be explained separately. Changing the stock exchange model will give more efficient results, if it is followed by changes in the laws that I mentioned.

Sam: The Macedonian Stock Exchange really deserves a separate treatment. But I am afraid that changes that are merely technical or technological in nature will not suffice to revive it. An index is very important when there is liquidity. Liquidity is there when shares are on offer.

Shares are on offer when companies think that they will benefit by listing. But in Macedonia, there are no companies, there are only managers. They have very little incentive to introduce new shareholders to their little kingdoms. Shareholders ask questions, sometimes uncomfortable questions. So, very few companies are listed. The dull supply attracted even duller demand, lack of liquidity ensued and the market died. It was up to the government to resuscitate this vital instrument. It could have privatized through it, borrowed through it and it could have forced the new class of shareholders to conduct trading through the stock exchange. None of this happened. There was no political commitment to the success of a stock exchange. There was no mass education campaign, there was nothing to offer, there was too much paranoia and hostility.

Nikola: The impression, to put it mildly, is that the indeterminate strategic objective of the Macedonian legislation regarding foreign investments is not coincidental. This can be seen in the following:

TAX LAWS

According to many domestic and foreign legal and economic commentators, in this group of laws, the tax laws in Macedonia regarding the taxation of capital, especially foreign capital, are written as though they should not be understood. Unintelligible would also mean ambiguous. It means that they can be interpreted "either way", at whim, as it suits somebody in a given moment.

One part the law states that in Macedonia every physical and legal person, resident or not, is a taxpayer of the income tax, that is the profit that will be realized on the territory on the republic, and on another place (article 33 of the Law for the income tax) it is stated that in the first 3 years, under certain circumstances, the profit generated by the foreigner from invested funds is exempted from tax.

The uncertainty about existing ***official secret gazettes*** as a remainder from the communist period is increasing the confusion.

A repatriation of profit is encumbered by a 10% tax (article 33 of the Income Tax Law) and article 26 of the same Law states that potential investors who would like to invest in speculative deals (short term buying and selling with profit) are de-stimulated. Under current conditions, with a totally illiquid capital market - this is pure masochism.

According to this article, capital gains from the sale of shares and bonds (the capital generated by a sale minus the respective liability or cost assumed during the purchase) that the taxpayer held for a period of less than 12 months will be completely included in the tax base. Long-term capital gains from the sale of shares and bonds that the taxpayer owned for12 months or more, will be included in the tax base in an amount equal to 50% of the difference between the cost of purchase and the sale's income.

To think and act long-term, an investor needs security, something that the foreign investors doesn't see in Macedonia (for now). Without their risk capital there will be very little or no liquidity at all on the stock exchange. No businessman is against quick profit. The only difference between the investor and the speculator is in how long they remain in the same market. The joke that the investor is a speculator who did not succeed in his speculation is very famous.

There are similar regulations in the laws of other countries. For example, in Germany there is a deadline of 6 months, instead of 1 year in Macedonia. Not only is the deadline twice shorter, but the fact that Germany is not as risky a state as Macedonia is crucial.

The speculators are essential in the markets with high uncertainty and in the economies in transition. They are very important in this phase of the economic cycle in Macedonia. In these circumstances when long term investors are hard to attract, the speculators would be a good temporary replacement, and the Macedonian tax law should not stop it.

Sam: Speculators have two important functions. Firstly, they provide liquidity to illiquid markets. They are like high risk bankers. They stop the gap between conventional financing (mainly debt) and long term financing (equity and multilateral lending). Additionally, they help the markets generate a price mechanism. In other words, speculators fix prices by taking into consideration all the information, both publicly available and less available. The prices fixed by speculators in themselves constitute important information: corporate warnings, exciting announcements, major crises – the speculators know it all and convey these data to us through the prices that they trade in. Speculators also carry out invaluable arbitrage transactions. They equate the prices of the same good, commodity, or securities in two or more markets by buying (at a rising price) in the cheaper market and selling (at a declining price) in the more expensive one.

However, experience in tiny to small stock exchanges (example: Vancouver, Tel-Aviv) teaches us that it is better to discourage speculation as long as the market is thin and immature. In the absence of transparency, sophistication, experience and, above all, liquidity, speculation deteriorates very fast to market cornering, stock manipulation and insider trading. This, in turn, leads to major crashes and, ultimately, to long years of illiquidity. I, therefore, do support the law. I think that it is reasonable, under the circumstances. I know of no country in the world that does not have similar provisions – a discrimination in the treatment of capital gains in accordance with the length of the period of holding. Some countries prefer not to levy capital gains at all – or to treat capital gains as a regular income to all intents and purposes. The former approach might be the best for Macedonia. Israel has no capital gains tax applicable to traded securities. It helped to turn the Tel-Aviv Stock Exchange from a puny, criminal ridden, place to the vibrant, interesting small stock exchange that it is today.

PART SIX

Nikola: ***The possibility for certain privileges on the basis of the invested foreign capital is provided in the Law of Customs Officials (The Gazette of the Republic of Macedonia no. 20/93, 1/95, 24/95, 31/95,63/95,40/96 and 15/97) and in the Income Tax Law (Gazette of RM no.***

80/93……71/96) which are not sufficiently compared to the same laws in some other countries in transition.

At first sight, article 33 of the Income Tax Law provides some benefits, but when one analyzes the article, one sees that only a small number of foreign investors (those who plan to keep the capital in Macedonia for a period longer than 6 years) are able to enjoy these benefits. According to this article, to the three years of tax exemption, at least three more years should be added, in which the capital must not leave the firm of the foreign investor in order not to have to return the tax exemption to the state. Again, the speculators that are needed so much at this moment are discouraged.

It is interesting that the new laws (for example the Law of Business Associations) that replaced some old ones (Law for Foreign Investments) do not have any particular planned modifications for improving the conditions for attracting foreign capital.

The transfers of the deposit and the profits of a foreigner are regulated in article 28 of the Law for Business Associations, paragraph 2 and in article 48 of the Law for Working with Foreign Capital (Gazette of RM no. 30/93 and 40/96). Again, these are all right at first sight, but when it is scrutinized, many unascertained things are revealed.

Some countries, Poland for example, which are very successful in promoting shareholding and their domestic companies, introduced tax benefits in the years when their stock exchanges were forming. They exempted from taxation the capital gain realized with issuing securities through brokerage firms. Besides that, countries like

France and Great Britain offered tax benefits for collective investment programs. The objective of Macedonia must be to create the most favorable environment for attracting foreign capital. The means for achieving this, must not have any negative effect on the budget income, and should contribute to the global development of the national economy in the country.

Actually the main problem in the tax sphere is not the low degree of exempting foreigners from taxes, but the large and slow bureaucratic procedures in carrying it out, the indetermination and the ambiguity of the Macedonian laws.

For example, on the question how many percent should the legal persons - foreign investors pay on interest income from bonds, on dividends and capital gains in Macedonia, one Macedonian expert answered: "maybe they will pay 15% and maybe nothing. Many details in this field are not regulated, so if they don't pay nobody will charge them … except, if they are in the way"...

Is it all accidental, or is it a result of a thought-out policy in Macedonia?

Sam: I, personally, am no fan of conspiracy theories. There is a famous "Hanlon's Razor" which says "Never attribute to malice that which can be adequately explained by stupidity". I think that in the case of Macedonia, a shock was involved, so enormous, that it paralyzed the elites. Short term thinking is the daughter of insecurity. People began to seize whatever they could, as though there will be no tomorrow. The legislation reflected the total chaos that ensued. I see no policy in the mess that Macedonian laws are – I see human beings cast into a totally unknown situation, fearsome and awesome, with enormous potential and even greater risks.

Nikola: Besides the provision for unlimited participation of foreigners (in the Law of Business Associations) in an enterprise partly or wholly foreign-owned, foreigners can not obtain a majority stake in other associations.

If this case, the rights of the association which holds the majority will be limited at the depending association based on the number of shares.

The bureaucratic procedure for foreign capital according to the same law is too complicated. The investments of foreigners in the newly founded or the existing association must be registered at the Ministry for Economic Relations with Foreigners. On the request of the foreigner, the authorized ministry will issue a permit for the foundation of an association which is totally in the ownership of one or more foreigners, meaning that they have the majority (article 27 from LBA). If within 60 days from the day of submitting the request, the authorized ministry does not issue a permit then the permit for foundation i.e. foreign holding is deemed to be denied (!!!). When the foreigner does not reach or exceed a major holding, the participation in the newly formed that is the existing association is only registered in the Register of Foreign Investments, in this Ministry.

The question is asked:

What will happen to the prices of the shares of a Macedonian private company on the stock exchange, when one whole Ministry (which means the entire public) will find out that a certain foreign company intends to buy the majority of the shares? (especially if the domestic company is totally privatized through an employee buyout scheme). We must not forget that Macedonia is a small country, and news travel fast. We are forced to conclude that the small shareholders will ask for a higher price for their shares, even before the foreign company asks for a permit from the ministry. This is a serious reason why the foreign investor should reexamine his intention. This method is acceptable (in a milder form) for taking over a domestic bank or specifically determined legal entities which are of a strategic importance for the state. But does Macedonia need this kind of barriers in its present conditions?

Sam: When I go to a hotel with my Macedonian girlfriend, I pay twice as much as she does, in the best case. My passport is confiscated and my details are immediately reported to the police on a special form. This is discrimination, not to say xenophobia. The law should treat locals and foreigners in the same way as far as ownership is concerned. Trading shares, buying and selling them from other shareholders voting rights, capital rights – there should be no difference. That there is still a registrar of foreign investors is outlandish. That a foreign investor should depend for his investment on a bureaucrat who usually is not qualified or educated to deal with these matters is surrealistic. These things, these remnants of a dark past of idiocy should be immediately and unconditionally abolished if Macedonia wishes to become a respectable (European …) member of the family of economic nations. There is nothing to fear. Foreign investors don't bite and most of them do not even have horns. This is provincial thinking of the worst kind.

Nikola: Legislating a ***law of investment funds*** is one of the conditions for the creation of a free and liquid market. The investment funds are an ideal medium for saving, through which the domestic and foreign investors will be able to invest money in Macedonia. These funds will allow the potential investors to diversify the risk and through one policy of long-term investments to contribute to the stabilization of the prices.

In the Macedonian law the term "open funds" does not exist, and the status of the trusts is not regulated. Although conditions for proper forming and regulating investment funds can be created with a law, their formation and operation can not be brought about only by a law. Additionally, a market for their functioning can not be provided by making a law in this field.

The segment into which Macedonia can attract foreign investments the quickest, is state and municipal bonds. But the legislator created a "riddle" here both for those who want to issue the bonds and for those who are interested in investing their money in them. In the Law for Changing and Supplementing the Law for Building Terrain (Gazette of RM no. 21/91) the legislator, in article 5 declares: "the terrain in the cities and other regions prepared for housing construction and other complex construction for which an urban plan is made belongs to the republic."

This means that the communities don't nave their own property – in the form of territory, and if they want to construct with their own and/or borrowed money (bonds) they have three negative alternatives:

First, to tear down an old building on already existing locations that belong to them and with an alteration to the urban plan, to construct anew with the taxpayers money. This is a very long and complicated procedure, and in most cases impossible.

Second, to ask the republic (government) to award them a land plot for construction, which is even more complicated and the probability for realizing it is smaller. When one considers the bureaucracy, politics and the incomplete concept regarding when, where and to whom the state can (not) award land… and

Third, not to build, which means to stagnate. This is the most likely variant, judging by my conversations with several mayors of the biggest communities in Macedonia. Who is winning and who is loosing? It seems that everybody is loosing (the state, people, municipality, investors etc.) and nobody is winning.

The arguments "for" this law, which later is incorporated in several other laws, is not to endow the municipalities with greater power, especially those whose leaders have "suspicious intentions". But there are many other methods and means for the state to control the municipalities and their leaders, then to take away their land.

Sam: In very few countries is the majority of the land mass owned by individuals or even by municipalities. In countries as diverse as China, the United Kingdom and Israel the situation is very similar to Macedonia. Again, I think that the problem is not the land, or the construction, or the laws. I think that the basic isue is that of the breakdown of trust. In the USA "munis" (municipal bonds) are issued against future tax receipts or against future income from specific projects. People believe each other, they believe the issuing municipalities and, above all, they believe the financial markets. True, municipalities here do not own land and hardly have any tax receipts and this is bad. But no investor – foreign or domestic – would lend his money to a Macedonian municipality. They are mismanaged, corrupt, unreliable. Would you put your money in a construction project initiated by a municipality, even if the land was owned by it? Allow me to doubt it. The more realistic approach, would be to act in partnership with big private firms within well-defined specific projects with Western advisory services and auditing involved. These projects can be financed by issuing municipal bonds, because they have a projected or even a guaranteed stream of income. Such future income should go into a "sinking fund" under the control of a Western auditing firm. Legally, the whole things has to be tightly wrapped up. Sewage treatment plants, local toll roads, municipal hospitals, water treatment facilities, a shopping mall – all are such possible projects.

Nikola: ***When a serious investor wishes to invest his funds in another country, among the first things that he does, is to consult an in-house legal expert or to engage a lawyer, to make his idea legally possible and profitable. This lawyer will correspond with a local lawyer who will provide him with all the relevant laws in the country, translated and with his opinion. After joint consultations of both lawyers, the potential investor will develop or forget the idea for investing in that country.***

I hope that this explains the present situation with foreign investments in Macedonia, and why the foreign investors are bypassing Macedonia. But that is not all.

FOREIGN INVESTMENTS

Branch Offices of Known West Banks and Macro-Economy

Nikola: Besides the promotion of Macedonia and legal provisions, the third very important component of attracting foreign capital is the opening of foreign Western mega-national bank branches. **At least four reasons** can be given. They are:

1. ***Decreasing the risk to the foreign investor's money transfer;***
2. ***Creating competition between the domestic banks, which results in a healthier and more resilient banking system;***
3. ***Possibility for the injection of direct foreign credits to the economy and to the population;***
4. ***To return the trust of the clients in the banks.***

Probably, at the beginning, the clients will deposit their savings, now kept in their homes, though for a much smaller interest rate, in the foreign banks. But, in the longer run, the competition will strengthen the Macedonian Banks. By providing just a bit more acceptable terms (because the risk will still be much bigger in the Macedonian Banks) they will begin to reestablish the trust of the population in Macedonia and its confidence in the banking system. It would be the most effective and fastest way for changing the culture of savings in Macedonia and to eliminate the fear from the banks. It would be recommendable to have two branch offices of this type of banks opened, which would create competition between them, this being particularly important at the beginning.

Even the biggest Macedonian banks are to the big investment companies from the West:

1. Totally unknown (they never heard about them, and they can find their name only if they open the bank register);
2. High risk with low performance;
3. Banks with low capitalization, the same or lower than the amount of the transfer that would be done if they choose to invest 50 or 100 millions DEM in Macedonia in opening their own branch.

It is a positive sign that foreign Western capital entered one Macedonian Bank, and that the other perhaps will be bought by Western banks and institutions very soon, but it is still far from enough. The big brokerage houses are not interested in that. They ask which known banks (City Bank, Deutsche Bank, ABN – AMRO) have opened branch offices in Macedonia, and they are surprised that Macedonia is not the same as the other countries in transition where there are many branch offices of various west banks (see wider information in our first dialogue). E.g., in Bulgaria there are six branch offices of the west banks.

In Macedonia there were objective factors, which prevented banks from opening branches (instability of a region in war, closed borders, small market etc.). Still, there is information that in the first 5-6 years of the existence of Macedonia as an independent state, the Macedonian negotiators have been setting specific conditions to the interested Western banks: they were not allowed to accept savings, so that the Macedonian population was not likely to have transferred its money from the Macedonian banks to the foreign ones. Another prohibition was to ban them from making foreign exchange transactions, transfers, etc. Besides the already existing obligations for limited financial placements, in financing that was more than an unreal request. Subject to such restrictions and in view of the mentioned problems in Macedonia, we could ask what will those banks have done? Our opinion is that equal working terms should be completely supplied and extra state advantages should be given to the branch offices of the foreign banks: free location, unlimited financing, tax benefits for a longer period, time allowances for realizing the juridical processes which the bank will conduct in Macedonia until the law provisions in this field are settled etc.

Some of the domestic banks can not fight the competition and they will join or merge with the other banks or they will stop working.

The sick part of the Macedonian banking system will be amputated, the healthy part will become healthier and stronger. The foreigner's money transfer risk (short term and long term) and the risk of working with our banks (midterm and long term) for foreign investors and domestic investors and clients will decrease. The domestic banks will emulate the working methods of the Western developed banks, and this will influence the domestic economy (midterm and long term) By the way, without a doubt, the law that regulates the payments of the credit requirements of the banks must be urgently copied from the Anglo-Saxon law, because the existing situation in this field would seriously question the positive implications from the above mentioned suggestions.

Attracting at least two branch offices of famous Western banks to Macedonia will be a big plus in the eyes of the potential foreign investors. Also, the more efficient healing of the banking system on the domestic front will be thus achieved. This will have strong positive effects on the national economy, and obtaining credit will not be a privilege, or a result of personal interest, family relations and friendships, but the outcome of the quality of a project.

Besides that , the banks will expand and modernize the volume and quality of the operations, and will achieve the form of real banks - secure and more resistant.

Sam: There is nothing much that I can add to your excellent analysis. I just want to emphasize the importance of the existence of a healthy banking system to the operation of a thriving capital market. In the West these two are either complementary or competitive. On the one hand, the stock exchanges have taken over a lot of the corporate business of the banks. On the other hand, the banks themselves access the stock exchanges in order to raise capital for their operations. Many times a collaboration is forged. Mortgages, for instance, are still provided to individuals by banks. But the money comes from securitizing the mortgages: selling packaged mortgages to investors through the stock exchanges. Thus, the crystallization of a vibrant, innovative, customer-oriented, capital-adequate banking sector is very likely to encourage the formation of an equally exuberant stock exchange.

It is somewhat misleading to talk about "banks" as though they were uniform entities. They are not. There are important differences between a retail bank and an investment bank or a commercial bank. Because of the restrictive Glas-Steagall act, there are major differences between American and Continental (all-purpose) banks. Macedonia should open itself, initially, to retail banks and to investment banks. The appropriate legislation should be adopted. The right infrastructure should be made available. That foreign banks should not be discriminated against, goes without saying. Maybe a good place to start is with the capital requirements. A branch of a foreign bank has to come up with 21 million USD. This is a huge amount, unjustified by the size of the territory and by the potential to do business. Local banks require only 9 million USD. The conclusions?

(a) A branch of Chase Manhattan is less secure than a newly established Macedonian bank (this is why the larger capital requirement). And (b) Macedonia is a more interesting and lucrative market than Israel (it takes less money to open a bank in Israel).

Nikola: When the state will hasten the payment of the requirements of the banks on the basis of given credits with a law, the foreign banks (and in their footsteps, the domestic banks) will lower the interest rate and the housing mortgage market will revive, as a part of the long-term provision of credit based on a mortgage collateral, as invented and developed a long time ago in the Western countries. In these newly formed conditions, the interest rate on the domestic market will stabilize between the present interest rates in Macedonia and the interest rates of the banks in the Western countries. This will eliminate the main problems that high interest rates generate:

1. Capital Risks;
2. Capital (Credit) Supply.

Changing the consciousness of the individuals that are demanding credits, and raising the quality of the projects for which the credit is sought will follow quickly after realizing the above mentioned. Only in this way can Macedonia emulate the picture in the West, where instead of having individuals and companies compete for credits, the banks compete and advertise for clients, emphasizing their superior conditions. This way, the banks will start thinking about expanding the business, into investment banking etc. In the world today the banks are realizing the largest share of their profits through the trading of securities and derivatives in the global markets. Better conditions for reviving the trade in an effective stock exchange in Skopje will be created with the influx of foreign capital. At the same time the domestic capital will participate by finding direct interest in profit-making and investing in a portfolio of securities.

Sam: The present interest rates in Macedonia reflect not only the balance between meager supply of money and a much larger demand for it. They also reflect the fact that the default rate is probably more than 50%. I repeat: half the credits and loans are non-performing, not paid back (not even the interest) on time. It is a wonder that the interest charged is that LOW – not that it is that HIGH. Within the general disregard for contracts and obligations, it is considered acceptable not to pay back loans. People prefer to fantasize instead of face reality and this is reflected in the poor quality of the projects for which finance is sought. Even the concept of collateral is thwarted. A bank cannot rely on the debtor's cash flow precisely because the morale of payments is so low. The debtor might get paid by HIS debtors – and yet he might not. So, a lender has to rely on real estate as the only collateral realizable in case of trouble. I share your optimistic scenario as to what will happen with the introduction of branches of foreign banks in Macedonia – but I think that the process will be much longer and will not happen at all if the government does not reverse its erroneous monetary policies. A full blown restrictive monetary policy is now in force, leading to a contraction of the economy. In the absence of real liquidity, for instance, no mortgage market will take off. Buyers will simply be unable to pay the market prices of apartments. In Israel, the government stepped in and provided potential buyers with subsidized loans. Here the government is too poor to do even this. If you ask me, this – the reduced of money supply – is the heart of the problem. The economic body is starved almost to death. Under these conditions it is ridiculous to talk about investment banking. Equity investments rely mostly on discounted future streams of income and dividends. These will not be available unless the Central Bank changes its policy dramatically.

Nikola: In this context it is very important to prevent the politicization of the banks. ***Some lessons from the Asian tigers and the Eastern European countries must be learned in Macedonia. The banks must be apolitical, they should lend money only for commercial, and not political reasons***. The recent collapse of JRB, a big Slovak bank that was used for supporting sick companies is a classical case. South Korea was an inspiration for many Eastern European companies that were diversifying to many different fields. If you ask the Russian banks like Unexim why they took control over the key industrial segments, they will refer to Korea. But now when the Asian mirror shattered, the Koreans that had politicized banking system are not suitable as an example. Only one country in the region learned this lesson: Hungary whose banks are in foreign hands today and whose companies must justify it if they want money to invest. This is improved further by the restored expansion and the increased productivity.

Romania has this problem of involving politics and finances, and it seems that the reforms in this country were blocked because the ex prime minister did not dare to jeopardize his cozy relations with business and finances.

The Czech failure at restructuring its industry because of the "old boys" network that connects the banks, the funds and the managers of the companies was similar.

But the Asian collapse demonstrated one truth: businessmen and politicians can realize their dreams of poor judgement, but when the income stops, the collapse is inevitable.

Sam: It is better to generalize and say that the government should supply the conditions for the private sector to work. It should ameliorate market failures, attend to social problems, ensure a competitive environment. Market failures are situations when the private sector has no economic incentive to act. The provision of defense, crime prevention, welfare transfers and medical are for the poor are oft cited examples. The government must also ensure a competitive environment by fighting monopolies, opening up the market to foreign and domestic competition, liberalizing the foreign exchange and payments regime (gradually and carefully and after the establishment of a realistic exchange rate). It also means heavily deregulating and cutting red tape. So, there is no need to single out a specific sector. The government should definitely take its hands off the banking sector by selling it to foreigners or by refraining from politically dictating whom to lend to and how much. Politicians are unable to properly manage businesses, they are not skilled to face the harsh realities of the market. In an ideal world, politicians should do politics and businessmen should do business. This not being an ideal world – the two intermix but this should be minimized even by law. Otherwise, businessmen will find themselves engaged in lobbying and in political wheeling and dealing – rather than in profit maximization.

Nikola: It's clear that in the next few years there will be a technological revolution in banking in the world (especially in the biggest banks). The process of globalization will not skip the banks. That technological revolution will be available only to the biggest banks with the highest capitalization, biggest profits, and high quality staff and management. Investments in technology and staff training will be similarly sizable. So, the banking scene will witness the arrival of the so called "Global Players". The legal limits to Macedonian banks (It is possible to invest only 25% in fixed investments) will constitute a big problem. These limits are very strenuous. They would be possible in banks with big capitalization, but to the Macedonian banks, it will, obviously, be problem. The upper limit has to be 50 percent.

Sam: As you know, banks are merging fervently. Only in March 1998 there have been financial mergers worth more than 200 billion USD (including the Citigroup merger of Citibank and Travelers' Group). There are undeniable economies of size and competitive advantages in being big today. To cope with a global world, with global, around-the-clock, markets – global, around-the-clock banks are formed by merging and acquiring. The same trend is evident in manufacturing and in telecommunications. This is why it is surprising and very worrying that Macedonia is left out of this reshuffling. It looks as though the giants of tomorrow do not consider it to be a viable member of tomorrow's global networks. We must also not forget the Internet. Once a satisfying solution will be found to the problem of secrecy over public computer networks, it will become serious challenger to the established, old fashioned banks and financial houses. Already, shares are offered successfully through it and many off-shore banks have opened "virtual branches". The dream of "home banking" is about to come true. The Macedonian banks must be integrated into international banking alliances – otherwise none of them will survive. Even if all their capital were to be invested in technology it would have hardly been sufficient. Their clients are already complaining that they are not getting the minimal services that they require. So, technology in itself is not enough. Training is called for. The staff must become well acquainted with Western banking. There is a Macedonian Banking Operations Center (MBOC) in Skopje and I heard that it has to beg the banks to accept its (mostly free) services. It provides both training and advice in all banking matters. The banks would do well to use it while still available.

Nikola: The macroeconomic policy in Macedonia is relatively well received by foreign investors. According to the recent report of Merrill Lynch the stability in Macedonia will be preserved only if the real economy is rebuilt. So far this is not happening, judging by the slow growth and stagnating export incomes.

On the other hand, if you start from the formulation that the inner economic stability of a country means:

1. Stable prices in the national economy, and
2. Complete employment (in the relative sense of the word),

and external stability means:

1. Stabile rate of the domestic currency,
2. A balanced balance of payments.

It is clear that the present stability is under serious pressures. Also, the reality of the exchange rate is very suspicious, because a real rate is a rate that maintains a dynamically balanced balance of payments, but without control over the foreign currency, without inflation and deflation and with no use of foreign currency reserves. However, besides some imperfections from the point of view of the foreign investors, the macro-economic situation is satisfying, taking into consideration that we are talking about a country in transition.

The low inflation rate is a plus for the introduction of foreign capital into Macedonia, but it must be mentioned that if the other problems are solved, foreign investors are ready to invest even in case of a higher rate of inflation. Proof of this is that almost all the other Eastern European countries have a higher rate of inflation and, yet, much more foreign investment. An inflation rate of up to 20% annually, is not a serious obstacle for foreign investments, providing that the other mentioned problems are improved.

Sam: In my opinion the macro-economic success – and success it is – was bought at a very high price. In the past, this price had to be paid but today it is wrong and dangerous to continue fighting the last war rather than the current one. The money supply was cut down sharply, the exchange rate was maintained artificially high, liquidity was suppressed. The beast of hyperinflation was tamed and this really is a major achievement. But now the risk of inflation is small. There is no pent up demand for goods and services, which might translate into inflation. On the contrary, Macedonia seems to me to be in the throes of a deflationary cycle. Thus, the Central Bank can afford to relax the reins a bit. The exchange rate should be adapted (a devaluation of 20-30% must ensue). The budget deficit must be allowed to grow (and the excess money must be used wisely, to encourage economic activity), the money supply must be increased, credit must be made available through the banks. An inflation target of 10-15% is not destructive to an economy in transition and in growth. If these measures are not adopted, the economic outlook might turn to the worse: a widening trade and current account deficits, a panicky collapse of the currency, a depletion of the foreign exchange reserves of the country (which, anyhow, suffice for only 2 months of regular imports) and a major financial crisis leading to a recession.

FOREIGN INVESTMENTS (6)

Competition, Privatization and other Issues

Nikola: ***While in Macedonia certain companies are preoccupied with the exploitation of the unusual opportunities that article 290 of the Law for Business Association is offering, and are acquiring 51% of the***

shares through their managers, their competitors from the other ex-Yugoslav republics are moving ahead with great speed.

For example, the Serbian pharmaceuticals factories are producing medicines that they did not manufacture until now and that they used to import from Macedonia. This is closing the Serbian market to Macedonian exporters. Furthermore, their products started penetrating the Macedonian market. A lot of foreign capital was invested in the Croat firm, Pliva, (only Nomura invested 92 million German marks in 1996). It bought a pharmaceuticals and veterinarian food factory on the brink of destruction in Poland for a very high price. This way, the company will penetrate the Polish 35 million strong market through the back door. Also, thanks to the large export markets and connections that the factory has in Russia, Pliva will also enter the 200 million strong market of the Russian federation, where at the moment, Macedonian manufacturers are placing large quantities of exports. Following this deal, the German corporation BASF offered to Pliva to buy the mentioned ruined Polish factory for a higher amount. Pliva refused, but that represented an additional appreciation of the deal. The market capitalization of PLIVA before being listed on the London Stock Exchange was 500 million dollars, and after a short period of time it reached 2 billion dollars. In February 1998 PLIVA, according to its capitalization, was ranked on the 466th place among all companies in Europe.

The Slovenian Krka is building (from scratch) a new factory in Poland. Many western companies, directly (by buying Russian factories) or indirectly (by constructing new ones) are now penetrating Russia and are competing in the Russian market, so the Macedonian exporters are wasting their time in exploiting article 290 from the LBA and are missing great opportunities for foreign investments. In the meantime, they are "gaining" serious competition in their traditional Eastern European export markets.

Two years ago, two Czech research institutes prepared a special detailed study concerning foreign investments and the national economy of the country, and reached a conclusion that the Czech companies, without foreign capital, are realizing only 64% of their productivity potential compared to those with foreign capital. In certain industrial branches, for example in textiles, the processing of lumber, printing, the glass industry and the ceramics industry the number was only 50% or less. The companies that didn't have foreign capital were exporting on average 10% of their own production, while the companies with foreign investments were placing approximately 40% of their production on the foreign markets. The presence of foreign capital can bring fresh capital from abroad, enhance productivity and exports and establish a new work ethos , something that Macedonia needs badly.

Sam: This is precisely what worries me. Time does not stand still for anyone. While one country is held back by its internal problems, the others take its place. Luckily, international trade is not a "zero-sum" game. It is not that what is gained by others is eternally lost to us. Markets are constantly growing and we can still re-enter them but the price of penetration increases steeply the more a country is out of tune with the world.

Nikola: ***The model of privatization, whose strategy closed the door to foreign capital, regressed Macedonia, and obviously did not achieve the anticipated - paid privatization with a full state treasury.***

The idea behind the mass privatization in the Czech Republic was based on the assumption that the state should not try to realize profits from the process: that will slow privatization down, and with the exception of selling monopolies, like telecommunications, is not successful. The fact that the Czechs weren't burdened with large state debts, like Macedonia and others, contributed to avoiding this stupid mistake. The importance was to eliminate the state or the party from making business decisions as fast as possible, and to leave a space for developing a system, open enough to evaluate from within itself. This does not mean that this kind of a system doesn't have certain weaknesses, but they are far less damaging.

The concept of "case by case" privatization (Macedonia) requires the existence of financially powerful individuals and institutions (big amounts of domestic savings), that will be interested in what is offered and of a developed financial system. The alternative is to open the doors and to attract foreign investments. Unfortunately, Macedonia had neither, but a quasi-system of domestic insider purchases, after which the state was again left with an empty treasury as a result of this "commercial privatization".

When we talk about the domestic potential investment audience, it should be noted that choosing this direction, the state media should educate and inform the domestic public. A series of educational programmes on subjects related to the capital markets, five minutes every day in the main news and one page in a weekly newspapers should have been devoted to the current financial events in the world.

Millions of transactions are taking place daily in the world markets, and they are prime news on foreign television networks, because of their importance and influence. Only in Macedonia nobody seems to care. The Macedonians are living in an informational void with regards to business information from the planet Earth.

Sam: It is amazing how little the media – especially the electronic media – dedicate to matters economic. The only program on MTV fully concerned with finances and economics ("Business") was lately abolished. The print media are more interested – but much less all-pervasive. Television is still the preferred medium. People hardly read newspapers. But even in newspapers, there is a shortage of qualified economic reporters. They either copy whole sections from news agencies, or add on interpretations which do not always match reality. The Macedonian government has at its disposal the means – mostly free of charge – to effect an educational campaign. Foreign experts from all around the world are ready to come and teach, lecture or guide on and off the media. It is not only that the public doesn't know what is a stock exchange, or LIBOR, or loan-loss reserves. The public doesn't know what is capitalism and how – in the deeper, philosophical sense – is it different from socialism. The pursuit of personal profit is common to humans under all regimes. This is not what makes up capitalism. To properly judge the performance of their elected representatives, to understand their place and the place of their country in this rapidly changing world, people need to learn economics. No one pays attention to politics in the West. Politics has become a branch of economics. Presidents and prime ministers go up and down on the waves of economic performance. But in Macedonia, time stands still in this respect as well.

Nikola: ***Forming a central register and a clearing house is inevitable, and must be completed very soon. Introducing a legal obligation of every stock company with over 30 employees, to keep their shareholders books in a central register, will solve many problems.***

Sam: Central Registrars of EVERYTHING are essential. Today, if someone puts up his factory as a collateral – there is no certainty that it has been mortgaged over five times to six different lenders. Minority shareholders are not registered properly anywhere. Ownership of all sort is not properly attested to by any central state functionary. The absence of mutually acceptable, universal, central, well-maintained registrars means that property rights are not protected. Investments and lending are the first victims of this lack. They cannot be affected. The inefficiency and notorious slowness of the courts only adds to the deceleration of economic activities.

Nikola: ***The privatization of the public enterprises should be the next step by the government.*** This will mean more efficient and profitable operations, higher income from taxes, better customer service, etc. This should be performed very carefully, and at the same time care should be taken not to leave large space for monopolies. After the telecom, railroads would follow, the lottery, water supply, gas lines, the electrical supply industry etc. The fiasco of the state in the privatization of the City Shopping Center should serve as a good basis for a more serious approach to the next projects.

Concluding international agreements for a free customs zone will significantly annul one of the biggest imperfections of the Macedonian economy (if not the biggest, looking from the aspect of foreign investments): the "small market". Macedonia should solve its problems with the neighbors and the other countries in the region more intensively. This way, the Macedonian companies will gain a multimillion dollar market, where they should have equal competitive conditions.

PART SEVEN

The government of Macedonia should revive the issuing of bonds in Macedonia, and above all, Government and Municipal bonds. The government will appear as the guarantor, and at the beginning, the government can serve as the guarantor of corporate bonds issues of the best Macedonian companies (with a prior mortgaged property of the company and the state as a collateral). When it comes to capital projects, in the absence of a big and modern bank (or a consortium of banks) which would serve as a guarantor to the corporate bonds the government should jump start the "game". This would be a positive example for the banks to support quality projects in quality domestic companies by issuing bond guarantees. There is a great interest of foreign companies to invest in Macedonian bonds, providing that they are guaranteed by the state or by a consortium of the prime banks.

Sam: I don't think that I can support this idea. To me it would seem like nationalization through the back door.

What if the enterprise will not pay his debts? The government will have to take over, own and manage it. I am afraid that the government will end up, this way, with more assets than it succeeded to "privatize" hitherto.

Nikola: Actually, the state issued a small package of bonds against a part of the obligations for the so called "frozen deposits" in the amount of $120 million. These bonds mature in 2001, and are not traded on the Macedonian Stock Exchange, what seems, at first sight, to be a great pity. But if some unofficial sources are correct, the state intends "with a law" to prolong the maturity of these bonds. In that case the damage will be much bigger if they are traded on the Stock Exchange, and thus possessed of a greater transparency.

The government must understand that in the eyes of the foreign investors (although in this situation they are not directly involved, nevertheless with the present moves of the government they would anticipate its next), postponing the payment of issued state bonds - "with a law" is not very far from making a decision "with a law" to deprive them of their property in the future. That would be a classical example of loosing the low international rating.

In the future the state must think twice before assuming any financial obligations.

Sam: I hope that your sources are wrong. There is no such thing as "prolonging the maturity" or "postponing the payment" without the consent of the holders of the bonds. If this will be done unilaterally by the government, it will amount to a default on its obligations. A state which does not respect its obligations towards its own citizens – is not very likely to respect its outside obligations, either. Such an act will mean an abrogation of property rights in the worst sense of the word.

Nikola: The government and the local authorities should review the question of issuing domestic bonds. Besides that, it must be explained to the future owners of bonds what happens in situations when the association that issued the bonds is not in the condition to fulfill its obligations for payment of the principal and the interest. Also, some changes must be made in the Macedonian law, which would determine the status of trusts.

The state should issue a small amount of Eurobonds in spite of the availability to obtain credits without interest, in order to improve its own rating. According to many rating agencies (e.g. Euromoney) the access to capital markets plays a significant role when it comes to ranking the country. The country must demand to obtain a rating from a renowned country rating agency. At this moment any kind of rating is better than none.

For example, in 1996 Kazakhstan in its first emission of bonds on the European market reached $200 million. Even the bankers from this country were concerned about the success. The assumption was that the investors would not be convinced about the expected economic perspectives of Kazakhstan, and that they will not be ready to invest their money in the bonds. The experts advising this emission, taking stock of the circumstances in Kazakhstan, thought that this country did not have an urgent need to raise money by issuing bonds. The emission was with a view to establishing its ranking for future lending from the European bond market and for attracting foreign investments in the country. That would be an incentive and opportunity for some of the best domestic companies to demand and obtain foreign capital in the form of the sale of bonds in the future.

Sam: Good idea. I think – as you do – that just to establish a presence and generate a benchmark rating are sufficient reasons to have a Macedonian Eurobond issued. The only caveat I suggest is that the proceeds of this issue should not go into the regular budget, but rather should be earmarked for amore "noble" (that is, profitable) cause. For instance, the money can be used to encouraged small businesses through business incubators. Inventions by Macedonian citizens are now plundered by rich companies in the West because the money is not available to develop them inside the country.

Nikola: The strategy of developing and attracting foreign capital, called "development by demand" is based on developing cooperation with companies from the developed countries, above all, with the transnational companies. In other words, it is based on attracting investment capital from abroad. This was successful in many examples like Hungary, Czech, Poland, China, Singapore, South Korea, Taiwan and others. This strategy is applied by countries which don't have an internal market, and the main channels and outlets for their sales should be abroad. The countries that wish to be successful in realizing this strategy must provide some legal guarantees and privileges to the capital from the developed countries.

Some of the above mentioned countries managed to secure a quick economic development with this strategy, and they even became exporters of capital.

Sam: Playing with lions can be dangerous to one's health. Big western firms bring with them an abundance of capital, know-how, technology and access to export markets. However, they are never found in a missionary capacity. They are not looking to educate the "natives". They teach the locals the minimum needed to comply with their demands. They mostly import their management and skilled labour. They prefer to buy parts and capital assets outside the host country. They rarely transfer technology, let alone share it or the ownership of it. They are quick to dismantle their tent and move on, to greener pastures, they have no local patriotism. Their contribution to the economy – with the exception of opening up export markets and discounting the tax and investment benefits and grants that they normally demand and get – is now in great doubt. It was China, though, who found the redeeming formula. It forced all the foreign companies which wanted access to its enormous market, to establish plants on its soil. Additionally, it compelled them to transfer technology and share it, to buy local goods and services and to participate in the development of the local economy and of the capital markets. But very few ations can offer the investor a choice of 1.2 billion people. To the rest of the nations, this subordination of the foreign investment beast must await better, more prosperous, times.

Nikola: The global approach to the privatization in Macedonia was commercial, as opposed to the mass character of the processes of privatization in many other central and eastern countries. As a result several inconveniences appeared:

First, the business associations are owned and controlled by their managers and by their employees, which, in the process of privatization should buy off 51% of the shareholders capital within 5 years. In many cases that made the associations pay large dividends, for the management and the employees to be able to finance the privatization. As a result the reserves of the associations, that are needed for financing the further development drastically decreased. Also, because of the obligation to buy 51% of the capital, the incentive to collect additional (foreign or domestic) capital through the stock market is very small, because this would lead to diluting the percentage of the shareholders capital owned by the management and by the employees.

Second, in the countries where the method of mass privatization was applied, the public discovered very soon how to use the stock market as a venue for issuing and trading securities and for raising capital. In some cases, the basis that is used for evaluating the enterprises in Macedonia proved damaging for the development of the Macedonian stock exchange (for example the City Shopping Center).

Sam: To be fair, no one knows what is the "right" model of privatization, or whether there is one at all. In Britain, Margaret Thatcher was accused of cronyism long before Eastern Europe dreamt of privatization. In Israel companies were sold for a fraction of their real worth to a select elite of businessmen long before the Czech Republic repeated the procedure and Russia perfected it. Vouchers spread the national wealth equally – but prevent the formation of ownership and management nuclei. Management Funds are hotbeds of corruption and mismanagement. Incestuous relationships characterize them more than any Western methods of modern organization. Management and Employee buyouts are wasteful in the long run. How should something that nominally belongs to everyone – be sold to the few that must control it, risk their capital in it and reap the rewards, if any? No one succeeded to come up with a model which will be, at once, equitable, workable and implementable.

Nikola: The nonexistence of ***international accounting standards*** does not only negatively affect the establishment of foreign investment institutions in Macedonia, but also influences global investments in Macedonia negatively. Without uniform accounting standards it is very difficult for brokerage firms and for investors to evaluate the shares of the traded companies.

Sam: It is not only a problem of the adoption of international standards. Anyhow, there is no agreement as to which standards reflect reality best. The SEC refuses to accept the IAS (International Accounting Standards) and demands the strict implementation of the GAAP (Generally Accepted Accounting Principles) as a precondition for being listed in any American Stock Exchange. The problem is that the financial reports ae tax driven. Put less gently: accountants and managers collaborate to cheat the tax authorities by falsifying financial reports. This can be done with IAS and with GAAP, as well. It is the intention that counts. Tax evasion in Macedonia is a civil war – the citizens against the tax authorities. It indicates an abyss of trust between the populace and the various establishments. Unless and until this more fundamental problem is solved, no accounting standards will suffice.

Nikola: ***The nonexistence of foreign capital as commercial direct and especially indirect investment is very expensive for Macedonia:***

- ***Lack of serious growth of production;***
- ***High unemployment;***
- ***Stagnation in the technical and organizational development of the companies in Macedonia;***
- ***Lack of new ideas and philosophies of thinking and working;***
- ***Low standard of living, with a chance for further deterioration;***
- ***Missing the opportunity to increase the exports and to conquer new markets;***
- ***Losing the race for new markets, and especially losing the old markets;***
- ***A poorer state budget;***
- ***And as a result of all above mentioned, sooner or later, a stronger pressure on the domestic currency and inflation, meaning new debts and impoverishment.***

Until the above mentioned "open questions" are resolved, the probability of generating a greater interest in institutional investment in Macedonia is very small. This still doesn't mean that steps should not be taken to facilitate this kind of investing. The broker associations and the stock exchange can achieve very much in promoting the Macedonian market through the major investment firms and investment funds in Great Britain and in the USA. Even convincing these institutions to start seeing Macedonia as an investment opportunity could take a long time. To reach this stage, this it is necessary to establish contacts, and to activate the government of Macedonia on all the fronts mentioned in this dialogue. Detailed studies of the market and its promotion must be embarked upon. The foreign institutions will want to conduct their own analyses, but the existence of institutions in the country to which they can refer for the collection of local data and inside information is always helpful.

Until Macedonia does not open up its economy, except through declarations, it will remain without the necessary foreign commercial investments, and will wait a long time to enter the EU and other economic alliances.

Macedonia, Trade

Dialog between **Nikola Gruevski** (later, Minister of Finance and Prime Minister of Macedonia and **Sam Vaknin**, later Economic Advisor to the Government of Macedonia)

NG: The characteristics of the Republic of Macedonia, in its post independence period, from a macro point of view of the activities of exports and imports, are:

- The presence of high trade deficits;
- An increase in the portion of imports not covered by the export of goods;
- A bad structure of both exports and imports.

This, put together, led to an increase in the debts of Macedonia, and to the rescheduling of its older debts, though with no built-in strategy for their gradual decrease.

The Macedonian economy is traditionally dependent on the importation of goods and services, under conditions of deficiencies in domestic raw materials and products for consumption, hi-tech and know how services.

SV: This situation is not unique to Macedonia. With a few exceptions it applies almost fully to the USA, for instance (not to mention Russia). There has been an explosion in international trade in the last two decades (it grew more than threefold). But it has been an asymmetrical explosion: some countries were on the receiving side and benefited disproportionately (like Japan) – others financed this largest unilateral transfer of wealth in history. The result is a new form of mercantilism and economic colonialism. Some countries have become the suppliers of raw materials and cheap labour to others – and ended up consuming the very finished products created with their own raw materials and labour. No one knows why some countries end up this or that way. Geographical location has some influence: sea bound countries do better than landlocked ones. But all other factors suggested by the pundits are nothing but guesswork. Political stability, lack of corruption, good management, developed capital markets, encouragement of exports, macroeconomic stability – all seem to be only mildly relevant. Japan and Germany had endured gross destruction during the Second World War, Brazil and Israel had hyperinflation, Israel went through a bloody path of wars and terror, there are few countries more corrupt than Russia – and yet all these are major exporters. Some of them (Japan) do not even have any natural endowments or relative competitive advantages to speak of. It is a mystery to this very day.

NG: The deficit, basically, can have both positive and negative effects.

The positive effects can be generated if the realized imports include equipment, state of the art technology and techniques, investment in production capacity, re-processing etc. After a prescribed period of time, the conclusion of sales and/or exports, above all of final products, will create higher feasibility, competitiveness and profits, a flow of foreign currency into the country, and finally, will animate new investments and exports. Such developmental deficit will mean additional outside accumulation, opening the possibility to exit to foreign markets, higher production and exports.

SV: This distinction, is, of course, critical. There is a "bad deficit" which goes towards financing consumption (like Macedonia's) – and a "good deficit" which goes towards financing investments with foreign capital. Few people know that Foreign Direct Investment increases the deficit in the balance of payments of a country. But, of course, this is not considered bad at all! The reason is that a good deficit generates sufficient value in the future to return the borrowed money plus a return on it. A bad deficit generates only debts without the future ability to return them. If a deficit were generated by purchasing a new textile machine – it will bring sufficient earnings in its future to cover its cost (which created the deficit in the first place).

But if one buys a fancy Mercedes car – it generates no future income. On the contrary, it generates even more foreign exchange losses (fuel, etc.).

NG: Unfortunately, RM in the latest period, by leading an extremely liberal policy of imports and in the absence of a strategy for economic reconstruction and higher exports, instead of a developmental deficit had realized worryingly high non-developmental deficit. This was the result of the import of consumer goods, often with very suspicious quality, and as "substitutes" for what RM anyhow produces in quantities larger than needed (e.g. tomatoes, are officially are protected, yet big quantities of tomatoes from Turkey are imported). Against it, many products, which RM is forced to import, are not produced locally even though there are conditions for their profitable production. But, because of the lack of capital and of insufficient and non-trading distribution of the banks' credits (both domestic and, more so, foreign capital), such projects are not realized.

The consequences of the non-developmental deficits can be noticed in:

- The unilateral outflow of part of the national income;
- A decrease in the rating and credibility of the national economy and the "attainment" of a status of "country with high investment risk";
- Slow economic development and dynamics, on the way to deflation;
- Higher economic and political addiction of the national economy to foreign countries;
- As a result, the closure of many factories in RM, decreased production, high unemployment, a growing number of welfare recipients, a poorer budget, and an increase of the outside debt of the state. This results in low standards and quality of living.

The last consequence mentioned implies long term non-pay-back consequences, because in the last 10 years we witnessed the following process: the drain of a high percent of the well educated people, against an inflow in the last 50-70 years of which the bigger part was from the less educated classes. So, if in that period we had "cleansing", today we register the process of "brain drain".

SV: It would be naive (and I know that you are far from it) to blame all these dire consequences on a single economic factor, no matter how important. Moreover, deficits are symptoms, not the disease. By treating one's symptoms – one does not achieve healing. The brain drain – to take one example – is the result of the division of wealth among corrupts oligarchs and politicians through bogus "reforms". It is a result of the feeling of the younger generations that there is no where to advance to – unless you were born to the right family or are willing to grossly compromise your moral principles. Corruption, low social mobility, bad "communist-socialist" mentality, oppression, dysfunctional institutions, ignorance, intolerance, lack of foreign investment, geopolitical complications, (financial) crime – are all as important as the trade deficit in retarding the growth of Macedonia.

NG: The trade deficit in RM in 1995 was $514 million, in 1996 - $479,5, in 1997 - $538,8. No doubt in 1998, a deficit of about half million dollars will increase the foreign debt of the state without creating conditions for the founding of more qualitative export companies. The deficit in the current balance of payments of $216 million in 1995 increased to $276 million in 1997.

It is assumed that current account deficits of over 5% of GDP (over 3-4 years) should turn on the red light, especially if the deficits are financed by short-term debt or foreign currency reserves and if the same are the reflection of excessive spending. RM in 1997 officially reached a current account deficit level of 8.3% of the

GDP. That definitely presents the upper limit of tolerance. It cannot be expected (especially not in the longer term) to maintain such a high current account deficit without provoking tremors and cracks in other dimensions of the economic system of RM.

RM is not alone in the group of East European countries in transition with such results (Poland sports a 3.2% deficit, Slovakia 7.9%, Czech Republic 6.3%, Ukraine 1.7%, Hungary 2.2%), but it is after Bulgaria which has a surplus of 4.3%, Russia with a surplus of 0.8%, Slovenia with a surplus of 0.4%, etc. According to Business Central Europe, in absolute numbers, in billions of dollars, the situation in 1997 was as follows: Bulgaria +0.2, Croatia –1.9, Czech Republic –3.2, Estonia –0.6, Hungary –1, Poland –4.3, Russia +3.9, Slovakia –1.5, Slovenia +0.1, Ukraine –1.3, etc. It seems that RM is not alone in the club of countries with current account deficits . According to the summer issue of The Wall Street Journal Europe's Central European Economic Review, RM definitely trails the countries in the region in terms of GDP increases (below 2%) in 1997. Belorussia had 10%, Estonia - 9%, Yugoslavia more than 7%, Poland, Latvia, Slovakia, Lithuania, Croatia, Hungary and Slovenia preceded RM. Furthermore, RM is an impressive record-holder in terms of the rate of unemployment, (the lack of) foreign investments, and finally, more positively, it is second-rated in terms of its low inflation rate. Trade deficits are exhibited by many developed countries, but this is different and not comparable with RM.

SV: The saying goes: "There are white lies, plain lies and statistics". Deficit figures are highly misleading. The important questions are: is the economy on a path of growth? Is it export oriented (that is, most of its foreign exchange income is derived from exports? If so, it can easily service its mounting foreign debt. The larger the GDP growth – the smaller the share of the projected deficit. What is the deficit made of? Was the money used to finance the consumption of luxury goods or to finance research, development and capital expenditures? Is it part of an on-going pattern or an aberration? Is the economy booming? If it is prospering – deficits are a good thing because they help to prevent inflation. By directing consumption to imports – inflationary pressures are, in effect, reduced and "exported". Can the country rely on unilateral transfers? Israel can rely on billions of dollars annually from the World Jewery and from the USA. These transfers amortize a large portion of its deficits. Is the country open to outside competition and highly dynamic and mobile? If so, trade deficits are not necessarily a bad thing. They increase the competitive pressures and force the local industry to become leaner and meaner. There is no economic rule that says: "Trade deficits are inherently bad – low inflation is inherently good". In the case of Macedonia, for instance, I think that the low inflation rate is a sign of death – the demise of the economic body. Macedonia needs to reflate urgently – before its markets are deflated out of existence.

The problem with Macedonia's balance of payments deficit is that it is of the wrong kind. It signifies the collapse of local manufacturing, the death of local industries. The consumer is rarely faced with a choice. He has to purchase imports. A lot of people make money from legal (and less legal) imports in Macedonia. Smuggling, contraband, piracy of intellectual property, are rampant. Members of the political elite were given monopolies over certain types of imports. A sizable part of the trade deficit goes to Macedonian pockets. There is simply no interest to encourage local production or exports. This will hurt the profits of the robbers of the national wealth (not to mention the profits of certain customs officials and police officers). Coupled with a stagnant GDP, high unemployment, foreign handouts and strangely and suspiciously stable currency – this is a bad omen.

NG: Indeed, from these data it is easy to conclude that the deficit level is not the only important parameter – there are others that count in trying to determine the consequences. It is obvious that the deficit in RM has seriously restricted its economic development (as distinct from some other countries), which complicates the problem.

The parameter of the imbalances of the current account should be observed parallel with the policy of exchange rates and structural factors, such as the level and the composition of the foreign debt, the level of market openness and the composition of trade, the levels of savings and investments. The longer-termed deficit of the current account basically should cause alarm when the export sector is small, the servicing of the debt is onerous, savings are low, the control of the banking sector is weak and equity investments are small (weak financial system). The ratio of exports to GDP plays an extremely important role. Countries, which successfully adapted themselves, after they experienced gaping imbalances of their current accounts, such as Korea, Israel and Ireland, increased their exports dramatically, as distinct from Mexico in 1982 and Chile, which endured hard external crises. Long-term deficits, as a rule, make foreign investors reluctant to lend to the state, fearing that the country is insolvent and ready to default on its borrowing. Fast growing countries can keep longer-term deficits without increasing their external debt in relation to their GDP. Unfortunately, in RM that is not the case. The ratio of exports to GDP represents the level of openness of an economy.

To make the picture clearer, I would emphasize that all Macedonian exports in 1996 amounted to 1,147,440,000 USD and in 1997 to 1,201,255,000 USD. In global terms, these amounts are very small and not meaningful in the world economy, not even when contrasted with certain private corporations. For comparison, we could study the annual sales of the top industrial and servicing companies in the world (source: Fortune, a chart in The Economist).

In fiscal year 1997, General Motors (USA) had sales of $178 billion, Ford (USA) $150 billion, Mitsui (Japan) $140 billion, Mitsubishi (Japan) $140 billion, Royal Dutch/Shell (Netherlands/Britain) $138 billion, Itochu (Japan) $137 billion, Exxon (USA) $125 billion, Wal-Mart Stores (USA) $124 billion, Marubeni (Japan) $117 billion, Sumitomo (Japan) $100 billion, Toyota (Japan) $80 billion, General Electric (USA) $78 billion, Nissho Iwai (Japan) $71 billion, IBM (USA) $70 billion, HTT (Japan) $70 billion, AXA (France) $70 billion, Daimler-Benz (Germany) $64 billion, Daewoo (South Korea) $64 billion, Nippon Life Insurance (Japan) $64 billion, BP (Britain) $63 billion. The American car producers led in the list of Fortune 500. Nine of the ten biggest companies worldwide were Japanese and six were American. But, 12 of the 20 most profitable were not American, nor Japanese. Exxon topped the list of the most profitable with $8,5 billion. Intel was on the 125th place, judging by its sales, and on the fourth place according to its profits.

If, after these numbers, we go back to RM and ask ourselves how is it possible that exports in the last 7-8 years did not increase by at least 50%, we will be forced to conclude that something is wrong in the system. Even if we take into consideration the circumstances in the region (embargoes from north and south, Bosnia and Kosovo) the conclusion that something should be changed, holds. In support of all this I will mention that our neighbour Bulgaria last year had no deficit in the trade balance – rather, it made a small surplus. Russia, under adverse circumstances, also achieved a surplus.

SV: I am the last person to object to your conclusion that something is rotten in the current state of things and that it needs to be amended urgently. But I wish to make a pertinent distinction between "optical surpluses/deficits" in the trade balance and "real surpluses/deficits". The fist kind is generated by factors external to the country and not in any way under its control. For instance: the Russian impressive, consecutive trade surpluses were the result the of stable prices of its commodities in the world markets (over which it has very little influence – it is a "price taker"). The minute the prices of oil collapsed, the Russian surpluses went down under and with them the Russian economy as a whole. The same can be said about Nigeria, Venezuela, Saudi Arabia and dozens of other countries. A surplus can also be the result of the elimination of the purchasing power of the population. When people cut down on consumption – they cut down, first of all, on imports. It is very easy to maintain a trade surplus (and low inflation) in a state of economic depression. Another type of artificial surplus is created through the introduction of protectionist or anti-competitive measures. A country can block all imports, impose levies, customs, duties and quotas on them, deter foreign investment – and, as a result, have an eye-popping surplus.

The "real thing" is the result of open markets in sophisticated, efficient competition. Whether a country has sufficient relative advantages to sustain a trade surplus is discernible only under the "pure" conditions of free markets, unadulterated by state intervention. The country has to be open to international trade and to foreign investment. It must not protect its economic players. It must let the markets determine its exchange rates. It must encourage efficient, frictionless, banks and capital markets. Even then it stands the risk of running trade deficits (witness the USA).

NG: The balance of payments, ab definitio, is balanced. It includes all realized income and payments. Nobody can have more financial resources to pay with than he/she receives. That means that payment is either effected immediately or deferred as credit. But in economic analysis the total balance is not important. What is of importance, is only a certain part of it. The partial observation of the balance underlies the surplus or deficit approach to the balance of payments. It is for this reason that we make use of the method of "splitting" the balance of payments. After the horizontal "splitting" of the balance, employing one of three methods, there is no accounting balance left in it. The balance of the balance of payments is an element of the general economic balance, which represents the external balance.

The Macedonian balance of payments is balanced by: 1) rescheduling of debts and 2) new debts. For a real balance to exist in the long-term, without foreign currency restrictions, without frequent devaluation and appreciation and without increasing debts, the presence of an INTERNAL BALANCE is called for. The reasons for having a deficit in the balance of payments can, basically, be either monetary or structural. The latter would involve a divergence between domestic savings and domestic investments – a deficit, which if financed with foreign debts without a long-term irreversible increase of the investment side, leads to even deeper structural imbalances. A temporary remedy is incurring external debts and aiming at long-term recovery, which is the subject of this dialogue.

Besides assuming credits and debts, RM has lately covered the deficit through substantial non-returnable foreign help, which has decreased from year to year. Last year it had been only $7 million against $52 million in the previous year. This says that RM has to start living without a foreign, non-returnable "infusion". The sooner it prepares itself for such a life, the less painful will prove to be the habit of spending only as much as it makes. Alternatively, it has to implement some measures to earn more (produce and export). The large amounts transferred by Macedonian immigrants who help their relatives in the country financially, appear in the state's balance of payments in the second place after the exporting of goods, and before the exportation of services. This only confirms the sick situation in the country.

The external balance of the Macedonian economy is long-term, realistic, fundamental and destructive.

SV: Macedonians (politicians as well as "the people") adopted a magical mode of thinking. They believe that Macedonia is geo-strategically so important, that it will never be abandoned by the West. True, unilateral grants, aid and other non-returnable transfers have dwindled lately (to the point of disappearing altogether). But Macedonia is getting increasing amounts of credits, loans, military aid, structural aid (EU through PHARE) and other forms of lending. Some of this money is directly injected to the arthritic veins of the banking system in the vein hope that it will trickle down into the real economy. But most Macedonians find the idea that these monies have to be returned one day – hilarious. They believe that, when push comes to shove, these debts will be rescheduled, rolled over, renamed, converted, diverted, reverted, anything – just NOT PAID. The West will take care of it.

A parasitic economic culture has developed, dependent to an unhealthy degree upon handouts, charity, donor conferences and tacit blackmail (Kosovo, Albanians, anything goes). Instead of developing their businesses – managers dedicate all their energy to lobbying, wining, dining and bribing the politicians that hold the right purse's strings. Instead of production and exports – the country sprouted a breed of financial mediators, financial consultants, contact men and go-betweens who know (or purport to know) how to extract money from international financial institutions. Instead of worrying about structural changes – the elite concerns itself with the perpetuation of tense geopolitical situations. The nation becomes submissive, obedient and oppressive. Central Planning by faceless bureaucrats has been replaced by the Central Planning of Eurocrats, dictates from Moscow – now come from Washington, Communism is now called IMF-ism. How convenient it all is!!! How cozy!!! If the economic policies fail – the minister can blame the IMF. If they succeed – surely it is the undeniable fruit of his towering intellect.

NG: In 1949, Stalin asked a specially formed group of professionals to calculate the exchange rate of the ruble against the US dollar. Their final calculation was 14:1 to the dollar. Stalin became angry and from "14" he deleted "1". That way the USSR nationalized their first post war "exchange rate": ruble – dollar 4:1. Unfortunately, that didn't help them much in their economic development.

The dilemma: Has RM lately paid too high a price for the stability of its currency, the denar, is getting more pressing recently. The balance of payments deficit as a percentage of the GDP according to the data of the National Bank is as follows: 1994 - 5.5%, 1995 – 5.8%, 1996 – 6.4%, and according to official sources in 1997 it is pretty high, 8.13%. It seems that the macro-economic policies of RM in this respect were created only to maintain currency stability, until the balance of payments was in its function. RM should lead a more balanced policy of these two very important parameters: exchange rate of the domestic currency and balance of payments deficits. That means that in no case should the unlimited (or considerable) fluctuation of the exchange rate of the denar be allowed. Such a phenomenon will become entrenched and will foster a bigger volatility of the domestic currency. This will facilitate the conditions for an extremely unstable economy. Rather, we should create an atmosphere for a more realistic exchange rate of the domestic currency with the possibility to control the average fluctuation instead of the present de-facto fixed exchange rate. This will create a better export climate in the short-term. Even the variant of programmed monthly fluctuation of the domestic currency is already exercised in some countries, and can be subject to discussion. Anyhow, a higher instability of the domestic currency will have, besides the positive consequences, some negative ones, as well. It is like poisoned medicine which, while curing one organ harms the other. But if the patient is in a very difficult condition, the first thing, which should be done is resuscitation, the better of two evils. A More flexible domestic currency is a measure of the same caliber as short-term debts, but it seems that, at this moment, it should be a less harmful short-term interventionist measure.

By the way, maintaining an unnaturally stable domestic currency has its own time limits, following which it becomes extremely exposed, because the consequences increase geometrically and are borne by future generations.

SV: "The Economist" referred to the Macedonian denar as "eerily stable". There can be no question that it is artificially stable. The Central Bank is evidently at play and is doing a commendable job in as far as its goals are defined. Prices are stable and the domestic currency is stable – what more can a Central Banker ask for in life?

But this is an illusion, which will cost the country dearly – and very shortly. It is useful to be reminded that Russia had low inflation, a trade balance surplus and a stable Ruble rate for two years. Now it has none of these "achievements". It lost its illusory stability because it was illusory. No country in the world can maintain an average of 6% of its GDP in balance of payments deficits year in and year out and maintain a stable exchange rate. This can be done only through strangling the economy. The money supply is draconically curtailed, liquidity is snuffed, cheap imports are encouraged, inflation remains subdued and even turns into deflation. With price stability – exchange rate stability is obtained. But at what a horrible economic price!!! In a graveyard there is no inflation and the exchange rate remains eternally stable.

Granted, Macedonia should not succumb to the latest fashions. It should not allow its currency to be fully convertible internationally or traded in foreign stock exchanges. These steps are advisable only after a certain level of foreign exchange reserves is reached together with a high credibility of the Central Bank, the result of a long and successful track record of reliability. Only an exporting country with its balances in equilibrium can afford itself these luxuries of the absence of exchange controls. Even the foremost free marketers (Hong Kong, the USA) manage their currencies and intervene in their capital markets. This is not only legitimate – it is essential.

But the unnaturally overvalued denar damages Macedonia greatly. It encourages the export of scarce foreign exchange (also known as the importation of goods and services). It distorts the domestic interest rates structure. It destroys whole industries. It leads to deflation. It threatens a run on the currency, a panic similar to the one that engulfed Russia. What will the government do if Wall Street will collapse, the IMF and the World Bank will cease all disbursements, foreign investments will completely dry and thousands of citizens will want to buy dollars at any price? Will the government impose exchange controls? Freeze denar savings? Lose what remains of the credibility of the banking system?

NG: All this makes for social instability in the country, because, even ignoring the stable currency, investment rapidly decreases. Under such conditions, interest rates not only do not decrease (for which there are other reasons), but they remain at incomprehensibly high levels, where especially big margins between active and passive interest rates (about 18%) exist, a situation which sends many messages. According to some experts even this interest rate level is not very high taking into consideration the whole social instability and uncertainty as much in the economy as in the political and geopolitical situations.

SV: High interest rates in Macedonia do not intend to insure lenders against inflationary risks, because today there are deflationary risks rather than inflationary ones. Taking deflation into account, real interest rates are outlandishly high. We are forced to believe, therefore that the high interest rates are intended to compensate lenders for the risk of lending money in Macedonia (country risk) to Macedonians (half of whom never pay back) in denars (which might be severely devalued within the life of the loan).

NG: The monetary policy is an important auxiliary measure for improving the balance of payments deficit, but not the main one, especially in countries where the problem nests are of a structural (realistic) character. Its basic aim should be: matching the money supply with the money demand (transactions) while realizing the planned rate of inflation in a given year. At the same time, the monetary policy should find an optimal relation between maintaining a more realistic exchange rate together with reasonable deficits/surpluses as a function of a dynamically stable economy and in support of exports.

The balance of payments is a mirror of the national economy, and the exchange rate is the reflection in that mirror. RM has a twisted picture of that mirror.

To balance the balance of payments (realistically, not only for accounting purposes), the main aim of every macro-economic policy should be to reach a medium sized surplus in the trade balance. Of course, that is impossible to achieve in the short-term. But by implementing additional measures, which we will discuss later, the realization of the new trend in this direction should start.

The first and the most important step intended to change the situation in the long-term and to find the exit from the never-ending labyrinth of the heterogeneous structure of the problems of RM, is to present a developmental-monetary-political strategy and STATE STRATEGY FOR STIMULATING A TRANSFORMATION OF THE CURRENT ECONOMIC STRUCTURE. The sooner the basics of this policy will be revealed, the sooner the realistic solution of the problems we are discussing will start.

In the beginning I would like to emphasize that privatization doesn't mean re-structuring (transformation of the economic structure). The state can fully privatize its property and again to have an extremely bad economic structure. To start to develop the Macedonian economy, first an act is needed in the direction of changing its current structure... because a man cannot go ahead with a view to the stars if he has needles in his shoes.

The long-term aim of the Macedonian macro-economic policies should be to reduce the imports and at the same time to increase the exports.

Promoting exports (and import substitution) is a strategy around which the development of RM should revolve, through which the biggest economic problems should be solved, such as the deficit in the balance of payments, unemployment, and the indebtedness of the country.

Basically, as I have already mentioned, to secure more serious results in the field of the trade deficit and exports, a change of the economic structure is needed. Something like this, basically, should be a spontaneous process. But if that is not the case anymore, or it is being realized very slowly, the state should more actively, using the democratic and usual instruments available in the world economy, chart a way to the harder basics for the Macedonian economy.

SV: It is a paradox of sorts that only governments can secure the conditions necessary for the operation of free markets. A good government prepares the way for its own act of disappearance from the marketplace. It should construct the edifice and let other tenants occupy it. There are a few things that only a government can do. Maintaining law and order, defending the country, providing certain unprofitable public goods (education, health). But I agree with you that a government's most important role in the economic arena is to provide working conditions, a structure. Such a structure should include pro-competition policies (antitrust), protection of intellectual property, encouragement of high value added activities, training and qualification of manpower, maintaining transparency and equality as well as the supremacy of the law, providing functioning institutions (courts, customs, tax authorities, banks, capital markets, social security), mass re-education, investment in the future (for instance, in research and development activities), fostering good international relations through treaties and agreements, pursuing peace, actively encouraging foreign investment and the importation of know-how and technology, the encouragement of small businesses - and this is a very partial list.

The main orientation within the restructuring of the economy should be exports. The government should help companies and research institutions identify the relative advantages of Macedonia, in general and of particular regions, industries and companies in particular. It should then proceed to assist them to put these advantages into good use. It should put at their disposal all the information and assistance that they might need. It should speed up or, better still, eliminate altogether, bureaucratic hurdles and procedures. It should connect them to businessmen, companies, industry associations and authorities in their target countries. It should then proceed to intercede on their behalf, protect them, lobby, cajole, negotiate – in short, the state should be the exporter's partner not only in the income side (through taxes) – but also in the efforts, in the expenses and in the capturing of new markets. The government should encourage exporters financially (tax holidays, grants, exemptions, other incentives) and non-financially (awards, rewards, consultative capacities within specially constructed councils of exporters and government representatives, special speedy courts). There is no need to invent the wheel: there is the accumulated experience of tens of successful exporting countries to derive from.

NG: What should be the instruments and sources for the financing of such a project?

A suitable instrument for starting the policies of the restructuring of the Macedonian economy is THE BANK FOR EXPORT DEVELOPMENT AND SUPPORT through which the export-oriented production companies will be supported by providing them with suitable long-term credits. For these reasons, an argument can be advanced for a bigger capitalization of the above-mentioned bank of not less than DM 200 million (the best would be DM 400 million). This capital should be provided from the privatization of the Telecom, donations from other countries (specifically for this aim), the sale of the rest of the property of the state (including the sale of the public companies in RM, which will generate very high foreign non-returnable revenues). Besides a higher capitalization, this bank should provide more credit lines from abroad. The most important part of this bank's work, should be the multileveled supervision and control of the issuance of credits in accordance with pre-determined criteria. The state banks, by definition, are beset by corruption and non-commercial working methods. According to this, only a high quality control system to supervise the managerial work in this bank, which is in the process of being founded, can ensure its qualitative functioning and positive results in the long run.

SV: Many economists dispute the efficacy of such a bank.. "The Economist" dedicated a whole cover story to methods that governments use to encourage their exports. Banks such as Ex-Im Bank in the USA are considered highly ineffective. So much so that the American Senate is seriously debating the elimination of organizations such as OPIC (the Overseas Private Investment Corporation). They are forced to act indiscriminately both geographically and sectorally. They are bloated bureaucracies. Their actions are politically rather than commercially motivated. They often fall prey to swindlers and bogus transactions. But, above all, they create a moral hazard. In other words: traders and exporters take upon themselves risks that otherwise - without the bank's support - they would have refrained from. They know that if they lose money - it is the bank's money, not theirs. This makes them callous and haphazard. Granted, such banks make it possible for domestic businesses to conquer new, potentially dangerous, export markets. But why go into risky markets in the first place? Just witness how much money was lost by these "special purpose banks" in Russia in the space of two weeks. The EBRD alone lost between 1.5 and 4.7 billion USD of taxpayers money. I am absolutely against the intervention of the state in what should be processes powered by pure profit calculus. If an exporter finds a market appealing enough - he will be there, with or without such a bank. If he does not - why do we, the taxpayers, have to hedge his bets and participate in his losses (while not benefiting from his profits)? There are only two exceptions. First, the government should subsidize exports to destinations, which suffer from high trade protectionism and state subsidies. If Japan subsidizes its rice heavily - rice exporting countries should subsidize their exporters and help them penetrate this market, crooked by illegitimate state intervention as it is. The second exception is if the country has no functioning banking system. Even then, the bank should act strictly under commercial considerations and refuse to finance non-profitable transactions, no matter how politically desirable or expedient they are. On the one hand, in RM, there is a great need for such a bank, as all the other banks are dysfunctional when it comes to international trade finance (either because of their shaky standing in the world or because of ignorance, corruption and a host of other ills). On the other hand, experience shows that it might turn into a hotbed of corruption, exploitation and worse. A way must be found to supervise such a bank thoroughly and, preferably, with outside assistance.

I want to mention that an export development bank is one instrument at the disposal of governments. Insurance companies are another. In the past many governments set up special insurance arms. Their role was to insure exporters or investors against country risk, political risk, war, terror, expropriation, non-payment, sovereign default ad a host of other problems which private insurers were unwilling or unable to tackle. These insurers acquired monstrous proportions (OECD in Britain, COFACE in France, OPIC in the USA and others). They were notorious for their laxity, lack of professionalism, unreliability (they mostly refused to pay up when trouble struck) and incredible losses and creative accounting. The nineties witnessed the privatization of these behemoths. Today, every risk is insurable for the right price. If it is not insurable – the exporter is advised not to venture into that market, no matter how tempting.

NG: Within the scope of the roles of increasing investments and changing the economic structure there is the implementation of an efficient court system, which will create an environment in which the commercial banks of RM, by a speedier settlement of their own claims, will make long-term and cheaper credits available. This, indirectly, will influence the process of structural economic change and start to create an export-oriented efficient economy. At this moment, financial resources available in RM, from the banks' point of view, are really "a cat in a bag". The bank can never be certain that its financial resources will be recovered. First, the court mechanism is very slow and inefficient. This means that even if the bank were able to recover its financial resources within a year, or more - the principal plus regular and penalty interest rates would amount to more than the mortgage value and the bank will not be able to recover the full amount of the debt. Second, the realization of a mortgage is a real BINGO in RM. There are a thousand ways to cheat the bank and the creditors with the aim of not returning the credit. The system, instead of protecting the banks, protects the debtors. Thus, in the long run, the basics of the financial system are damaged and it boomerangs. The desperate banks lose the courage to place financial resources because of the uncertain environment, which doesn't guarantee the recovery of their financial resources, or the danger that an eventual devaluation will erode a part of the property's value, especially of the banks of foreign origin, which directly invested in foreign currency after increasing their capital. Slow justice is injustice. Because of that, the banks choose to impose high active interest rates, as they will cover the risk of investing in the economy with a judicial system with the appearance of "Swiss cheese". On the other hand, high interest rates increase the costs of production, which realistically diminishes the export competitiveness of firms' products, casts in doubt new investment projects, and at worst, casts in doubt the very survival of the company and its ability to return the invested money to the bank. This never-ending spiral is vicious if not nipped in the bud. RM is in the situation "invest and export or die". To start with, what should be done is what is written in one of Hitler's biographies: "the negative appearances should be destroyed in the very beginning, not to be analyzed later".

SV: Needless to say that I fully share your views. I just want to remind all of us that an efficient court system is only one of a long series of measures that should be adopted prior to the establishment of a healthy and functioning banking system. Assets need to be registered reliably using advanced computer systems. There should be centralized, real time registers of liens and mortgages. Bad debtors should be blacklisted and the lists should be made public. Bankruptcy proceedings have to be streamlined and implemented. Personal bankruptcy should be introduced with severe restrictions imposed upon such individuals. Legal procedures of seizing assets and materializing them should be made much simpler. A lot of the functions of collection and appropriation of collateral by creditors should be transferred to the private sector. This is a very partial list. There is nothing I can say about the courts that hasn't been said before. They are slow, inefficient, clogged and subject to political meddling. Special commercial courts need to be established to cater to the needs of special groups such as exporters and foreign investors. Judges urgently need to be retrained. But the banks themselves have a lot to do. Their image will be transformed only through actions. It is easy not to repay a loan to an "enemy of the people" (as banks are perceived to be). Banks should become more personal, attuned to the needs of small businesses, young couples, students, industry, exporters. The level of professional education of bank employees must improve. They must be exposed to financial products and instruments in the West. They must innovate and be active partners in the economy and not just money conduits. They must charge interest discriminately: good borrowers should pay MUCH LESS than bad ones. They must share their profits with their employees and with the public. They must be forthcoming to the client: ATM machines, simpler procedures, smaller queues, home banking, information services, capital markets services. They must get rid of political decision making, cronyism and corruption – all rampant nowadays.

NG: Also, RM should impose a policy for the export of finished products, and discourage the export of semi-finished goods and raw materials, of course, after it has already secured the conditions for it. Credits, from the bank for export development and support and from international institutions, should be directed exactly at stimulating the production and the export of as many finished products as possible and towards investments in the construction and tooling of highly profitable factories, in which the bigger part of the production will be export oriented, or import substitution.

As a result of the bad structure of the Macedonian economy (created as part of the old Yugoslav Federation and as result of the extreme liberalization of imports lately), the import coverage ratio in RM drastically decreased. In 1992 the coverage of imports with exports was 99.3%, in 1993 90.6%, in 1994 it drastically plummeted to 73.2%, in 1995 the trend continued to 70.0%, in 1996 it was 70.5% and in 1997 it broke the limit of 70% coverage down to 69%. Such long-term dynamics cannot be withheld even in stronger economies than Macedonia's, and this leads to the total collapse of the economy and the state in the longer term.

SV: Hear, hear. Perhaps it is important to explain to the laymen why. The only reason why a country exports is in order to receive payments in foreign exchange. Why is this needed? After all, internally, all the transactions are concluded using the Macedonian denar. The foreign exchange is needed in order to finance imports. In other words: we export ONLY so that we will be able to use the proceeds to import goods and services. Imports are a good thing. Different countries have advantages in the production of different goods and services. It is better to import a product from a country, which has an advantage in producing it – then to produce it ourselves. Our resources can be better employed where WE have a relative advantage over others.

This is why a consistent, multi-annual trade deficit is dangerous. Ultimately, the country will run out of foreign exchange. It will not be able to import. Its resources will be employed in producing goods and services in which it has no relative advantage (and which it used to import) – in other words: its resources will be wasted. Its wealth will decrease. As its wealth decreases, the value of its commitments will diminish – because people will not be sure how risky the country is. This is why currencies depreciate and debt payments frozen when a balance of payments crisis erupts. Currencies and debt instruments (bonds) are commitments made by countries. They are supposed to store value. But if the value of the country itself is reduced (because its wealth is squandered through the inefficient allocation of economic resources) – the currency must be de-valued.

As trade deficits mount and accumulate (=as the country's foreign exchange reserves dwindle), the country either loses its independence and becomes the surrogate of its donors – or a crisis sweeps across it. Its currency collapses, it freezes its obligations and is doomed to a prolonged recession and to a shortage of goods and services that it can no longer import.

NG: Besides the low quantity of exports, RM has a huge problem with the structure of its exports. The bigger part of the exports of Macedonian products is comprised of cheap raw materials with low-level processing (zinc, tobacco), classical semi-finished products (a hot-cast composite of iron and nickel), pre-paid production (lower level working force and low profitability) or (fresh) agricultural produce. In support of this thesis, here is the list of products, which generated the most foreign exchange income for RM (data from the Bureau of statistics of RM) between 1/1/97 and 1/12/97. At the top of the list appears zinc (raw material) with a value of 54,268,000 USD. Second place is occupied by male shirts (pre-paid production) with 53,706,000 USD, followed by cigarettes and tobacco 50,102,000 USD, other hot-cast iron products (raw material, semi-finished) 49,222,000 USD, tobacco (raw material) 47,508,000 USD, Feronickel (raw material, semi-finished) 33,607,000 USD, Ferosilicium (raw material, semi-finished) 32,252,000 USD, female shirts and blouses (pre-paid production) 31,361,000 USD, mineral water 28,963,000 USD and wine made of fresh grapes (mostly not bottled) 28,944,000 USD.

The bad structure of the exports can be demonstrated by an analysis according to economical uses. The total exports of materials for re-processing in 1995 stood at an extremely high 54.2%, in 1996 it was 49.5% and in 1997 - 52.3%. The export of machine tools in 1995 was 4.2% of the exports, in 1996 - 3.3% and in 1997 -2.9%. Goods for general consumption amounted in 1995 to 37% of the total exports, in 1996 to 47.1% and in 1997 to 44.7%. From these data it is clear that more than half of the Macedonian exports is comprised of the export of materials for re-processing. This is very worrying, especially considering the fact, that the resources, raw materials and mines have a limited life-span, which is about to end soon, and that the price of raw materials might keep falling in the world markets. These are the facts. Naked facts. Every idea has to start developing from facts. The economy, like life, is a drawing where it is not possible to use an eraser.

SV: Macedonia belongs to a much derided economic club, whose members are fervently trying to abandon it: the club of the group of countries who export mainly raw materials and semi finished goods and import finished products. This is the classical definition of a colony in the old mercantilist theory. Colonies are doomed to run deficits, equal to the value that is added by the industrialized countries to the raw materials that they import from the colonies. Additionally, the colonies get "hooked": they get addicted to the advantages that poor labour, for instance, provides. They tend to suppress anything that is perceived as a threat to their status as a colony: democracy, better education, higher wages, better infrastructure (not related to production) and so on. In this restricted sense, Russia, India and Macedonia belong to the same club. Even if they do get integrated (as poor relatives) into a more prestigious grouping of nations (such as the EU) – they are likely to maintain the "poor relation", "handout prone" status – see Greece and Portugal. They will become the sources of cheap labour, the junkyard (chemical waste, ecological catastrophes) of the richer members, the preferred vacation spots, the industrial hinterland and the fuel in the growth engine of the industrial and service nations. Colonies are not only endless sources of raw materials and high-quality-low-pay workers – they are also superb, reliable markets for finished products. In this sense, it is a mistake to try to join the club of prosperous nations at this stage. To do so is to eternalize the sorry state of Macedonia's economy and the sorry status of the composition of its exports.

NG: The step, which RM should urgently make, is the direct intervention of fiscal politics in the transformation of the economic structure to export oriented. Within this scope, it should provide the commercial and private banks with strong fiscal stimulus for the placement of credits in the production of goods for export (with a well-matched mechanism for the control of the delivery of goods) and with tax stimulus for the financing of final projects. Such stimulation should be given to private firms, which do or will start to produce and export finished products. Much more tax stimulation should be provided to those companies whose production of finished products is in accordance with international quality standards. The state can also provide credits for (pre-defined) strategically important products in the first few years through the Bank for export development and support. Such loans should come with a lower interest rate, and even through the commercial banks under the same conditions, wherein the state will cover the difference between the bank's interest rate and the interest rate approved by some commercial company.

If the state will tell the Banks that they will pay lower taxes on their income realized through the financing of projects for the production of finished products or for export-oriented production (providing that the products were indeed exported) or for the production of products of higher quality, it is logical that the managers of the banks will finance such projects more often.

Also, if the state will explain and promise (by law) to the manufacturers and to the potential manufacturers of finished products (especially to those which are on the import-substitution list) and to the current and potential manufacturers of products for export and especially to the manufacturers of high quality products (by international quality standards) that they will pay less tax or, in certain cases, will be fully released from this obligation, and on the other hand will be entitled to receive bank credits and support from commercial or from state banks (under the condition that they have a qualitative project by Western standards), it is most likely that within a few years of the positive effects of this policy, the trade deficit will seriously drop or be annulled. All this combined with additional stimulation of foreign direct and portfolio investors, make the chances of terminating the agony much higher.

SV: I am flatly and unequivocally against any kind of state intervention in what should be pure economic and commercial processes. Only profit and loss calculations and considerations should determine whether a bank lends, an investor invests and an exporter exports. Such considerations are bound to take into account the feasibility of the transaction or the project and the risks associated with them. Where no money is lent – there are, usually, excellent reasons for it. Where no exports are effected, it is proof of lack of competitiveness. Where no investment is consummated – the environment is wrong. By intervening, stimulating, encouraging and so on, the state puts itself in the position of a judge. Why should we assume that the state knows better? Why should we entrust it with our tax money to dispense to banks and to manufacturers? What does the state know about financing, international trade and manufacturing – that the market participants do not know? If a market player (=a bank, an investor, an exporter) changes its behaviour due to state intervention – this is not a free market. It is a distorted imitation, which leads to waste and inefficient use of scarce economic resources.

There is a lot the state can do to encourage exports. First it should create the right environment for conducting business. It should encourage competition, discourage cartels, improve the judicial system, tax evenhandedly, eliminate excess bureaucracy, improve infrastructure, take its hands off the capital markets, really privatize (as opposed to robbing the assets of the country and dividing them among a select few), sign international and bilateral economic treaties, ensure macro-economic stability, disseminate information and professional knowledge, train manpower, use its public procurement to enhance market activity, stamp on corruption and crime, protect property rights and intellectual property, reduce taxes – and this is a very partial list. In other words: governments should ensure the conditions for a fair play. They should supervise the rules of the game – but not become a player in it. Create the right conditions in the economic garden – and the right export flowers will bloom.

Whenever and wherever (domestically and internationally) governments encounter injustice, distortion of allocation of economic resources, favouritism, cronyism – they should fight back. They should impose quotas and duties on products subject to similar quotas and duties elsewhere. They should retaliate in economic warfare. They should act against dumping, market cornering and other anti-competitive or politically motivated dimensions of economic activity worldwide. Governments should never be vegetarian in a carnivorous world – lest they find themselves preyed upon. But they should only re-act, not act.

NG: I wish it too, what you are saying, and I would be very happy when RM becomes a country which is not in need of state simulative intervention in order to change the economic structure.

However, I am not talking about some strictly managed system, about which I don't even think. Every country wants to stimulate exports, and beside the measures that you mention and which I fully accept, there are other measures, with which, this way or the other, governments try to help their companies in penetrating export markets.

This is done even by the biggest and most developed countries in the world, and that's a fact. RM, AT THIS MOMENT, IS FAR FROM A POSITION OF IMPLEMENTING A PURE MARKET ECONOMY, and for now that's only a pleasant dream. It's wonderful to dream pleasant dreams, but in the meantime we must live. If Japan and many other countries could adopt such measures, why shouldn't RM for one LIMITED AND PREDETERMINED PERIOD do so? Here, the question what the country knows about financing, what the country knows about international trade, production, etc is irrelevant. I accept your thesis that the country doesn't know much about these matters, even though under the conditions of the (generally) current bad management structure sometimes it is different. BUT THE COUNTRY KNOWS ONE THING: IT NEEDS HIGHER EXPORTS, AS FAST AS POSSIBLE, and this is why I suggest these measures.

Every country minds its interests. Such interventions exist also in the EU, especially in the area of agriculture, and much wider.

Disputes between Switzerland and France about agriculture, threaten to become a trade war, especially after the accession of Poland to the EU. You will see what will happen with the USA if it is engulfed by the crisis of the recession, as you predict in your text in "Nova

Makedonija" dated 30-th of April this year. Then you will see what state intervention means and what is "market economy". What I am suggesting will be "a sugar-cube in the coffee" against what the USA administration will legislate and what from time to time other countries do (not to mention John Maynard Keynes in the crisis of 30s). Above all, RM isn't in the classical crisis situation, which means that in the past its capacities were used well and now less, and there is a worry as a result. In RM for a long time a very big number of manufacturers DO NOT WORK AT ALL, AND NEW ONES ARE ESTABLISHED IN MUCH LOWER NUMBERS. I think it's unnecessary to describe the situation and the role of RM in the borders of SFR Yugoslavia and the consequences. This means that the country faces a difficult task. It is not to create conditions for increasing the production up to the capacities, but to foster conditions for a part of the old and very new capacities to start working practically from zero.

The tax simulation for exporters in the first 4-5 years is the minimum that the country can do until a few production cycles will be activated. I agree with you that there is a danger that these companies will "go to sleep", but when it will be made clear in advance that their chance is limited in time, I believe that most of them will behave otherwise. From most of these companies the country at this moment doesn't collect taxes, because they don't work or aren't established. It follows that in the future the country can eventually produce new income and in no way losses.

RM very often makes the same mistakes. The Macedonians were the most ardent Yugoslavs before 1991, almost up to the last moment, while all the other republics were preparing themselves for independence - materially, financially and militarily. RM led in the last 6-7 years a more liberal import policy than much more powerful countries (Croatia, Slovenia...) and the results aren't better.

A similar mistake was done by RM in the period 1993-1994 when hyper inflation was defeated and interest rates remained on the same level for the following two years (25-30% per month). Tell me which company in the world can work successfully paying credit bearing a 25% monthly interest rate with an inflation of 18-20% yearly? The country then decided to adopt a market economy and not to intervene. The companies had to take credits to finance their production and the result was hundreds of bankrupt companies, unable to return the credits together with the high interest charges. Besides this the companies' insolvency strongly changed to the worse the picture of the banks' balances. Even today we feel the consequences: strong falls in production, in exports, enormous and increasing unemployment, the instability of the bank's.

IT'S VERY EASY TO READ THE LESSON HOW THE MARKET ORIENTED ECONOMY SHOULD LOOK LIKE AND THEN FOR IT TO FAIL. IT'S DIFFICULT TO SAVE IT EVEN BY A COUNTRY'S SHORT-TERM INTERVENTION. Shock therapy didn't present itself as very successful "medicine" in Eastern and Central Europe. Before implementing a pure market economy, a pre-preparatory period must exist, same as helping a child when it makes the first steps or helping a man when he is sick.

The fact is that reconstruction is expensive. But, it is worthwhile. Examples from other countries have proved it. The government, which supports such a project, has to be very efficient, honest and decent, determined and decisive. Decisiveness develops like a muscle. Practice is needed. It may again lose its position (especially in the first phase of the reconstruction). Maybe, because of this, the fastest and most efficient reconstruction is to be found in countries with half-dictatorial or dictatorial regimes, which have strong positions of non-democratic fundamentals. But, this does not mean that democratic governments cannot finish such a project with success and be rewarded for it by the voting citizenry.

The question how the state will finance such a project arises. I think that RM is still in the phase when it has superb possibilities to adopt such a policy. RM, luckily, still has a lot of state property. Above all, I would mention here the public companies. With their sale, without any problem, the project "economic reconstruction" can be financed. So, for example, at this moment, it is known that the state will receive about $800-900 million for the telecommunications company. Imagine that one half of this money will be invested in the Bank for export development and support and the second half will be used to compensate for the budget expenditures caused by the tax holidays and stimuli for supporting exports, providing bonuses, etc. It is understood that this method of financing budget expenditures would be for a limited period of time for two reasons: 1) In the short and medium terms, the financial resources arising from the sale of the state's companies are limited and can only suffice for a limited period of 5 to10 years, 2) In the longer run, the economic reconstruction would require from 10 to 15 years. If administered as foreseen, there will be a possibility for the establishment and development of new successful firms (which today don't exist or have low profitability, which, on the other hand, translates to low tax receipts), which by opening new production and export businesses with the help of the new state policy, will start to gradually fill in the void in the budget created as a result of export bonuses, exemptions, relief, etc. (which I have mentioned above as measures for economic reconstruction). So, for example, if one company operates today with a profit of 100.000 DM yearly, and with the new state measures (an easier access to credits for production, exports and tax holidays on a similar basis) it will increase its business and make a profit of a half million DM, this means that the state will receive about five times more financial resources from taxes.

But, not to forget that in this example we discuss only the money, which RM will receive from the selling of the Telecommunication Company.

If we add to this the financial resources resulting from the sale of the electricity utility, railways, post office, state owned hotels, community enterprises and others which in more sophisticated countries in the last 10 years are subject to a trend of privatization... We are on our way to conclude that RM has a historical chance to reconstruct its economy, to become export-oriented and with high quality products and services.

SV: If the government decides to finance exports directly, it can, indeed, do so through export subsidies or through credits provided by a specialist bank or through the general banking system, as you suggest. I think it is wrong. But I agree with you that the best source would be the proceeds of the privatization of the assets of the state. These are one off income items. Normally, the proceeds of the sales should be kept off the regular budget (extracurricular). Most governments sell their capital (=the companies that they own) and use the money for current budgetary expenditures, not for development. This is very wrong. The money should be used either to finance infrastructure or to support the reconstruction of the economy, as you have delineated. Your approach is a bit "Reaganomic", though. You believe that if money is injected into the economy fiscally it will translate to bigger tax receipts in due course. History does not support this (apparently reasonable) assumption. During the eighties, the USA was engaged in supply side economics. Money was injected by the government (including introduction of the biggest programs ever for encouraging exports). The result was a quadrupling of the national debt and chronic budget deficits. By the way, the USA engaged, during this period in mass privatization. For instance, it sold its airwaves to private telecoms operators, the air control system, prisons, hospitals and numerous other state enterprises.

NG: I must explain because I noted that I was not understood. My idea was not the idea of the protagonists of supply side economy, because I don't think that with the reduction of taxes, investments will increase, the total (macro) revenues will increase, and so on. The idea was much simpler: lower tax rates for those which produce products for export in order to stimulate the others , which do not produce or export, or which produce but not export, or which just started in business, to get them to be oriented towards export projects. This doesn't mean that a reduction of the taxes of exporters will increase the investments, rather that it will motivate potential and actual producers to think more about exports as a more profitable business (we agreed that exports are very important for any country). But all these matters must be within a pre-defined period (in which the companies must begin to work), because if this is a long-term standing opportunity, the exporters can become inefficient, non-competitive and a problem for the country.

In the whole system, the most painful point is the fact, derived from past experiences, that the individual always succeed to con the state and to abuse its "big ideas". The big ideas sometimes are like big old trees – they make more shadow than they give fruit. That means that, even before we embark upon this policy, a control system and an efficient penalty system, geared to tackle abuse of the functions, the laws and cases of corruption, should be created (or copied from countries in which they were implemented successfully). For as long as the corruption is very deep inside the system, no project stands any theoretical chances to succeed, even one which brings development and prosperity to the state. The dilemma in this situation, is the state guilty or the individual, isn't a dilemma anymore – it is the state. The individual's psychology is to earn more (especially in times of crisis) even at the state's expense, when everyone else does the same. This psychology, if one wants to preserve civilization, is changeable only by the introduction of an efficient penalty system with multi-level control. For as long as the state creates a system, which applies to all, but not to "us and ours", it doesn't stand a chance for success, no less because RM is small country and most people succeed to find a way to belong to the group of "ours". The system, which the state creates, determines the business etiquette and culture, the mode of thinking, the environment and the habits, both negatively and positively. The state first has to make order with a multi-level control system of penalties, and only many years after that will follow the spontaneous creation of "moral shame" associated with the acts that I am talking about. Maybe the penalty isn't always justified, but it serves to block a hundred other evil deeds. Who doesn't punish evil, provokes it. So, first is fear and than shame will join it. The shame after discovering the act of deceiving the state is almost not present in RM. Some people perhaps don't even understand the meaning of these words. This is the way new habits and customs are created among people, and also the transformation, from the roots, of the individual's psychology in view of its responsibilities towards the state. About the fear and especially about the system of shame, much can be learned from the Japanese system, certain parts of which can serve as an interesting example for RM and for the people who live in the Balkans. In Japan the court is not a very frequented institution. In the USA statistically there is one lawyer per 323 citizens. In Britain 723, in Germany 1345, in France 2099, and imagine in Japan 8200 citizens to one lawyer. In Japan the lawyers are not very rich people. But, to reach this level, a long evolution, also a tradition, which it is obvious that the Japanese will not retract, are needed. We will get back to Japan later.

SV: There is always time for some philosophy in an economic discourse. I maintain that economics is a branch of psychology. Your thesis is so nicely put (seriously) that I have nothing much to add to it. I think, though, that to guilt and shame one can add a third force: utility. In general, therefore, I believe that human societies can be divided to Fear-driven, Shame-driven and Utility (or agreement)-driven. The first type of societies is characterized by a constant battle between the state and other institutions and the individual. Brute force, subtle force, threats, intimidation, censorship are applied by the state to its citizens. They react with sabotage, crime, subterfuge, subversion, dissidence and terror. Shame-driven societies apply peer pressure and consensus building mechanisms to their members. The individual is subjected to a barrage of ethos, myths, conformity, social do's and don't's, social sanctions, social rewards, stereotypes and is in a constant trial by his compatriots, colleagues, peers, suppliers, clients, family, social stratum and so on. The individual reacts by losing a big part of his identity and adopting a surrogate identity instead. In due time this leads to extraordinary cruelty and violence or to milder forms of sadism. The revolt exists but it is more disguised and it does not involve open defiance, dissent, sabotage, or terror. The third category of states is the most stable, enduring, flexible, adaptive, functional and ideal for wealth creation. It involves an agreement between the individual and the state. Both parties acknowledge the supremacy of individual utility (money, pleasure, comfort, entertainment) over any other consideration or constraint. Individual utility supersedes even the utility of the state in most cases (with a few exceptions, such as taxation or army service). Both parties retain the right to remedy any breach of the agreement through predetermined mechanisms of arbitration. The attitude is businesslike and game-like. Nothing is sacred, everything is subject to review. Mutual belief in the good (read: rational) intentions of the parties prevails. Violations are punished severely because they constitute not only a breach of contract but the undermining of sacred trust.

The USA is a supreme example of such a country.

NG: Besides the above-mentioned sources of financing, the development of the capital markets, as a source of financing in RM, will depend on the establishment and development of investment funds. The privatization model wasn't best suited for the development of this kind of institutions, which will probably reflect upon the long term. They basically should secure the mobilization of small financial resources to different investments and of much bigger amounts to be directed to the economy by investing in securities, foreign currencies and money.

Within the scope of the financing sources we should not forget a few foreign credit lines and the foreign credit and insurance organizations/institutions such as: the EBRD, The World Bank, MIGA, IFC, OPIC, SEAF, USTDA, West Merchant Bank Ltd., Alliance Scan East Fund LP., East Europe Development Fund Ltd., NEPA and others.

One of the possible decisive factors in the financial choices of the firm is the level of the development of the financial markets, especially the securities market.

In the last 10 years the total capitalization of securities exchanges worldwide increased threefold, from 4.7 trillion DM to 15.2 trillion DM. After the realized liberalization of stock exchanges and after the successful effort to attract foreign portfolio flows, many developing countries removed the restrictions on foreign ownership, liberalized the transactions through the capital account and improved the accounting and information standards. The role of the stock exchanges in collecting and publishing information is more important to larger firms, because their shares are traded more often. The high fixed expenses of issuing securities handicap the smaller companies. The stock exchanges offer new possibilities for providing capital and new investments. Unfortunately, in RM this is not the case, because of many reasons: the privatization model, lack of political motivation for attracting foreign investors, unsuitable and fuzzy judicial system, the absence of state bonds and of branches of the big western banks, the absence of a central share register, the absence of a stronger presentation of the possibilities of the domestic stock exchange and its role, etc. The privatization model in RM was built on the basis of inside relationships between shareholders and managers, in most cases they were the same people. It led into a situation whereby companies preferred to abandon the stock exchange and to rely on bank guarantees with high interest rates coupled with slow or no development. This state at the micro level created implications at the macro level. If the companies in a country stagnate or don't prosper, the question is how is it possible for the production and the exports to increase on the macro level? Almost everything that we see as data pertaining to the macro level is a result of micro units working in unison. There is only small hope that in the next 2-3 years companies, which are in the process of privatization or which still have a diffuse ownership structure, will be provoked to conceive new big projects and markets. This means that the new private companies and the privatized companies with a more centralized structure of ownership should carry the weight of the reconstruction and be the first quoted companies, which will try to raise new capital through the stock exchange in RM. Unfortunately, according to The Wall Street Journal Europe's – Central European Economic Review, from a total 15 countries in transition in Central and Eastern Europe, RM (judging by the coefficient of private property per GDP) is fourth - but from the end of the table, with 50 percentage points.

SV: Sometimes I simply fully agree with you without needing to add anything.

NG: The feeling of uncertainty, which is all around us in RM, (in the judicial, economic and political systems) is still a strong de-motivating factor, as much for the domestic as for the foreign investor. In a country where "(with) and without Skopsko beer everything is possible" it is a real risk to invest. This doesn't mean that if someone invests, he will loose his money or will not earn, but the fear is meaningful and such an atmosphere often de-motivates. The political instability in the region, and the recently obvious uncertainty in the internal political and inter-ethnic scene – indicate that this bad atmosphere might last longer.

The Macedonian stock exchange will continue, for a long time, not to be a very important source of corporate financing, perhaps never, unless certain steps are taken to make it an alternative for the bigger and more powerful companies at least in the medium-term (3-7 years).

Of course, the improvement of the global economic environment in RM, the increase of the manufacturing and exports sectors is very important for the stock exchange's development and its transformation into a source of capital. One joke says that the economy and the stock exchange are like an old man with his dog. The old man walks ahead very slowly and stops from time to time. The dog runs around him, behind and before him, sneaks and goes back. It is thought that the stock exchange anticipates the economic processes at least six months in advance. If we put to one side two or three big takeovers (a process which is usually conducted in the world by KHV, apart from the stock exchange), we will still obtain poor trading results in the stock exchange in Skopje. If the domestic companies do not have interest in publishing their financial results, the state has to find a way to change their mind (as it was done with the banks, which are obliged to publish their results in a daily newspaper).

But let us go back to the basic theme - the trade deficit, the new economic structure, the increase of exports… In addition to changing the economic structure higher export bonuses and preferences for products with a higher level of finish should be provided. The financial resources for paying bonuses to the exporters for penetrating foreign markets should be provided from the already mentioned sources in the first few years and from the non-returnable financial help (which RM receives gradually less of and which we should stop making a habit to live off).

I think that RM should directly force the production of certain goods traditional to RM, for which the markets are sizable and there are preconditions for their production. For example:

To financially assist the increased sophistication of wine production, to improve the quality of seeds, more sophisticated bottling and marketing with an aim for better placement of the Macedonian wine abroad as one of the more strategic export products. An American expert team, a few years ago, noted that RM has superb geographical conditions for high-quality wine production, but it is necessary to upgrade the technology of production, to change the variety of seeds and to improve the bottling. Despite the fact that competition among wine producers in the world is great, RM, with small efforts can find itself in a much higher place in the list as a quality wine producer. In England there are three big supermarket chains and one of them is SAINSBURY. Last autumn, I was able to see Macedonian wine only there, and, though cheaper than the Bulgarian wine – it was still selling less.

One friend of mine, in London, told me that in the above-mentioned chain of supermarkets the wine produced by others in Macedonia used to be sold, but because of the fact that wine deliveries were never on time and in the exactly agreed quantities, the English partner decided to cancel the collaboration.

Or, for example, the stimulation of lower exported quantities of fresh apple and higher export quantities of finished apple products (juice, jam, etc.). The private companies, which will buy equipment for such purposes should, by law, receive bonuses from the state.

SV: Wine and apples are two fine examples of the "Macedonian Malaise" (typical to most so called "countries in transition"). The condition is characterized by an overwhelming sense of inferiority. Having been oppressed and subjugated for so long, small nations convince themselves that they deserve it, that something is wrong with THEM, that they are no good, bums, stupid, or simply unlucky. But always lacking and deserving of punishment. With such a national mood, there is no room for initiative, self confidence, self worth, trust, belief in the future, planning, legal behaviour, postponement of immediate satisfaction (also known as savings and investments) and capturing of markets. The weapons of the weak are socialist: poverty for all, steal from your employer, increase the information fog and dis-information, think now, there is no future, no loyalty, hide your true emotions and so on. The weapons of the strong are capitalistic: market yourself, believe that you are the best, improve constantly, think big, think ahead, fight your competitors on equal terms, honour obligations. Macedonians still have to make this transition. This is the

ONLY transition that they have to make – because the only transition is in the mind and the rest follows from it.

The second symptom of the "Macedonian condition" is laziness brought about by the "Big Brother" phenomenon. Central planning is a very comfortable thing: no responsibilities, just blind obeisance of faceless instructions and plans, no headaches, no profits but also no losses. Each one has his own, undisputed, irrevocable and irreversible place. Admittedly, the former Yugoslavia suffered less from this malignant form of communality (thanks to Tito). Still, Macedonia had to export all its raw materials to Croatia and Slovenia. The latter would process them and sell the finished products to Macedonia. The Macedonians remained poor but happy: their lives were uncomplicated, straightforward, predictable, clear and controllable. Many Macedonians still miss these times of black and white. Now that the world has been coloured by the palette of personal profit, it is less easy. I personally met wine manufacturers in Macedonia who refuse to even entertain an idea of introducing bottling, packaging, branding and marketing of their wine – even if it means TEN TIMES the income! I met people in Gevgelia who preferred to let their apple crops rot rather than transform it to HOME MADE jam (no complicated industrial processes and no costs involved – the buyer was willing to pre-finance the whole operation). This is the power of comfortable habits and hundreds of years of sabotage, avoidance of all effort and labour and being someone else's colony (cheap labour and raw materials).

Whether money incentives will solve this state of things is an open question. There is a lot of fear of the new and untried. A lot of ingrained conservatism. A lot of hostility towards the educated, the foreign, the "superior", a lot of false pride (which is truly stupidity in its purest form). People are not used to a life of cut-throat competition. Many will prefer to stay poor. A few will take up the challenge. Will their number be sufficient?

NG: These are the things, which the Macedonians for a long time cultivated and thus experienced the "Slovenian complex" - the state bought unfinished wine, apples and other agricultural produce from its citizens and placed them for export for a price much higher than the one paid to the Macedonian producer.

There is one inevitable condition, which has to be satisfied to enable these "plans": the realization of a satisfying profit and the ability of the relevant companies to survive and develop by themselves.

I think that the development policy of RM in the future should be directed at stimulating and developing the industrial sector and products, which are not "tradable commodities". That does not mean that tradable commodities should be de-stimulated, only that the tremors of the commodities exchanges can reverberate very strongly in small countries such as RM.

SV: It is essential for a country in the process of modernization and integration in the global economic community to decouple itself from the volatile prices of commodities. One of the main reasons for the recent crisis in Russia was its over-dependence on energy products. But I would like to add two recommendations. First, whenever and wherever possible, the state should strive to hedge its commodity exposure. In other words, it should buy futures contracts in the world markets (Chicago Board of Trade, Chicago Mercantile Exchange). These contracts are like insurance policies. By paying a small premium, the future price of the commodity is guaranteed. True, if the price goes up above the guaranteed price – the difference is lost. But, if it goes down, the guaranteed (higher) price is paid to the holder of the contract. In the last three decades commodities were a one way business: down. Almost every type of commodity has such contracts available: pork bellies, lamb cuts, certain species of tobacco, corn, wheat, rice, currencies, interest rates – everything. It would be a wise idea to use financial futures to limit the exposure of Macedonia to variations in international interest rates or in exchange rates. All this can be done today. The second recommendation is to establish an "Exchange Rate Guarantee Corporation". The state will ensure exporters against foreign exchange fluctuations. The exporters will pay a premium and will purchase from the state an insurance contract, which will guarantee the rate of the foreign exchange that they are going to receive in terms of denars. This will enable them to price their products with an element of certainty. In most economically advanced countries in the world, such mechanisms do exist. Gradually, the state will be able to pass on this function (of insuring exporters against currency exchange fluctuations) to entrepreneurs in the private sector.

NG: A few months ago we have discussed attracting foreign investments to RM. One of the most important measures, for attaining a suitable balanced state in RM, should be directed at attracting foreign commercial investments in RM.

Foreign investments bring fresh and non-returnable capital, which doesn't have negative implications on the state's balance of payments, because the state doesn't have obligations to return and to pay interest rates on it. Foreign investments open new markets for domestic companies, where they haven't invested their domestic financial resources, by increasing the exports, the foreign currency income (or by reducing the foreign currency outflows if they substitute for imports), increase the financial resources of the budget, provide new ideas, technologies, working methods, management, and new employment. Very often the profit is reinvested in the same state. All this will have strong positive influence on the balance of trade.

The basic task is to create a safe legal environment for foreign investment and laws of a western standard.

From this point of view, it is needed to provide a secure and fast judicial system, which will finish all processes in a few months time.

SV: Perhaps even special courts, dedicated to foreign investors, with judges who had special training in applying the relevant domestic and international laws. These courts could operate within the existing court system but will be endowed with special powers and will be obliged to terminate all cases that come before them in six months. This will not constitute a discrimination against domestic firms because many joint ventures with foreigners involve domestic firms and they will benefit from these special courts as well. Secondly, anyhow foreign investors are "discriminated" in the tax code, in the company law and so on. They are given special incentives (example: tax holidays) – isn't this discrimination? It is legitimate to discriminate in favour of a good thing.

NG: For a start-up period (2-3years) until the whole change and reform of the judicial system will be done, it would be better to accept your idea to form another court for foreign investors, which will have the same rights and obligations as the domestic investors, with a difference that they will be obliged to finalize all legal processes within a given period of time. On the other hand, this does represent a kind of discrimination towards the domestic subjects, but in the current situation in RM, if there is a wish to attract foreign commercial investments, the presence of discrimination, at least in the medium-term, is required. Also there is a need to change many laws: the law for trade associations, the securities law, the law for foreign currency operations, the tax laws, the banking laws, etc., and create new laws (law for foreign investments, law for investment funds, etc.).

Concurrently, the strong promotion of the Macedonian market should be done to potential investors using all the possible promotional tools (human and material). The relationship with multinational companies is the only bridge between the Macedonian companies and the world markets, the only possibility for development. From the macro aspect, this will have a strong positive influence in RM. In this context, the creation of conditions for the opening of branches of the big western banks, which will reduce investment risk, will offer new credits and financial resources to the domestic companies according to standardized methods and evaluation of the credit applications, will revive domestic savings, will introduce new methods of work and behavior, etc – is inevitable. I will not continue with this subject, because we explored it in detail in our first dialogue.

SV: True, we did explore it in great depth. The dialogue is available (in English) on the internet at: http://samvak.tripod.com/nm059.html and deals not only with foreign investment but also with country marketing, the banking system and the capital markets. I want to make one comment, though: Macedonia is a lesson in the abject failure of its self promotion. It is virtually unknown outside a part of the Balkans. It has so many advantages that the fact that it does not attract foreign investors is amazing. It is macro-economically by far the most stable in CEE (Central and Eastern Europe), the manpower is the cheapest (if the wages are adjusted for the level of education). It is superbly located geographically (better than Slovenia), it is naturally endowed, it has reasonable infrastructure (much better than Russia's). Still, it attracted 30 million USD in FDI (Foreign Direct Investment) last year. This is a shame. It is easily marketable as a tourism country, an industrial hub, a crossroads between all parts of Europe and Asia, an island of macro-economic and geopolitical stability. True, the Kosovo crisis and before it, the Serb Wars and the conflict with Greece marred this outlook considerably and still do. But these conflicts will be over some day and Macedonia has to prepare for this day. The task is so challenging and rewarding that I would gladly promote Macedonia abroad – in international forums, banks, multinationals – for one denar a year. This would be one denar more than I am getting currently for the same work that, anyhow, I am doing voluntarily. I am doing it now not only because I fell in love with Macedonia (and I did). I am doing it because I am a great believer in the future of this country. Having lived in five other countries in CEE I am saying it openly: no place like Macedonia. I prefer it to any other country in this region. And if I do – why not other foreigners?

NG: The foundation of the state's Agency for Marketing, as a means for increasing the exports, will also enhance export's ability to increase domestic production.

The small domestic market and the strong pressure of foreign competition on the domestic market, in the conditions of the strong liberalization of the Macedonian economy, forces the Macedonian companies to achieve a better competitive performance of their products and to be keen to conquer new markets.

The bad economic undercurrents come from the bad situation of a big number of Macedonian firms, which is a product of unutilized capacities, as a result of their inability to place their products on the market.

The reasons for this are:

1. The product is not price-competitive (is too expensive);
2. The product is not up to the consumers' needs and requirements;
3. The products are adequate, competitive, but cannot find their way to the consumer.

SV: To this I would add the bad image of the Macedonian industry. It is world notorious for its unreliability. Promises are not kept, contracts not honoured, schedules ignored, the quality of the products is shoddy. The managers are ignorant (possess no minimal knowledge of finances or marketing), ill-qualified, selected arbitrarily. There is usually no identifiable center of command and control. The whole structure of a typical Macedonian (big) firm is diffuse, "magla-fied". No foreigner wants to do business under these conditions. The placement of Macedonian products abroad is also influenced by the domestic conditions in Macedonia which prevent foreign investment (political meddling in business, no protection of property rights because of an inefficient court system and so on). The trend today is that most exports are done through multinationals, which open branch offices or factories in the country of export. Thus, for instance, the Japanese carmakers manufacture most of the cars that they sell in the USA inside the USA. Multinational food companies open branches and import food from the host country – and so do big retail chains (like Marks and Spencer, Tasco and others). So, today THERE IS NO DIFFERENCE BETWEEN EXPORTS AND FOREIGN INVESTMENTS. One is the mirror image of the other. If Intel opens a factory in the Czech Republic or a research facility in Israel – the products are then exported to the USA. EXPORTS ARE THE CHRONOLOGICAL END RESULT of the FOREIGN INVESTMENT PROCESS. Most of the exports of the Vysehrad Three (Poland, Hungary, the Czech Republic) are the products of multinationals, not of domestic firms. Most domestic firms tend to concentrate on domestic markets. Like everything else, exporting has become a global specialty, which requires expertise and experience.

NG: The first problem of the three that I mentioned can be solved by the employment of managerial techniques involving better organization and the combining of resources and by the state creating a better economic environment (monetary measures, bonuses, etc.).

Besides, all these problems come from not implementing marketing methods and concepts by Macedonian firms. Those, which do, are the most successful. The word marketing for many, even today, is synonymous with TV advertising. Today people don't buy shoes simply for their feet to be hot and dry anymore. They buy them because they feel manly, feminine, young, gorgeous, or sophisticated wearing this or that brand. Buying shoes becomes an exciting act. Today the shoe manufacturer's job is to sell excitement not only shoes. Cosmeticians don't sell only cosmetics, but also hope. We drink labels. From the bottle of Coca-Cola we drink the picture of a pretty girl or a boy from the TV screen or from the billboard, we drink the motto "a rest which refreshes", we drink the big American dream, and we drink less with our jaws and more with our brain. Marketing is a philosophy and a knowledge, which influence all senses.

SV: "We drink less with our jaws and more with our brain". This is the best summary of what is marketing that I ever heard. I wish Macedonian managers would understand this. Marketing is a branch of mass psychology. Throwing money at advertising is not everything there is to it.

NG: Every enterprise has to subject its business policy to His Majesty – the consumer. The time when you could produce a product and sell it through a strong propaganda campaign on the global market has passed a long time ago. Marketing policies, especially international marketing, demands continuous market research, and the dedication of professionals and financial resources. Most Macedonian enterprises don't have the possibilities to engage in these.

Knowing that the implementation of a marketing strategy, is a fundamental of management philosophy, and that it is imperative for the success of Macedonian economic subjects - the establishment and financing of the state's marketing agency, which will serve as a service to the economy, by the Macedonian government, is a big necessity.

The basic functions of the agency will be:

- The education of managers: holding seminars, preparing projects for international marketing, researching and discovering more adequate markets for the activities of Macedonian enterprises and adequate strategies for penetrating these markets;

- Upon request from its clients, it should provide services: preparation of studies, analyses, project plans, strategies and the financing of marketing projects proposed by the clients;

- Of their own initiative to advice, to notice if there is any problem and to propose a solution for it.

In the start-up period, besides domestic experts, foreign marketing experts should be made accessible to the Macedonian firms. This is in view of the absence of sufficiently experienced experts in the country. In parallel, the agency should work on the sophistication of its experts in this region. Professionalism is like a candle – from one candle a thousand others are lit, without losing its own flame…

I will illustrate the need for this agency by one concrete example. The production of oil for consumption is relatively well protected. But even so, a good part of the Macedonian market is controlled by foreign producers, even though their prices are higher on average by 10%. One study showed that what deters consumers and repulses them and forms their negative position towards the producer is that the bottles are oily. Regarding the quality of the product there are no more serious claims. That is why those consumers with a higher standard decide in favour of the foreign producer. The domestic producer didn't conduct market research because probably he assumed that something like that is not needed because the oil is a basic consumer product which people have to buy and it is the cheapest on the market. By adopting the suggestion of the consumers, the manufacturer may obtain a bigger market share and from this the national economy will derive undoubted benefits. Recently data were published which demonstrated the physical growth of production. Even if we accept these data without any deeper analysis, the question regarding the financial results of the production appears, or about the feasibility of the production and of the employment of the assets.

SV: It is customary to say today that the investor has gained an added measure of sophistication and choice. He will no longer be dictated to, coerced, or cajoled. He fiercely objects to brainwashing. Information is freer. In the sixties, the tobacco companies were able to hide results of studies regarding the addictive properties of tobacco. In the eighties this was no longer possible. Information is more widely distributed and through a myriad of channels. Just think what the internet has done to knowledge and the VCR – to motion pictures. It is more pluralistic and relativistic – the consumer is given several options or points of view and the decision is usually his. It is faster – the full text of Kenneth Starr's report regarding President Clinton's conduct was available within 24 hours on the internet. The whole world has been consumerized. Sex, pregnancy (through surrogate motherhood), soft drink, political candidates, books – are all products to be bought and sold. This blurs the traditional distinction between reality and fiction. Spin doctors (political marketing gurus) created the myths of Tony Blair and Boris Yeltsin. Presidents play themselves in movies (as President Clinton has done a few times). Actors become presidents. We consume, as you say, images.

The second pertinent point has to do with images. A product evokes in us a host of related images, every time we consider buying it or we consume it. These images determine the objective properties of the product. This is the mistake of managers, which deride marketing and advertising. Products have no OBJECTIVE qualities – only subjective ones formed in the consumer by layer upon layer of data, memories, associations, fears, images, sound bites. The VHS standard in VCRs prevailed over the Beta standard DESPITE the fact that it was technologically inferior. MS-Windows is far inferior to the Macintosh operating system – but who is the market leader? Quality counts to a certain extent, of course. But packaging, labeling, positioning, imaging – are as important, usually more so.

Macedonian products suffer both from inherent quality problems – and from a lack of set of associated images. Say Britain and we see the queen, Diana, pompous aristocrats, dry humour, an island, the Tower of London. Say Japan and we conjure up images of small, clever, yellow men toiling at making products better, more reliable and cheaper. Say Macedonia and we draw a blank. It rings no bell. This is bad – but changeable. This is one field of the economy where I welcome government intervention: marketing. Today, all over the world, politicians regard themselves as directors in a huge firm called The State. Presidents conclude export deals. Ambassadors promote trade and joint ventures. Ministers of Finance market their country. This, perhaps, is the main role of the state in the Post Cold War World.

NG: Macedonian products have to attain a higher level of quality.

Macedonian exporters should be stimulated to obtain a higher quality of the working organization and its products, or ISO 9001/2/3 standards of quality and ISO standard certificates for product quality. The data that only 20 Macedonian companies own this standard (and not for all processes and products, but for one, two or three of all the products which are produced by one company) says that the situation is unsatisfactory and worrying. Many Macedonian companies lose markets because of lack of ISO 9001 or 9002 certificates. In today's world of competition one of the most important things, which separates the leading companies from the rest, is quality. Even companies, which are renowned for their qualitative products or services, must work on getting better in everything they do with an aim to remain on top. This is quality management. Quality means the fulfillment of all the agreed demands, not more nor less, which satisfy the clients. But, to reach work quality it is not enough only for the company to implement an internal system of standards. In the chain of consumers, buyers, partners, distributors, etc. there must be present a certain quality of work. The European Union issued many directives, which made exporting to it extremely hard without having the above-mentioned certificates. For trading within the Union these certificates used to be only a good recommendation, but not a prerequisite for the external traders, more and more they became a condition. The quality standard ISO 9000 is also needed for export destinations in the USA and for many other countries, including even the Arab countries. This means that in the future it will be more difficult to export even to the poorer countries without having this certificate. The quality is not something, which can be guaranteed by controlling the work of others and uncovering their mistakes. The key is in preventing the mistakes, above all by securing the right finish of the work. The systems for quality control should cover everything that we do, or do not do, and which can influence the quality of the product or the service quality, which we forward to our clients. Implementation of the quality standards system represents a documented way of introducing control of the quality. ISO 9001, above all, requests management responsibility and expects it to come up with a policy for quality and to make sure that everyone in the organization understands it. Also, the managers should obtain enough financial resources and trained personnel for doing the job, to appoint a quality coordinator for the system and to check the system in real time for quality to make sure that it is still adequate and efficient. In the other 19 of a total of 20 points of the Agreement it is mentioned that the quality system should be fully documented, to satisfy the requests and expectations of the clients, etc. A review of the Agreement with the confirmation that the order is fully understandable and that we are capable to fulfill it precisely anytime is also a point in it. I will only mention, not analyze, all the other points: the control of the design (projection), control of the documents, ordering, control of the product ordered from the seller, identification of the product, control of the process, inspection and testing, control of the inspection's measurements and testing of the equipment, the situation during the inspection and testing, control of defective products, corrective and preventive measures, operations, warehousing, packing, storing and delivering, control of quality reports, internal quality check-ups, training, service and statistical techniques. To achieve such work and organizational standards, the company needs to employ specialists, whose job it is to prepare the companies to receive a certificate from an independent and juridical body of certification, which, on the other hand, will confirm that the company operates according to the world standard. In the Macedonian Chamber of Commerce there is a register of specialists, which are trained, noted and recommended by the very well known English house Bywater, which has provided the training and comments through the exactly defined standards. This will provide a certain preparation for the time when the representative of the one of the many companies, which issue this kind of licenses, will try to find errors in the system and abstain from granting the license (the money, which is paid in advance, is lost, in such a case). Well known world institutions, which grant ISO 9000 certificates are: BSI – England, Lloyds – England, Bureau Veritas, OQS – Austria, TUF – Germany and others. A big problem is that the preparation and the check-ups needed in order to receive the above mentioned certificate, require an investment of between 8.000 and 25.000 DM (depending on how big the company is) with a validity of three years. Within this price are not included the costs, which the company will, probably, have to commit to for an increase in the level of technical equipment (computers and so on), and are a variable depending on the firm's developmental level. It is important to mention that the company, which issues the certificate, makes regular inspections of the company, which receives the certificate, and if it discovers a breach of the agreement, it has, according to the Agreement, the right immediately to revoke the license without reimbursing the expenses that the company incurred.

Besides the quality standards of the working-organization, there are ISO certificates attesting to the quality of certain products, which is also very important for penetrating and surviving in the world's markets.

There are even higher standards for quality than ISO 9000, such as TQM (Total Quality Management), which I noticed during my visit to the Toyota factory in Japan. But it seems that RM is in too premature a stage for such type of certificate (TQM).

SV: One technical comment, though. TQM is a more comprehensive management philosophy, which revolves around the assurance of quality in all phases of the economic activity of the firm. But TQM is one of many such philosophies (and lately very much out of favour). These fads are by no means comparable to ISO, which is a set of procedures and processes which are rigorous, clearly defined, objective, management-independent to a large degree and widely and unanimously accepted. ISO is a standard, almost mathematical in its purity. TQM is a management fashion. Comparable to TQM is the system of thought developed by Isaac Adijes, a Macedonian (!!!) Jew. Adijes deals less with quality and more with corporate survival as a function of the corporate life cycle. There are numerous such management theories. Their implementation depends to a very large degree on the instructor or teacher in charge. ISO is a science, TQM is an art.

NG: Having ISO 9000 doesn't mean that the company reached the top. It only means that a specific production process offers guaranteed quality standards, which afterwards can be graded. Such a certificate would be very useful also for firms, which do not export, because it makes it possible to improve the firm's operations.

We discussed earlier the way to stimulate producers in RM - tax stimulation, bonuses and in certain cases tax holidays for limited periods of time, providing advantages for using credit financing (stimulation both of the users and of the banks). For a start, the state can cover the basic costs for obtaining quality certificates to the 20 to 40 most strategic Macedonian companies, elected according to predetermined criteria for qualifying. With this the process of economic reconstruction in the export sector will be much quicker. This represents the state's investment, which will be returned very soon, through increased exports (and production), increased inflows of foreign currency and finally bigger income to the budget from the companies, which will increase their production and their exports. I am convinced that if RM will ask for it, it will receive non-returnable help from some foreign funds for this purpose, with a big part of the financial resources obtained on this basis. If RM plans to become a member of the EU and to increase the trade exchanges with it, it has to achieve higher standards of operations and production. This means that, basically, this should be a concern of the producers and the managers of the national economy have to find the way to speed up this process.

SV: Quality plays a dual role in the advanced and developed economies of the West. True, it is intended to guarantee some kind of uniformity and predictability, which make the consumer's life easier. He knows what to expect when he buys a product. Uniform quality standards also facilitate economic activity because the amount of information, which has to be exchanged is reduced dramatically and disputes are more easily solvable. When the two parties agree – through the medium of the quality standard – what should be the minutest and precise characteristics of a product or a service, there is an ever smaller room for misunderstandings and arguments.

But there is an uglier side to "quality standards". This is the side of protectionism. Countries use quality, health, environmental and other standards to protect domestic producers from foreign competition. Shielding them from competition is costly because it is economically inefficient. It is always better to buy cheaper imports than to manufacture the same products locally and expensively (the relative advantage theorem). But it is politically popular because it saves jobs and makes some people richer. Crazy health, safety and environmental regulations mix with unearthly and outlandish demands for purity and performance to protect rich countries from their poorer brethren. It is virtually impossible to sell agricultural produce or textiles to the EU or textiles to the USA –

unless the exports are regulated in special agreements and treaties. It is totally impossible to export to Japan and very difficult to export to China. But the same produce (wine, meat) or textiles – refused under the quality or health pretext when it emanates from Macedonia - are often sold in the very same markets under Italian or German or South East Asian labels. This only serves to expose the amount of hypocrisy with which quality standards are applied in order to block free trade. To this there is only a political solution and small countries are too insignificant to influence market giants like the EU. But they can and should operate through the mechanism of the WTO and the various international commercial arbitration courts available even to small countries. The advantage of puny trade players like Macedonia is that their nuisance value is higher than the potential damage that their negligible produce can inflict if given free access to the target markets. In most cases, they will be given exemptions and preferred treatment on condition that they do not rock the boat of international trade. Shut up and export as much as you like – is the warning-cum-promise. Macedonia should take advantage of its nuisance value.

NG: Every company, which has attention to enter or to invest in another market, has a need for reliable data on which it will base its decisions and plans. It needs to know the potential market's volume, the preferences and principles of the buyers, the characteristics of the distribution channels, the competition. As the more sophisticated companies reach the decision to invest or to act in the markets of undeveloped countries (such as the countries in transition) they need more detailed and reliable data without incurring big expenses. Also, the local investors have such needs, and it is very important for the small and medium enterprises, most of which are oriented towards the domestic market. That's why I think that RM needs a database for each economic field. The data will be detailed, efficiently processed and presented through the internet, in publications, bulletins and at the request of the clients. Similar databases exist in the Chamber of Commerce of RM (an information center) and in the Bureau of Statistics, but I think that they are not sufficiently analytical, and are inadequate for certain types of market research and not sufficiently available to the wider circle of users. Such a database can be managed within the Agency for Marketing and it can be under the same budget. Its data will be on disposal free of charge to every economic entity and to any other interested party. Even though, in the beginning, the interest in using these data will be low, because of the low level of investment activity and the wide rejection of the concept of marketing in the enterprises, it will start very fast to play a big role in the improvement of work of the economic entities and in their development, as in that of the whole economy.

Beside the export-oriented policies, great care to secure the substitution of imported goods is needed, in order to prevent the outflow of foreign exchange, through the provision of cheaper credits, tax holidays (especially for higher quality goods), projects from the governmental agencies and eventually through duty protection.

According to the Bureau of Statistics the structure of imports in RM, classified by economic use, is as follows: materials for re-processing constituted 57.6% of the total imports in 1995. In 1996 – 55.6% and in 1997 – 61.4%, which still has to increase. Imported machine tools constituted 4.2% of the import structure in 1995. In 1996 – 3.3% and in 1997 – 2.9%. The situation with imported consumer goods is not good: in 1995 – 37%, in 1996 –

47.1% and in 1997 – 44.7%. It is remarkable that consumer goods represented almost one half of the total imports to RM. It is known who drinks and who pays, but can it be known until when?

Within the Macedonian imports, the highest part belongs to oil and oil derivatives, because of the absence of gas, as cheaper energy sources and the dependence of RM on energy imports. But it is interesting that in the second place, according to the amount of foreign currency spent, is the import of cars. Car imports comes second in the structure of Macedonian imports and this implies that the state should increase the cost of purchasing cars, which, on the other hand, is against the improvement of the environment and the renewal of the fleet of vehicles in RM, which still is on a very low level. The arguments for and against this measure are strong and they can be a subject for a separate discussion.

I think that the policies of the state should also be directed at limiting the imports, but by more sensitive measures and at the same time more useful, for instance, by determining high standards for the quality of the imported products. The quality standards should be determined in advance and be compatible with the EU standards. This policy would be implemented especially regarding the import of agricultural products and consumer goods.

SV: As I said earlier, imports, in themselves are good to the economy because they optimize the use of economic resources through increased efficiency of the allocation of economic resources. The question is only: WHAT is imported. There are imported goods which generate sufficient income in the future to cover their cost plus a reasonable return on equity. Others (such as cars) only get depreciated with time and consume more and more foreign exchange (fuel, spare parts). I think that a few rules are cast in stone. They should be applied cumulatively, not separately:

a. Import goods and services that can be manufactured and provided more cheaply abroad than domestically. Simply, if something costs more at home (and is of comparable quality) – import it.

b. Import goods and services the will increase the use of your economic resources and your future inflows of income in foreign exchange.

c. Minimize imports of goods and services that will have no effect or a negative effect either on the optimization of the use of the economic resources – or will generate outflows of foreign exchange in the future for further consumption.

d. Emphasize the quality of imports – not their quantity. Buy state of the art goods and services. Buy the few best rather a lot of the mediocre.

e. Refrain from financing your purchases with debts. The only exceptions are the financing of infrastructure and public health (defense, education, health). Very few goods and services provide a return that it sufficient to cover the principal and interest of such debts.

f. Have clear priorities and preferences. What is more important: to have sufficient foreign exchange to buy food – or to preserve and improve the environment? I think that the answer is self-evident.

g. Employ discriminatory policies. Impose customs duties and quotas on some goods and services – and exempt others. Tax cars prohibitively – but exempt catalytic converters (or even help to finance them) and, thus, preserve the environment.

h. Encourage import substitution only when it is clear that the domestically manufactured or provided goods and services will be cheaper (=economically more efficient) than the imported equivalents.

i. Punish smugglers, bootleggers and other trade violators. Be fair and evenhanded. Make your priorities, punishments and rewards known and lucid.

j. Act fearlessly against other countries that violate the acceptable principles of international trade. Impose duties and quotas or quality and health requirements on their products as well.

k. Encourage importers to establish factories and open offices in your country. Go ton the extent of subsidizing their presence. It is important to be revealed to these people. A lot of trade is the result of mere presence, of daily friction with reality and with its needs.

NG: This way and only to a certain extent, not only will the domestic production be protected and the outflows of foreign exchange decrease, but the Macedonians will also be able to buy goods with a better and verified quality, though understandably more expensive than the domestic ones. Protecting the agricultural sector is not unknown either to the USA, or to the EU. The latter absorbed negative energy from the USA's 1988 Trade Act concerning the issue of trading agricultural produce within the Union, especially from France. Even though the USA claimed that it will cancel the subvention of agricultural produce, protectionism and even measures of "economic revenge" are present.

In the framework of export stimulation and import de-stimulation in order to reduce debts, should include reciprocal measures against countries which do not respect signed free trade agreements. Also, in order to reduce the Macedonian deficit in the balance of payments it is needed to implement retaliatory duties against countries which block the import of Macedonian products for consumption and otherwise.

For the purposes of protection against imports and the outflows of foreign exchange it is preferable to use fiscal instruments such as taxes and fees (and rarely duties), prior to imposing administrative quotas. The administrative taxes open wide possibilities for corruption and crime and they are not very popular. I think that definitely the duty on the imports of investments, equipment and raw materials, should be reduced to a minimum or cancelled altogether, which will make the production enterprises more competitive.

SV: Absolutely. This is a fine example of discriminatory practices. Raw materials, infrastructure, computers, investments – should be exempted. This will be a tremendous boost to domestic manufacturers. There is, of course, an even simpler way: the introduction of a Value Added Tax (VAT). Such a tax applies to imported goods and services – but not to exported ones (the tax is returned to the manufacturer or exporter). Research has conclusively demonstrated that in the first year after the introduction of VAT there is a surge in exports and a decrease in imports (which become more expensive). People either consume goods produced domestically and which substitute for the imports – or they resort to exporting.

NG: We shouldn't forget the leading role of an active anti dumping policy as applied to import products, which are more expensive in their domestic market and for which there is an obvious knowledge that they fall within the scope of the anti-dumping measure.

At the same time, the efforts of RM to enter in the World Trade Organization should be more vigorous. But, until such time it is possible to take advantage with regards to certain limitations, which are not obligatory for non-members of that organization. The membership in WTO guarantees a mutual respect of the issued rules of the game between the trading countries.

For a small country like RM, it is interesting to regard the idea of an economic relationship with some other very big and powerful economic power (if the latter will find any interest in it: concessions, extra investment bonuses or even a covert political benefit). For a small country that would mean a lot, and for the bigger one the trade with the small partner would not even be noticed.

For sure there is a danger of long term political dependence, but if a few moves would be adopted cautiously, the two parties would be satisfied. The second danger is the so-called "butterfly effect" - an economic crisis in the big country. The waving of the butterfly's wings in the big country would mean severe hurricane over the smaller country a week later. Following the Asian crisis, everything is regarded with fear. The speed of the crisis hopping from one country to another appears like a thunder.

The scale of dissertation process on the basis of exports made the country more or less sensitive to the fluctuations in the conditions of trade.

Of course that are some other problems. First, RM doesn't have access to the sea nor the ideal geographic position necessary to become the subject of this kind of collaboration in the sense that it is not territorially close to one economically powerful country, as for example is the case with the Czech Republic and Germany, or Japan and some other countries in the south-east Asian region.

Second and very important component is that RM has a serious problem with its manpower requirements.

The whole export of RM is a drop in the ocean compared to the export of the big economical powers. For example the whole export of Japan in 1996 was $333.832 billion and the whole export of RM in the same year was less than $1.2 billion. The exports of Japan that year were about 278 times the exports of RM. A similar conclusion would be reached when we compare RM with other economic powers (USA, France, England, Germany, Canada, etc.).

The regional free trading zones appear to be a better option for the smaller countries, supported by WTO, which battle fiercely against duty restrictions. But, taking into consideration prices of the competition and more rarely the quality of the products of neighbouring and other countries in the region, there is a danger of such situation developing (regional free trade zone). In this development phase, RM could experience a rude awakening if excluded from such a regional club.

In my opinion, RM should definitely institute new policies for its economy by more actively and more vigorously pursuing foreign policies for the opening of new markets in a political way (through bilateral and regional agreements), parallel with the internal economic reconstruction, preparing the conditions for a free market economy and stimulating the enterprises to think about their development and future by themselves. The latest example, the involvement of the Minister of Agriculture in the sale of Macedonian wines in the Slovenian market, should be a positive example for further dealings. I think that with bilateral contacts at the highest level, RM will be able to significantly increase its exports and to contribute to the opening of new markets in the long run and to the attraction of foreign investments. Of course these measures are not economically healthy, nor are they the ultimate solution. The Macedonian economic situation is not very healthy , so they can be used more pervasively in the short and medium term. Such an idea should not be understood that domestic economic entities should rely on the government for help, on the contrary, it should be only an additional effort on the way to achieving quicker economic prosperity.

In this context I will mention one recent example. While I stayed in Japan, I discovered that RM doesn't have an Ambassador or a Consul or any other representative (Macedonian) in the SECOND LARGEST ECONOMIC POWER IN THE WORLD with 126 million people and a nominal GDP per capita of $36.572 (source: Japan 1998 an International Comparison - Keizai Oho Center – The Japanese Institute for Social and Economic Issues). I assume that the answer to the question "why" is that RM conducts only small business with Japan. According to my opinion it should be an additional reason for a representative to be sent there in order to prepare the territory and to make conditions for this situation to be changed drastically.

SV: You touched upon the three alternatives available to small countries that wish to increase their exports and to extract themselves from a chronic state of poverty (=of deficits). The first alternative, is to attach itself to one big economic power. This is the case of the Czech Republic and used to be the case of Israel, Cuba and dozens of other countries. The lessons show clearly that this is a good strategy as an interim measure. A small country can attach itself, economically, to a bigger one, ONLY if it uses the time that it thus buys to get rid of this dependence. While closely and overwhelmingly collaborating (usually, not only economically but also politically) with the bigger power – the small country should fervently and ceaselessly develop alternatives: other markets. Otherwise, it will end up like Cuba did. It sank into abject poverty when its main "sponsor" (USSR) became economically defunct. "Sponsor-Client" or "satellite" relationships are good as a stopgap measure or in times of emergency. There is no such thing as "pure" economics. In the global arena, economics is a reflection of political and geopolitical realities. Ask Saddam Hussein. There is a political price to pay for attaching oneself to a global power. Many will find this price unacceptable. Germany allows itself to publicly humiliate and chastise the Czechs (regarding the Sudetenland Germans issue) precisely because it is economically dependent. The wish of Macedonia to join the EU has always hampered its ability to negotiate freely with Greece.

The second option is to join a regional trade club. The most prestigious is, of course, the EU. I have expressed my opinion many times: it would be unwise for Macedonia to join the EU now. These are the conditions under which a country should join a regional club:

a. That it includes all the major trade partners of the country;

b. That it will not be overwhelmed by the size, importance, wealth, history, experience, or personality of the other participants;

c. That it will not be consigned to one role (Macedonia – the supplier of cheap and educated labour or the supplier of cheap, good quality raw materials, for instance);

d. That it will benefit by joining. In other words, that due to the privileges of the membership either the net foreign exchange outflows will decrease or the net cash inflows will increase. This could be achieved by lowering trade barriers and simplifying bureaucracy or by providing investment and export incentives;

e. That it will not get involved in a trade war as a result of joining the club and that it will not breach any international treaty or convention;

f. That it will have well defined and clear opt-out options, clear procedures for the settlements of disputes, equitable and fair treatment of all the members and a clear political and economic stance vis-a-vis other clubs and countries;

g. That the rules of the club will not conflict with its rules, the mentality of its people, its ethos, its political structure or any other important component of its identity.

Historically, regional clubs are doomed entities. The trend is to GLOBAL trade, free of all regional restrictions, as embodied in the WTO charter. Most Economists regard regional clubs with horror because they consider them to be obstructions on the way to completely liberalized trade. Regional clubs tend to encourage trade between the members at the expense of trading with external partners. This is bad and counterproductive economically. But reality is that everyone (including the mighty USA) is engaged in initiating, constructing or becoming a member of a regional trade club. If you can't beat them – join them. Like the first option its is a good stopgap, temporary measure until the country's accounts get balanced and it gets fully integrated into the global economy.

The third option is always preferable and admissible. Politicians, diplomats and spies all should participate in the new "Green (economic) World War". Politicians and statesmen should sign bilateral and multilateral agreements. Lesser political mortals should protect the interests of their businessmen and exporters. Diplomats should educate, disseminate information, visit, lecture, cajole, convince, threaten, negotiate and matchmake (joint ventures). This activity is the raison d'etre of modern government.

NG: I wish to concentrate more on Japan as a country which was devastated after the second world war and as a country which with very little natural resources succeeded to become the second rated world economic power. Even though I risk that someone will "teach me a lesson" concerning the weaknesses of the system which Japan had built and which from last year became very evident, and if we connect all of it with certain illusions of the South East Asian countries, I still maintain that the current crisis cannot cast a shadow over the past successes of Japan and even of the countries from that region, which are enduring the recent crisis on a higher developmental phase than tens years ago, which for example is not the case with RM. Of course, it is not right to compare RM Japan in its condition today, but let's talk about: WHEN JAPAN WAS RM, or let's compare Japan's past to Macedonia's past and PRESENT.

I discovered that Japan in the past and RM today have many common characteristics and similarities.

Industrialization in Japan begun slowly with the revival of imperial authority in 1868. Japan remained closed to the external world for 230 years, a period known as the Tokugawa era. The country was very poor by way of natural resources and its people lived an improvised existence, something similar to RM at that time. According to some estimates GDP per capita during this period was $100-200, which placed Japan in the category of the world's poorest countries according to standards which are used by the UN today. People were employed in agriculture, and Japan today as in the past was totally dependent on imported raw materials. Today Japan depends on foreign imports for its carbon (92.9%), distilled oil (99.7%), oil derivatives (19.4%), natural gas (96.1%) (imported frozen in container ships), iron ore (100.00%), bauxite (100.00%), phosphate rock (100.00%), lumber (55.2%), pulp (20.3%), salt (90.2%). The energy and the metals are imported from a few countries in the world and Japan depends on them.

The four bigger and the few smaller islands on which Japan exists represent 0.3% of the planet's earth surface, and the Japanese population is 2.4% of the total population of the planet. Within the years following its opening to the world, Japan went from being a poor agricultural county to full industrialization. For them to start and to develop the industry on the basis of the European and American technology was imperative. At that time the Japanese government invited people from different countries, experts from different areas. So, in the period 1880-1910 the establishment of the most important science institutions, which started to conduct research, to transfer and develop western technology, started. The construction of a complete travel infrastructure started. Governmental intervention and planning were big at that time. Prior the second world war, Japan became one of the most advanced countries in the world even though it depended heavily on imports, which means that it had to export and with the foreign currency earned, to import. Unfortunately, in 1936 the controlled economy begun, the economy which was prepared for war, from which Japan emerged totally destroyed (as a result of mass bombarding), territorially and humanly damaged and above all suffering the consequences of the nuclear bomb. It was tortuously difficult to find work for 7.2 million ex soldiers plus 13 million unemployed workers, students and others from factories, faculties etc. The real income in 1946 had been 30% of the average one in the period 1934-1936 and the inflation was 200% in the period August 1946 - March 1947. Everything that was built before had been destroyed and Japan started its development anew.

In the beginning of the 60s Japan had been on a level very similar to former Yugoslavia within whose borders was RM. But where is Japan today (ignoring the current crisis, which is incomparable with the Macedonian one) and where is RM? What is the Japanese secret of success, even taking into consideration the so called "bubble economy"? For the bubble economy to have existed, the system which inflated the bubble should have been formed, though at the end the bubble blew-up (as it happened in Asia last year) and crisis prevailed. The Macedonian bubble, unfortunately, still is just a sad drop. Kuzuhide Okada, a professor in Senshu University, says that the Japanese economy is principally a market economy, but from the very beginning the government understood that somebody should have led the policies to direct or control the operations of the firms, which acted in the specific foreign markets, as well as in their own, domestic one. This is related to the Japanese high level of dependence on the outside (which characterizes RM as well). This is the reason why I began to study the past of this geographically remote country. The government's active policies supported development very strongly. That was not a classical socialist way of planning, even though some similarities can be found. I think that for a country to reach the state of wholly free market economy, a period of governmental policies to direct and control the economy and raise it to a higher level is needed. I have the impression that in certain portions of the trade laws and their practice RM is more liberal than England, Germany or USA. I am not very convinced that it is useful to the nation. The system which Japanese built after the second world war meant strong fiscal, legislative, political and monetary support of exports (not to forget that the yen-dollar exchange rate during the period of development reached 300 yens to the dollar, with the latter falling in value during the period of crisis period) and on the other hand import restrictions. The Japanese motto was "to export or to die". The Japanese success was that it developed the exports mostly, in certain decades even three times faster than its competitors (the USA and Germany). In comparison with the above mentioned period, in the later years the Japanese government drastically reduced its involvement (but it would seem that not enough). The elimination of all governmental management and regulation, however, is not possible. Beside other activities, the Japanese government directly provides public works projects, through which and through the fiscal policies, the government still dominates the determination of the economic trends. Untimely deregulation, a badly structured financial system, and a certain conservatism in the management model (which is transforming itself according to western standards) are the main reasons for the current crisis, which however deeper it goes, will not be in a position comparable to the Macedonian crisis. This says that when one economy is in crisis, and especially when that crisis is during a low developmental phase of the economy and industry, the state should help in the construction of a regular strategy and in putting it into an appropriate framework. When the strategy starts to be implemented and the economy gets better by many parameters, the state should provide a self-withdrawal system from the body economic, because it can be transformed into an obstacle for further development. Today RM is in situation that requires a strategic change in the economy, and this cannot be realized spontaneously, the state should help, very carefully, not to allow an adverse effect to happen.

From the bottom of the list by its economic development and natural resources, the relatively small Japan pulled itself into the position of the second economic power in the world with the biggest foreign currency reserves in the world (which the current currency crisis reduced somewhat), a long term surplus in the trade balance, the second place in the world by GDP per capita (above $36.000), bigger than the USA's or Germany's (above $28.000), a country which almost one third of its exports (one way or the other) are placed ion the very sensitive markets of North America and 22% in Western Europe, transforming itself at the same time to a regional leader, and into a country with an unemployment rate which in the past few years increased from 2.7% to 4.1% (close to the American rate). Only 25 years ago its income per capita was less than one half of the American one. To reach a situation of having an advantage of 25% over the USA is an amazing feat. In the period 1900-1987 Japan with an annual average economic increase of 3.1% digested the biggest increase of the real income per capita.

Beside this, from a sizable importer of expertise transformed itself into a big exporter. For example in 1989 about 100 thousand professionals left Japan (more than half went to the USA) and it accepted 65 thousand from other countries (90% from the undeveloped Asian countries). Besides the stable political constellation, the Japanese built a separate strategy for car exports to the USA and Europe. However criticized, as much as it relied on dumping, it helped Japanese firms a lot.

Towards the end of the last decade, Japan became the biggest investor in the world. The Japanese began to invest twice as much abroad than they earned by their exports, their foreign investments in the mentioned period were eight times bigger than their domestic investments. The Japanese penetrated strongly the export of capital. They exporting capital to the West as direct investments in 1988 of more than $30 billion, which translates to ten times their imports of capital in the same year.

A closer look reveals the ten categories of products with at least 2% of the exports in 1989:

1. Cars (17.8%);
2. Office equipment (AOP processing machines) (7.2%);
3. Precision machinery (4.8%);
4. Steel (4.4%);
5. Car spare parts (3.8%);
6. Self-regulated instruments (integral movement, etc.) (3.1%);
7. Internal Combustion Engines (excluding aircraft engines) (2.2%);
8. VCRs (2.2%);
9. Telecommunications equipment (2.1%); and

10. Organic pharmaceutics (2.0%).

From a total of 7.864 thousand transport vehicles manufactured in 1996, Japan exported almost one half (3.232) and imported only 440 thousand. According to the IMF, in 1996 Japan controlled 7.8% of total world imports.

SV: It is a big debate whether the state should intervene in the operation of free markets. Granted, the state is not the most efficient economic player. It is slow, corrupt, ignorant, influenced by non-commercial considerations, short-sighted and either too aggressive or too placid. On the other hand, markets are not a panacea, either. There are some goods and services, which markets simply refuse to provide because they are inherently unprofitable or require some non-monetary motivation. Most of the public goods cannot be efficiently provided by free markets or can be provided only at a prohibitively extravagant price. This includes health, defense, education, prisons, police and welfare. There is no question then that governments should step in to fill the void. Another class of cases where the state is called to intervene is when the market fails. Markets can – and do – fail for a myriad of reasons. Speculative bubbles are market failures. Lack of investments, research and development, qualified and trained labour, patents and other intellectual property, work ethic, economic crime and corruption, anti-competitive behaviour are all market failures or lead to them. The government then is called to intervene, to regulate, to investigate, to imprison, to stimulate, to direct – and legitimately so. There is simply no one else to do the job. But industrial policy (which is what Japan has engaged in) is more of a mixed bag. Some countries have done very nicely without it (Estonia, for instance). Others have botched it to the point of self destruction (the USSR). Yet others regarded it as a "starter" (Israel, which adopted the Japanese path of government directives – but now has almost no involvement in the micro-economy). Japan simply did not know how to say to its industrialists and bankers: "enough is enough". As a result, Japan is in the worst financial mess in human history. It will recover, but at the cost of a recession which will erase many of its achievements.

Japan is an amazing economic experiment. It is the first time in human history that a government was more interested at micro-managing world trade than at managing its own markets and economy. Some of the Japanese products (the CD, the VCR) CREATED whole markets, that is fostered demand which was not there in the first place. But this neglect - the result of an obsession with attaining hard currency self sufficiency – was detrimental. Without the proper spine, even the best runner collapses ultimately.

World economic history teaches us that there is a benign and beneficial form of industrial policy. These are its characteristics:

a. That the government succeeds to attract top flight talent to manage the policy. In Japan, the brightest university graduates wanted to work … in the Ministry of Finance!

b. That the economy is so depressed that any stimulant would be better to no stimulant. Keynes was right. The IMF is dead wrong and has plunged

80% of the world into a very dangerous deflationary spiral. Sometimes, it is better to reflate. Sometimes, it is critical to reflate. Industrial policy is inherently reflationary because it involves the injection of state funds into the economy.

c. That the bases of material and human infrastructure are there. Japan was an industrial country and a regional military power long before the second world war.

d. That the core of the industrial policy would be the provision of a orientation as to the future of the markets worldwide and domestically. Direct and indirect monetary or fiscal involvement has to be minimized. The emphasis should be put on coordination, guidance, counseling, orientation, research, intellectual property, matchmaking (with investors), development of banking and capital markets. In short: industrial policy should prepare the CONDITIONS for an industrial and export-led expansion of the economy, but not for its financing.

e. That there exists a national consensus regarding the agenda of the nation in the economic sphere (and, preferably, in the political sphere, as well).

NG: The medium and small enterprises in Japan, which are indispensable partners of the large industry in Japan, employ 31% of the total number of employees. The big corporations hold a chain of small companies, with lower management expenses, to which they transfer part of the modern technology and in return they receive many components for the production plans. The European producers almost fully depend on American and Japanese components - microprocessors (chips) and memories. Japan has a high surplus with many countries but the low profitability of its companies gave it its negative image in the last few years. Japan really doesn't have armed forces which can be compared to its competitors (even though the parameter of military expenses in 1997 , according The Economist, is after the USA with more than $50 billion and before France, Germany, Britain, Russia and others) but that's why according to the Japanese, their chip industry and their microproessors don't have competitors anymore. The Japanese, in the last 35 years, took over (discovered, stole or paid for) all the possible strategic technological knowledge in the world, registering thousands of patents and licenses. Their business philosophy - to be the biggest imitators, compilers or innovators in the world, brought them big success. Their patents mostly are the result of the mistakes and weaknesses of their competitors. Japanese patents look the same as the Japanese do: small and efficient.

The country, which was destroyed by the Americans in 1945 and which quietly fell on its knees while signing the surrender on the command ship of general McArthur, didn't provie the Americans with peace until recently. And when the winner started to ask himself what and how that happened to it, the financial Japanese "sinner" was exposed, in June this year, now the ex premier Hashimoto, again fell on his knees, this time in front of the man who became famous for putting others on his knees - Bill Clinton. But once the "Japanese dwarf", this time it is so big that its crisis (currency-bank-stock exchange) again won't leave the Americans and Europeans peaceful, because the possibility of the contagion of the crisis from Japan and its economic satellites in south-east Asia, as well as from Russia and eventually China haunts them.

Despite the above mentioned successes, in which even we find "rotten beams in the building", in the last few years (which by the way are already recognized as such by the creators of the Japanese policies themselves), fascinate, especially when we come back to the domestic territory. Today if you ask a Japanese how their economy is doing, they will answer "very bad", because the Japanese regard their country from another angle, from the position of their biggest competitor - USA, without turning back. From the Macedonian point of view the Japanese crisis starts from such a higher level of the economy than Macedonia's, that it will make us uncomfortable to confirm "yes, your economy isn't doing well". The philosophy of the weaker and the smaller towards the stronger and bigger is still to regard it as bigger and stronger even when it is wounded.

The logic of the Japanese economic development was based on OFFENSIVE export politics, a subject, which we discussed and analyzed as a necessity for the development of Macedonia. It is not by mistake that I don't say survival, but development. I don't want to hear about "survival" eight years after acquiring independence.

We must talk about "development" otherwise tomorrow can be too late. Actually, tomorrow is always too late.

But I still ask myself if the entrenched national prosperity was only the result of the justified Japanese state policies. If we ignore the work ethic and the loyalty and strong feelings towards the company and the country, which is still very characteristic of the Japanese even in today's conditions, we will conclude that to succeed in such a short period of time to raise the economy so many levels higher many highly qualified professionals would be required. Technology and methodology could theoretically be transferred in this way or that in a short period of time, as foreign experts in various fields can be summoned. But it isn't possible to import a whole army of professionals, shaped through a well-constructed educational system. As much as we say that RM has strong professionals, as much as we are proud of individuals, who achieved many business successes in the USA or Germany, generally viewed (the exceptions only prove the rule) except the general knowledge of many areas (the philosophy is to know a little about everything) the Macedonian educational system doesn't produce a big number of well specialized professionals in specific areas. Even the bigger number of those very rare professionals, formed along these lines, do not encounter understanding and support and they leave RM very soon.

The essence of every weak long-term economy, actually lies in the weak educational and vocational education systems.

Macedonian manufacturers and other companies generally encounter serious problems with highly educated professionals, professional managers and other business operators. The fact, which was recently promoted in the media and which says that from the total number of students registered in the economic faculty in Skopje, only about 30% finish the faculty on time, means that something is defective in the educational system in RM, because in most faculties the same or similar trends can be discerned. The obvious non-existent minimal practice and training of students from almost all Macedonian faculties, as well as an insufficient theoretical background, very often the low level of mastery of foreign languages (needed for professional upgrading, because there is very little professional literature translated to Macedonian, as well as for business communication), have their effect in the future, when these former students attain more meaningful positions in business firms. The educational system very often is based on dull lectures, which would help the student as an orientation to find the professional literature after finishing the faculty.

Both of the state's universities still do not have a monopoly role in the system. While the youngsters are in high school their parents think more about how will they find a way to help their children to register in the faculty and less about how much they will be ready for it, and such a practice I believe is not accidental and is not the parent's or future students' guilt at all. Passing the exams in the best part of the cases is based on the parents' connections or on friendships. High grades go to the regiment of students who bought or who copied the professor's new book, to the students who learned the material by heart without a depth analysis and understanding. Students go through the tortuous process of overcoming the low level of professionalism and low authority of certain professors (not all). This all transforms some exams into "impenetrable barriers". It trains the students to be corrupt in the years when they have to practice by themselves to form their own thinking and to defend themselves with open and impartial discussions. Of course this is not relevant to all the professors and the faculties, but unfortunately it is relevant to the bigger part of them.

The scholarships for professional advanced studies abroad, even though a few, very rarely reach those who will make the best use of them.

In the Macedonian bigger companies there are almost no educational centers, as very important post-university education facilities, especially with more practice-oriented education and experiences. For example, if one economist in England is employed in Merill Lynch, the first six months or a year, he will have additional training in the same company during and after his working hours. Even in the smaller and poorer countries the bigger companies have this practice (e.g. Zagrebachka Banka - Zagreb). From this point of view, it would be a big handicap for RM or one idea for faster national prosperity.

The level of the management in RM is another story. Unfortunately, that is an important part of any strategy for economic reconstruction and export-oriented drive. Management is a distinct science, a separate economic branch, in many respects closer to politics and to psychology than to economics. Besides, it is a natural gift as well, which not everyone possesses.

The second unfortunate fact is that a big part of today's managers of the most important Macedonian companies are the same as in the socialistic period. Many of them were appointed to their current positions by a political key and through loyalty towards the party, without taking into consideration if they are suitable for the job or not. Actually, at the time, it wasn't very important if they were capable, because the bigger part of the production and trading was planned in advance on the union level. Maybe not as strictly as in the Russian block's socialist countries, but definitely very differently compared to the situation today. For example, it was known exactly, in advance, how many shoes Gazela - Skopje will manufacture for export and these shoes, would be exported to Russia through Centotextil (or to Italy or to some other country). There were some big trading and export firms and with political assistance all questions of distribution, production and placement were solved. The small luck in this misfortune was that one part of these people had a natural gift for managing (which was not very important in the selection process) and the practice of many years covered up for their educational deficiencies by specialization in a sophisticated management system. But the bigger part of this group have not advanced even by one centimeter in their professional development and do not speak English or German at all. It is interesting that they still survive very well, a result of timely political acquiescence and support, which not only insured their continued successful and cushioned business existence, but also, in this or that way, made it much better.

All this is acceptable until we start talking about a new policy of development based on the construction of a new economic structure, export-oriented, on the basis of market economy, but with a modicum of state policies in order to creat a framework for the new ways. It is a fact that this situation is difficult and slow to change. The logic of the bigger number of managers, is based on local principles instead of on the global. The philosophy of thinking of most managers, is different from the same ones in the developed countries or, putting it more politely, demodé. In this plane the country has limited possibilities. It is an impossible and unacceptable way of appointing managers of the stock companies. That can do only the shareholders who control the company, but unfortunately in RM the shareholders and the managers are the same people. Only the state could influence the firms indirectly, through the marketing agency, which we have discussed before, as well as by stimulating the introduction of the ISO 9001/2/3 international quality standards for operating enterprises. All this is actual in RM, at a time when the world is discussing the management revolution, the notion promoted 60 years ago according to which the technological changes in the production process separated the capitalist-owner from the management, and that function is effected more by the managers. The revolutionary changes in this plane can happen by creating possibilities and support for the entry of foreign capital into the companies, by the fact that the foreign investors will provide new markets for the domestic firms and will exercise a strong influence for changing certain negative habits and standards of the work of the Macedonian management.

SV: There is no point in separating the issues of education and management. The students of today are the managers of tomorrow. This old generation of mostly corrupt political commissars masquerading as managers and robbing the assets of the firms they are entrusted with – is bound to pass. Biology will do it if political processes will not. But is Macedonia looking into a brighter future? I am afraid that not necessarily.

To start with, there is a dramatic brain drain. Those who can leave, physically or intellectually, is doing so or trying to do so. Young people see no hope, they are angry, they never want to look back, they feel betrayed, they talk about Macedonia in terms usually reserved to treacherous wives. Those who stay behind are either patriots or unlucky or stupid or as corrupt as the preceding generations were.

Higher education in Macedonia is a farce. University professors are largely divied to two groups: the inept and the corrupt. Bribery is rampant. Marks are bought. Sexual favours, money and plain old favouritism determine the academic achievements of many students. The curricula are passe, the libraries outdated, the labs antiquated, the teachers do not bother to read foreign literature, the textbooks are plainly plagiarized rehashed. Many of them do not even know foreign languages, never been abroad for an extended period of time. The result is a dangerous mismatch between what the country needs and what the universities churn out. Additionally, many of the diplomas are not worth the material they are made of. There is a crying and desperate need for qualified, trained, skilled and properly educated manpower.

Where will the management cadre come from? From the bloated academia which produces nothing but make believe degrees? From the old socialistic planned economy? From the government's bureaucrats?

This reminds me of one last issue that we neglected to tackle: the disaffection of the Macedonian diaspora with Macedonia. Israel was virtually built with Jewish money, talent and political influence abroad. There is a relatively thriving Macedonian diaspora in Australia, Canada, the

USA. It would the first natural conduit for Macedonian exports. It would have been the first grounds for the recruitment of management, technological and financial talents. But it is not. This, to me, tells the whole story. If rich Macedonians do not trust Macedonia, do not support it, ignore it, debase it in public – why should the West behave differently? And why doesn't your country organize all these Macedonians into a powerful front wherever they are? The Czechs, the Slovaks, the Armenians, the Kurds, the Jews, the Arabs – every nation relies on it "delegates" in the outside world. Every nation, that is, except one. There wil be no prizes for guessing which.

NG: RM must find the way to hasten the spontaneous and very slow process of changing the economic structure, in order to realize bigger exports and debt reduction. Otherwise it will live doomed to disaster. Not to disaster, as one Macedonian theatre play says, because the disaster is a definite state, and even less to welfare, from which RM is still too far, but to a fall. Free fall. In the same holes. In the same way. Again and again. Persistently and stubbornly. Without deriving any lessons. This becomes comic. Even a bear in the circus can learn to ride a bicycle...

Maritime Piracy

In the second half of 2008, pirates based in Somalia have hijacked dozens seafaring vessels: yachts, fishing boats, small freighters, cruise ships (the Nautica), military cargo (the freighter Faina), a chemical tanker (the Biscagila), and an oil carrier (The Sirius Star), which contained a reported two million barrels of crude oil. Ship-owners and governments have openly admitted to paying ransom in excess of 200 million USD in the last two months alone. The pirates suffered one minor loss throughout this rampage: a "mother ship" (a previously hijacked boat) sunk in November 2008 by the intrepid Indian navy.

The rumors concerning the demise of maritime piracy back in the 19th century were a tad premature. The scourge has so resurged that the International Maritime Board (IMB), founded by the International Chamber of Commerce (ICC) in 1981, is forced to broadcast daily piracy reports to all shipping companies by satellite from its Kuala Lumpur Piracy Reporting Center, established in 1992 and partly funded by maritime insurers. The reports carry this alarming disclaimer:

"For statistical purposes, the IMB defines piracy and armed robbery as: An act of boarding or attempting to board any ship with the apparent intent to commit theft or any other crime and with the apparent intent or capability to use force in the furtherance of that act. This definition thus covers actual or attempted attacks whether the ship is berthed, at anchor or at sea. Petty thefts are excluded, unless the thieves are armed."

The 1994 United Nations Convention on the Law of the Sea defines piracy as "any illegal acts of violence or detention, or any act of depredation, committed by individuals (borne aboard a pirate vessel) for private ends against a private ship or aircraft (the victim vessel)". When no "pirate vessel" is involved - for instance, when criminals embark on a ship and capture it - the legal term is hijacking.

On July 8, 2002 seven pirates, armed with long knives attacked an officer of a cargo ship berthed in Chittagong port in Bangladesh, snatched his gold chain and watch and dislocated his arm. This was the third such attack since the ship dropped anchor in this minacious port.

Three days earlier, in Indonesia, similarly-armed pirates escaped with the crew's valuables, having tied the hands of the duty officer. Pirates in small boats stole anodes from the stern of a bulk carrier in Bangladesh. Others, in Indonesia, absconded with a life raft.

The pirates of Guyana are either unlucky or untrained. They were consistently scared off by flares hurled at them and alarms set by vigilant hands on deck. A Colombian band, riding a high speed boat, attempted to board a container ship. Warring parties in Somalia hijacked yet another ship in June 2002.

A particularly egregious case - and signs of growing sophistication and coordinated action - is described in the July 1-8, 2002 report of the IMB:

"Six armed pirates boarded a chemical tanker from a small boat and stole ship's stores. Another group of pirates broke in to engine room and stole spare parts. Thefts took place in spite of the ship engaging three shore security watchmen." Piracy incidents have been reported in India, Malaysia, Philippines, Thailand, Vietnam, the Red Sea, the Gulf of Aden, Nigeria, Brazil, Colombia, Dominican Republic, Ecuador, Peru, Venezuela.

According to the ICC Year 2001 Piracy Report, more than 330 attacks on seafaring vessels were reported in 2001 - down by a quarter compared to 2000 but 10 percent higher than 1999 and four times the 1991 figure. Piracy rose 40 percent between 1998 and 1999 alone.

Sixteen ships - double the number in 2000 - were captured and taken over in 2001. Eighty seven attacks were reported during the first quarter of 2002 - up from 68 in the corresponding period the year before. Seven of these were hijackings - compared to only 1 in the first quarter of 2001. Nine of every 10 hijacked ships are ultimately recovered, often with the help of the IMB.

Many masters and shipowners do not report piracy for fear of delays due to protracted investigations, increased insurance premiums, bad publicity, and stifling red tape. The number of unreported attacks in 1999 was estimated by the World Maritime Piracy Report to be 130.

According to "The Economist", the IMO believes that half of all incidents remain untold. Still, increased patrols and international collaboration among law enforcement agencies dented the clear upward trend in maritime crime - even in the piracy capital, Indonesia.

The number of incidents in the pirate-infested Malacca Straits dropped from 75 in 2000 to 17 in 2001 - though the number of crew "kidnap and ransom" operations, especially in Aceh, has increased. Owners usually pay the "reasonable" amounts demanded - c. $100,000 per ship. Contrary to folklore, most ships are attacked while at anchor.

Twenty one people, including passengers, were killed in 2001 - and 210 taken hostage. Assaults involving guns were up 50 percent to 73 - those involving mere knives down by a quarter to 105. Piracy seems to ebb and flow with the business cycles of the host economies. The Asian crisis, triggered by the freefall of the Thai baht in 1997-8, gave a boost to East Asian maritime robbers. So did the debt crises of Latin America a decade earlier. Drug transporters - armed with light aircraft and high speed motorboats - sometimes double as pirates during the dry season of crop growth.

Pirates endanger ship and crew. But they often cause collateral damage as well. Pirates have been known to dump noxious cargo into the sea, or tie up the crew and let an oil tanker steam ahead, its navigational aides smashed, or tamper with substances dangerous to themselves and to others, or cast crew and passengers adrift in tiny rafts with little food and water.

Many shipowners resorted to installing on-board satellite tracking systems, such as Shiploc, and aircraft-like "black boxes". A bulletproof life vest, replete with an integral jagged edged knife, was on display in the millennium exhibition at the Millennium Dome two years ago. The International Maritime Organization (IMO) is considering to compel shipowners to tag their vessels with visibly embossed numbers in compliance with the Safety of Life at Sea Convention.

The IMB also advises shipping companies to closely examine the papers of crew and masters, thousands of whom carry forged documents. In 54 maritime administrations surveyed in 2001 by the Seafarers' International Research Centre, Cardiff University in Wales, more than 12,000 cases of forged certificates of competency were unearthed.

Many issuing authorities are either careless or venal or both. The IMB accused the Coast Guard Office of Puerto Rico for issuing 500 such "suspicious" certificates. The Chinese customs and navy - especially along the southern coast - have often been decried for working hand in glove with pirates.

False documents are an integral - and crucial - part of maritime piracy. The IMB says:

"Many of the phantom ships that set off to sea with a cargo and then disappear are sailed by crewmen with false passports and competency certificates. They usually escape detection by the port authorities. In a recent case of a vessel located and arrested in South-East Asia further to IMB investigations, it has emerged that all the senior officers had false passports. The ship's registry documents were also false."

As documents go electronic and integrated in proprietary or common cargo tracking systems, such forgery will wane. Bolero - an international digital bill of lading ledger - is backed by the European Union, banks, shipping and insurance companies. The IMO is a proponent of a technology to apply encrypted "digital signatures" to electronic bills of lading. Still, the industry is highly fragmented and many ships and ports don't even possess rudimentary information technology. The protection afforded by the likes of Bolero is at least five years away.

Pirates sometimes work hand in hand with conspiring crew members (or, less often, stowaways). In many countries - in East Asia, Latin America, and Africa - Coast Guard operatives, corrupt drug agents, and other law enforcement officials, moonlight as pirates. Renegade members of British trained Indonesian anti-piracy squads are still roaming the Malacca Straits.

Pirates also enjoy the support of an insidious and vast network of suborned judges and bureaucrats. Local villagers along the coasts of Indonesia and Malaysia - and Africa - welcome pirate business and provide the perpetrators with food and shelter.

Moreover, large tankers, container ships, and cargo vessels are largely computerized and their crew members few. The value of an average vessel's freight has increased dramatically with improvements in container and oil storage technologies. "Flag of convenience" registration has assumed monstrous proportions, allowing ship owners and managers to conceal their identity effectively. Belize, Honduras, and Panama are the most notorious, no questions asked, havens.

Piracy has matured into a branch of organized crime. Hijacking requires money, equipment, weapons, planning, experience and contacts with corrupt officials. The loot per vessel ranges from $8 million to $200 million. Pottengal Mukundan, Director of ICC's Commercial Crime Services states in an IMB press release:

"(Piracy) typically involves a mother ship from which to launch the attacks, a supply of automatic weapons, false identity papers for the crew and vessel, fake cargo documents, and a broker network to sell the stolen goods illegally. Individual pirates don't have these resources. Hijackings are the work of organized crime rings."

The IMB describes the aftermath of a typical hijacking:

"The Global Mars has probably been given a new name and repainted. Armed with false registration papers and bills of lading, the pirates - or more likely the mafia bosses pulling the strings - will then try to dispose of their booty. The vessel has probably put in to a port where the false identity of vessel and cargo may escape detection. Even when identified, the gangs have been known to bribe local officials to allow them to sell the cargo and leave the port."

Such a ship is often "recycled" a few times. It earns its operators an average of $40-50 million per "cycle", according to "The Economist". The pirates contract with sellers or shipping agents to load it with a legitimate consignment of goods or commodities. The sellers and agents are unaware of the true identity of the ship, or of its unsavory "owners/managers".

The pirates invariably produce an authentic vessel registration certificate that they acquired from crooked officials - and provide the sellers or agents with a bill of lading. The payload is then sold to networks of traders in stolen merchandise or to gullible buyers in a different port of destination - and the ship is ready for yet another round.

In January 2002, the Indonesian Navy has permanently stationed six battleships in the Malacca Straits, three of them off the coast of the secessionist region of Aceh. A further 20-30 ships and 10 aircraft conduct daily patrols of the treacherous traffic lane. Some 200-600 ships cross the Straits daily. A mere 50 ships or so are boarded and searched every month.

The Greek government has gunboats patrolling the 2 miles wide Corfu Channel, where yachts frequently fall prey to Albanian pirates. Brazil has imposed an unpopular anti-piracy inspection fee on berthing vessels and used the proceeds to finance a SWAT team to protect ships and their crews while in port. Both India and Thailand have similar units.

International cooperation is also on the rise. About one third of the world's shipping traffic goes through the South China Sea. A conference convened by Japan in March 2000 - Japanese vessels have become favored targets of piracy in the last few years - pushed for the ratification of the International Maritime Organisation's (IMO) 1988 Rome Convention on the Suppression of Unlawful Acts against the Safety of Maritime Navigation by Asian and ASEAN countries.

The Convention makes piracy an extraterritorial crime and, thus, removes the thorny issue of jurisdiction in cases of piracy carried in another country's territorial waters or out on the high seas. The Comite Maritime International - the umbrella organization of national maritime law associations - promulgated a model anti-piracy law last year.

Though it rejected Japan's offer for collaboration, in a sharp reversal of its previous policy, China started handing down death sentences against murderous pirates. The 13 marauders who seized the Cheung Son and massacred its 23 Chinese sailors were executed five years ago in the southern city of Shanwei. Another 25 people received long prison sentences. The - declared - booty amounted to a mere $300,000.

India and Iran - two emerging "pirates safe harbor" destinations - have also tightened up sentencing and port inspections. In the Alondra Rainbow hijacking, the Indian Navy captured the Indonesian culprits in a cinematic chase off Goa. They were later sentenced severely under both the Indian Penal Code and international law. Even the junta in Myanmar has taken tentative steps against compatriots with piratical predilections.

Law enforcement does not tolerate a vacuum. "The Economist" reports about two private military companies - Marine Risk Management and Satellite Protection Services (SPS) - which deploy airborne mercenaries to deal with piracy. SPS has even suggested to station 2500 former Dutch marines in Subic Bay in the Philippines - for a mere $2500 per day per combatant.

Shipowners are desperate. Quoted by "The Economist", they "suggest that the region's governments negotiate the right for navies to chase pirates across national boundaries: the so-called 'right of hot pursuit'. So far, only Singapore and Indonesia have negotiated limited rights. Some suggest that the American navy should be invited into territorial waters to combat piracy, a 'live' exercise it might relish. At the very least, countries such as Indonesia should advertise which bits of their territorial waters at any time are patrolled and safe from pirates. No countries currently do this."

Massively Multiplayer Online Role Playing Games (MMORPG)

Games and role-playing are as ancient as Mankind. Rome's state-sponsored lethal public games may have accounted for up to one fifth of its GDP. They often lasted for months. Historical re-enactments, sports events, chess tournaments, are all manifestations of Man's insatiable desire to be someone else, somewhere else - and to learn from the experience.

In June 2002, Jeff Harrow, in his influential and eponymous "Harrow Technology Report", analyzed the economics of Massively Multiplayer Online Role Playing Games (MMORPG). These are 3-D games which take place in comprehensively and minutely constructed environments - a medieval kingdom being the favorite. "Gamers" use action figures known as avatars to represent themselves. These animated figurines walk, talk, emote, and are surprisingly versatile.

Harrow quoted this passage from Internetnews.com regarding Sony's (actually, Verant's) "EverQuest". It is a massive MMORPG (now with a sequel) with almost half a million users - each paying c. $13 a month:

"(Norrath, EverQuest's ersatz world is) ... the 77th largest economy in the [real] world! [It] has a gross national product per capita of $2,266, making its economy larger than either the Chinese or Indian economy and roughly comparable to Russia's economy."

In his above quoted paper, "Virtual Worlds: A First-Hand Account of Market and Society on the Cyberian Frontier", Professor Edward Castronova, from California State University at Fullerton, notes that:

"The nominal hourly wage (in Norrath) is about USD 3.42 per hour, and the labors of the people produce a GNP per capita somewhere between that of Russia and Bulgaria. A unit of Norrath's currency is traded on exchange markets at USD 0.0107, higher than the Yen

and the Lira. The economy is characterized by extreme inequality, yet life there is quite attractive to many."

Players - in contravention of the game's rules until recently - also trade in EverQuest paraphernalia and characters offline. The online auction Web site, eBay, is flooded with them and people pay real money - sometimes up to a thousand dollars - for avatars and their possessions. Auxiliary and surrogate industries sprang around EverQuest and its ilk. There are, for instance, "macroing" programs that emulate the actions of a real-life player - a no-no.

Nor is EverQuest the largest. World of Warcraft from Blizzard Entertainment has 1.5 million subscribers. The Korean MMORPG "Lineage" boasts a staggering 2.5 million subscribers. "The Matrix Online", released by Warner Brothers Interactive Entertainment and Sega Corporation in 2004-5, may surpass these figures due to its association with the film franchise - though Star War Galaxies, for instance, failed to leverage its cinematic brand.

The economies of these immersive faux realms suffer from very real woes, though. In its May 28, 2002 issue, "The New Yorker" recounted the story of Britannia, one of the nether kingdoms of the Internet:

"The kingdom, which is stuck somewhere between the sixth and the twelfth centuries, has a single unit of currency, a gold piece that looks a little like a biscuit. A network of servers is supposed to keep track of all the gold, just as it keeps track of everything else on the island, but in late 1997 bands of counterfeiters found a

bug that allowed them to reproduce gold pieces more or less at will.

The fantastic wealth they produced for themselves was, of course, entirely imaginary, and yet it led, in textbook fashion, to hyperinflation. At the worst point in the crisis, Britannia's monetary system virtually collapsed, and players all over the kingdom were reduced to bartering."

Britannia - run by Ultima Online - has 250,000 "denizens", each charged c. $10 a month. An average Britannian spends 13 hours a week in the simulated demesne. For many, this constitutes their main social interaction. Psychologists warn against the addictive qualities of this recreation.

Others regard these diversions as colossal - though inadvertent - social experiments. If so, they bode ill - they are all infested with virtual crime, counterfeiting, hoarding, xenophobia, racism, and all manner of perversions.

Subscriptions are not the only mode of payment. Early multi-user dungeons (MUD) - another type of MMORPG - used to charge by the hour. Some users were said to run bills of hundreds of dollars a month.

MMORPG's require massive upfront investments. It costs c. $20 million to develop a game, not including later content development and technical support. Consequently, hitherto, such games constitute a tiny fraction of the booming video and PC gaming businesses. With combined annual revenues of c. $9 billion in 2001, these trades are 10 percent bigger than the film industry - and half as lucrative as the home video market. They are fast closing on music retail sales.

As games become graphically-lavish and more interactive, their popularity will increase. Offline and online single-player and multi-player video gaming may be converging. Both Sony and Microsoft Internet-enable their game consoles. The currently clandestine universe of geeks and eccentrics - online, multi-player, games - may yet become a mass phenomena.

Moreover, MMORPG can be greatly enhanced - and expensive downtime greatly reduced - with distributed computing - the sharing of idle resources worldwide to perform calculations within ad hoc self-assembling computer networks. Such collaboration forms the core of, arguably, the new architecture of the Internet known as "The Grid". Companies such as IBM and Butterfly are already developing the requisite technologies.

According to an IBM-Butterfly press release:

"The Butterfly Grid T could enable online video game providers to support a massive number of players (a few millions) (simultaneously) within the same game by allocating computing resources to the most populated areas and most popular games."

The differences between video games and other forms of entertainment may be eroding. Hollywood films are actually a form of MMORPG's - simultaneously watched by thousands worldwide. Video games are interactive - while movies are passive but even this distinction may fall prey to Web films and interactive TV.

As real-life actors and pop idols are - ever so gradually - replaced by electronic avatars, video games will come to occupy the driver seat in a host of hitherto disparate industries. Movies may first be released as video games - rather than conversely. Original music written for the games will be published as "sound tracks".

Gamers will move seamlessly from their PDA to their PC, to their home cinema system, and back to their Interactive TV. Game consoles - already computational marvels - may finally succeed where PC's failed: to transform the face of entertainment.

Jeff Harrow aptly concludes:

" ... History teaches me that games tend to drive the mass adoption of technologies that then become commonplace and find their way into 'business'. Examples include color monitors, higher-resolution and hardware-accelerated graphics, sound cards, and more. And in the case of these MMORPG games, I believe that they will eventually morph into effective virtual business venues for meetings, trade shows, and more. Don't ignore what's behind (and ahead for) these 'games', just because they're games..."

(Mass) Media (in Countries in Transition)

A June 2005 IREX report, quoted by the Southeast Europe Times (SE Times), analyzes the media in countries in transition from Communism by measuring parameters like free speech, professional standards of quality, plurality of news sources, business sustainability and supporting institutions. It concludes that "most transition countries in Southeast Europe have made progress in the development of professional independent media". The Media Sustainability Index (MSI) for 2004 begs to differ: "...(F)ully sustainable media have yet to be achieved in any of the countries.

Karl Marx decried religion as "opium for the masses". Yet no divine worship has attained the intensity of the fatuous obsession of the denizens of central and east Europe with the diet of inane conspiracy theories, gaudy soap operas and televised gambling they are fed daily by their local media. There is little else on offer except the interminable babble of self-important politicians. It is the rule of the abysmally lowest common denominator.

In Macedonia, it is impossible to avoid a certain entertainer, a graceless Neanderthal hulk with a stentorian voice, deafeningly employed in a doomed attempt to appear suavely quaint and uproariously waggish. The natives love him. Private, commercial, TV in the Czech Republic - notably "Nova" - has surpassed its American role models. It has long been reduced to a concoction of soft porn, soundbite tabloid journalism and Latin American "telenovelas". Jan Culik, publisher of the influential Czech Internet daily, Britske listy, once described its programming as "sex, violence and voyeurism ... a tabloid approach".

The situation is no different - or much improved - elsewhere, from Russia to Slovenia. As Andrew Stroehlein, former editor in chief of Central Europe Review, so aptly put it - "Garbage in, money out". This sad state of affairs was brought on by a confluence of economic fads (such as privatization, commercialization and foreign ownership) and technologies of narrowcasting

- satellites, video cassette recorders, cable TV, regional and local "stealth" TV stations and, in the not so distant future, Internet broadband and HDTV.

Writing in Central Europe Review about the Romanian scene, Catherine Lovatt observed that "television was one medium through which Romanians could vicariously experience the 'Western' dream. The popularity of programmes such as Melrose Place indicates a preference for certain lifestyles - lifestyles that are as glamorous as they are out of reach. The seemingly unabating craving for commercial TV has been fuelled by the need to escape the Communist past and the stresses of today's reality."

Grasping its importance as a tool of all-pervasive indoctrination, television was introduced early on by the communist masters of the region. Still, tortuous stretches of personality cult and blatant, laughable, propaganda aside - monopolistic, state-owned communist TV, not encumbered by the need to compete, offered an admirable menu of educational, cultural and horizon expanding programming.

It is all gone now. The region is drowning in cheaply produced mock talk shows, hundreds of episodes of Latin American serials, hours on end of live bingo and lottery drawings, tattered B movies, pirated new releases and sitcoms and compulsively repeated newscasts.

From Ukraine to Bulgaria, commercial channels are prone to featuring occultists, conspiracy theorists, anti-Semitic "historians", hate speech proponents, racists, rabid nationalists and other unadulterated whackos and have taken to vigorously promoting their pet peeves and outlandish conjectures.

The intrigue-inclined postulate that this visual effluence is intended to numb its hapless recipients and render them oblivious to the insufferable drudgery of their dreary, crime-infested, corruption-laden and, in general, rather doomed, lives. It is instigated by unscrupulous politicians, they whisper, eyes darting nervously. It is a form of state-sponsored drug, also known as escapism.

How to reconcile this paranoid depiction of a predatory state with the fact that most private television stations throughout the region are owned by hard-nosed, often foreign, businessmen?

The suspicious point to the fact that "local content" and "cultural minimum" license requirements are rarely imposed by regulators. National broadcasting permits were granted to cronies and insiders and withheld from potential "troublemakers" and dissidents.

It is also true that, as Stroehlein puts it, there is a massive "repatriation of profits generated from newly private stations to Western firms." As a result, "local production companies are losing out, and the loss of funds damages the domestic entertainment and arts industry and the economy as a whole."

And the collusion-minded have a point. The dumbing-down of audiences is as dangerous to newfound political and economic freedoms as are more explicit forms of repression. Both democracy and the free market will not survive long in the absence of an informed, alert, intellectually agile public. It is hard to retain one's critical faculties under the onslaught of televised conspicuous consumption and the unmitigated folly of mass entertainers.

Many scholars and media observers believe that the battle has already been lost.

Péter Bajomi-Lázár, associate professor at the Communication Department of Kodolanyi University College, Budapest-Szekesfehervar in Hungary, wrote in January 2002 in a comparative study titled "Public Service Television in East Central Europe":

"The transformation of public service television from a tool of agitation and propaganda into an agent of democratic control has been but a partial success in East Central Europe. Public service television channels have failed to find their identities and audiences in a market dominated by commercial broadcasters. Some of them are underfunded and their journalists encounter political pressure."

But even where public broadcasters enjoy the proceeds of a BBC-like television tax - like in Macedonia - they fail to attract spectators. The stark reality is that when people are faced with a choice between intellectually demanding and challenging programs and easily digestible variety shows they always plump for the latter. It is easy to condition people to complacent passivity and inordinately tough to snap out of it once exposed. The inhabitants of central and east Europe are mentally intoxicated. The hangover may never happen.

In October 2008, the car of the outspoken editor of the Croat investigative weekly "Nacional", Ivo Pukanic, exploded as he tried to remote unlock its doors. Niko Franjic, the magazine's marketing director, also perished. Pukanic as investigating mob-related murders and racketeering.

This was only the latest in a series of gruesome and grizzly assassinations and attempted murders of journalists throughout the territories of the former Soviet or socialist Bloc.

Just two years before, in October 2006, Anna Politkovskaya, a Russian author, journalist, and human rights activist was gunned down at the entrance to her home (near the building's elevator). Politkovskaya was renowned for her opposition to Vladimir Putin (then, Russia's president) and to the Chechen conflict, in which fortunes were made by corrupt figures in the military and other unsavory characters.

Aleksandr Plotnikov died in June 2002 in his dacha. He was murdered. He has just lost a bid to restore his control of a local paper in Tyumen Oblast in Russia. Media ownership is frequently a lethal business in eastern Europe. The same week, Ukrainian National Television deputy chief, Andryi Feshchenko, was found dead in a jeep in a deserted street of Kyiv. Prosecutors suspect that he was forced to take his life at gunpoint.

In an interesting variation on this familiar theme, a Moldovan parliamentarian accused the editor of the government-run newspaper, "Moldova Suverana", of collusion in his kidnapping.

Governments throughout the region make it a point to rein in free journalism. Restrictive media statutes are being introduced from Russia to Poland. Romania's Senate approved, on June 6, 2002, a law granting persons offended by a print article the right to have their response published in the same media outlet and to seek monetary compensation all the same.

The Romanian president attacked the media and said that he is "amazed" at their "talent to distort" his statements. He attributed this to a "lack of information, lack of culture, or malevolence." In Belarus, journalists are standing trial for defaming the president. They face 5 years incarceration if convicted.

Early in 2006, Macedonia was poised to pass a long-overdue Freedom of Information law even as the government attempted to shut down the highly efficient and (from repeated personal experience) indispensably helpful Agency of Information. Thus, journalists, both foreign and domestic, cannot now obtain accreditation ("press card"). The distinct red card served hitherto as a form of much needed protection in these nether regions and a prerequisite to securing a mandatory work permit and custom clearances for bringing in TV equipment. Some say that the ruling party wished to minimize its exposure to the foreign media during the forthcoming, closely-contested, heated and sensitive parliamentary elections.

The Agency of Information survived as a department, but not so the freedom of the press. The media in Macedonia has been rendered completely subservient and dysfunctional in the last three years, under the governments of Nikola Gruevski.

This is the outcome of the confluence of a few developments:

1. Increasing involvement of corporate interests. The private sector in Macedonia is rent-seeking and the owners of the media can't afford to be seen to be "anti"-government. They implement self-censorship on a

ubiquitous and all-pervasive scale (including "black lists" of who not to interview).

2. The government's soaring share of the nation's advertising dollar. The media are reluctant to alienate the country's largest advertiser: the government.

3. The fragmentation of the nation's media market (with 12 daily papers and 10 national TV stations!!). This apparent "pluralism" actually allows the government to "pick winners" and favorites and to extend its "benevolent network of patronage" to hitherto independent media. Many papers and electronic media are too small to survive on their own.

4. The government micromanages the media. Government officials bombard editors and journalists with complaints, accusations, and what can easily be interpreted as veiled threats every time the media publish an unflattering bit of analysis (or even information that runs counter to the official line). Turnover of independent-minded journalists has never been higher
(translation: they are being sacked at record rates).

Macedonia is not an isolated case.

In 2002, Putin's Russia introduced a decree regulating the licensing of audio and video production duplication rights. According to abc.ru, a license from the Media Ministry is required to make copies of any multimedia work. The Culture Ministry licenses such oeuvres for mass audiences.

The frequency of A1+, Armenia's most vocal independent TV station, was auctioned off to politically-sponsored business fronts, forcing the hard-hitting station off the air on April 3, 2002 - just in time for the following year's elections. The new owners - "Sharm" - promised to concentrate on "optimistic news".

The station appealed the tender procedure to the Armenian Economic Court and opposition groups took to the streets. AFP carried a statement by the self-appointed watchdog, Raporteurs Sans Frontieres, that called the tender "the muzzling of the country's main news voice ... the most serious violation of pluralism in Armenia in years".

Even the US Embassy in Yerevan stirred:

"A1+ performed a valuable public service in offering substantial media access to a broad spectrum of opinion makers, political leaders, and those holding differing views."

The Azerbaijani prime minister promised to allocate $3.5 million in credits to media outlets - but, tellingly, made this announcement exclusively on the state-owned channel. The bulk of the television tax in Macedonia ends up in the coffers of the somnolent and bloated state channel which caters to a mere one quarter of the viewers. The independent media - both print and electronic - face unfair competition in attracting scarce advertising revenues.

The managers of six Latvian private television and radio stations published an open letter to President Vaira Vike-Freiberga, Prime Minister Andris Berzins, the Competition Council, the National Radio and Television

Council (NRTC), the State Support Monitoring Commission, and political parties.

They deplored the commercialization of the public media. State support - fumed the signatories - allows these outlets to undercut the prices of advertising airtime. They urged a major revision and modernization of the law. Latvia is considering the introduction of a monthly mandatory "subscription fee" to finance its state-owned media.

Media properties are awarded to loyal cronies and oligarchs - having been expropriated from tycoons and managers who fell from official grace. Such assets are often "parked" with safe corporate hands ad interim. Russian energy behemoth Gazprom, for instance, acquired a media empire overnight by looking after such orphan holdings. It is now dismantling these non-core operations.

In Russia, the tendered broadcasting rights of TV6 were allocated to Media-Sotsium, a consortium led by regime stalwarts such as Yevgeni Primakov, a former prime minister and the current chief of the Chamber of Commerce and Industry and Arkadi Volski, head of the Union of Industrialists and Entrepreneurs. The group included leading managers and active political figures. The consortium's general director is none else than Yevgeni Kiselev, the erstwhile general manager of TV6.

TV6 was taken off the air by the Kremlin in 2001 - as was Russia's most popular independent station, NTV. Quoted by Radio Free Europe Radio Liberty, the Editor in Chief of the Ekho Moskvy radio station commented that this "completes the redistribution of television property in Russia from one oligarch who was not loyal to the authorities to others that are".

Gorbachev, whose group bid for the station, concurred wholeheartedly. In a rare show of consonance, so did the communist Zyuganov. Muscovites polled in April 2002 said they hoped TV6 would become a sports-only channel.

In a speech to the National Press Club in Washington on April 9, 2002 Russian Media Minister, Mikhail Lesin, admitted that "developments surrounding the NTV and TV-6 companies certainly had a political background, and there is no denying it". He promised to substantially cut funding to "politically oriented mass media".

Russian media, insisted the Minister, is having "growing pains". Referring to the older and more mature media in America, he asked: "Let us remember how this 100-year-old gentleman looked when he was 10 years old. He did not have any problems at that time?"

State interference rarely stops at the ownership level. Subtle self-censorship by obsequious or terrorized journalists is often coupled with governmental micromanagement. The license of NTV, the eponymous successor of the shuttered independent Russian TV station, was renewed only recently for another five years - after many delays and public statements casting doubts on the outcome. This form of subtle pressure to self-discipline is common.

The Russian business daily Kommersant commented:

"(The delays were intended to) stimulate Gazprom to more quickly sell its shares in the company and to frighten (NTV's General Director) Jordan into being a bit more attentive to what NTV puts on the air."

Belarusian president, Alaksandr Lukashenka, instructed the chief of the Belarusian Television and Radio Company to "work around the clock" to improve programming. "The Belarusian Television and Radio Company works in the same information field with powerful foreign broadcasters: ORT, RTR, NTV, Radio Rossiya, Radio Mayak, Radio Liberty, Radio Racja, and others. It is in a state of ideological competition with them and, speaking straightforwardly, sometimes in confrontation."

"Belarusian Television, as before, remains an information supplement to foreign television companies." - he was quoted as saying by REF/RL. How would such a turnaround be achieved with a shoestring budget was left unarticulated. Belarus couldn't pay Kirch Media the $500,000 it demanded for the World Cup rights.

The Belarusian Language Society appealed to UNESCO and the EU to help launch a Belarusian heritage and culture satellite broadcast on the Discovery Channel. Russian-language broadcasts, they noted ruefully, account for a crippling 97 percent of airtime.

Lukashenka finished his diatribe with a practical advice: "Beginning from tomorrow, every manager in the Belarusian Radio and Television Company has to sleep with a television set." In a country where disagreeing with the president can be the last thing one does, his wish is a command.

The situation is especially egregious in the fiefdoms of Central Asia.

In Georgia, the politically-pliant tax police, often an instrument of intimidation of opponents, raided Rustavi-2, an independent thorn in the irate government's side. In Kazakhstan, in November 2001, all the media properties of Alma-Media - including its prized Kazakh Commercial TV - were suspended. Malicious rumors were spread by the police against the editor of the outspoken newspaper, "Karavan". The rumors were promptly denied by the Kazakh Minister of Internal Affairs.

If all else fails, crime does the trick. the independent Kazakh paper, "Delovoe-Obozrenie-Respublika", was first firebombed and then - five days later - closed by the court because it failed to provide a publication schedule. OSCE slammed Kazakhstan for its new Administrative Offenses Code which is replete with 40 media-related transgressions.

RFE/RL quoted a statement by Rozlana Taukina, head of the Independent Media Association of Almaty, in a press conference in Moscow. She complained that 22 independent media outlets have been closed in Kazakhstan over the past month.

Another instrument of suppression are libel suits which invariably result in exorbitant and destructive penalties.

Aleksandr Chernov, a Krasnodar judge, won in February 2002 $1 million in compensation from "Novaya Gazeta", a paper owned by the disgraced and self-exiled oligarch Boris Berezovsky. Senior Russian public figures issued a passionate plea to reduce the fine and prevent the paper's bankruptcy.

In an unrelated lawsuit, Mezhprombank, alleged by "The Moscow Times" to be a money laundering venue, won c. $500,000 in damages from the aforementioned besieged "Novaya Gazeta". Court bailiffs seem determined to force the closure of the paper despite a pending appeal.

The largest circulation Slovak paper, "Novy cas", was ordered to pay a whopping $100,000 in compensation to Real Slovak National Party (PSNS) Chairman Jan Slota. The paper reported that he had been seen drunk.

Vladimir Putin, Russia's president, encapsulated the philosophy of state interventionism neatly in an interview he granted to ITAR-TASS and other Russian news agencies:

"If freedom of the press is understood as the freedom of a handful of so-called oligarchs to buy journalists, to dictate their will in the interests of their groups, and to protect the way of Russia's oligarchic development that was thrust on the country over the past decade, then yes, it is in danger ... (The authorities should not) allow individuals to shape the country's strategy the way they like, (while) filling their pockets with illegally earned money ... (Freedom of the press) implies the ability of journalists and their groups to freely, openly, and fearlessly define their position on key problems of the development of the country and society, to criticize actions of the authorities (and to make sure that the authorities react properly)."

Putin harked back to the nanny state, calling Russian media immature and still in the development stage. They need assistance in developing ways to secure their future economic independence. The state will create the necessary conditions for the "economic freedom of the press".

The president's aide, Aleksei Volin, was quoted by REF/RL as having told radio Ekho Moskvy that state-ownership of the media is rendered meaningless in an age of multiple channels. The state, said the aide, should concentrate on programming and thus "ensure its role in television media".

Russia's then Media Minister, Lesin, hastened to make clear that the state has no intention of privatizing its television media holdings, ORT, the second channel (RTR), and Kultura, an educational cum entertainment network. The government - a minority shareholder in ORT - denies meddling in the editorial affairs and policies of either of these federally-funded channels. ORT and RTR just paid c. $40 million for the Russia World Cup rights.

A bill, introduced in the Duma by independents, failed to pass last week. It would have reduced state ownership of mass media outlets to 25 percent within 6 months. Anti-government deputies claimed that the state controls 90 percent of all the media in the vast country. Their colleagues from the coalition cited a figure of 10 percent.

In Moldova, a committee of lawyers, journalists, and deputies of parliament issued a report on May 3, 2002 advocating against privatization of the media. Both radio and television, they intoned, must remain in the safe hands of the state, though in the form of an "autonomous" public broadcasting authority. This flew in the face of recommendation issued earlier by the Parliamentary Assembly of the Council of Europe (PACE).

In response, incensed journalists, intellectuals, and lawyers established Public Television Company. Modeled after the BBC, it will be sponsored by private sector donations and advertising revenues - they told Infotag, the news agency. The head of an EU visiting delegation went as far as warning the Moldovan government that ignoring PACE's advice "will have catastrophic consequences both for the current government and the citizens".

The new Hungarian government is considering to shut down one or more of the state-owned TV channels and to reform the media law. But, EU-orientated statements to the contrary - Hungary's state media is still under the collective thumb of its politicians. According to the May 15, 2002 issue of "Nepszabadsag", the Socialist party media spokesman publicly "suggested" that the President of Hungarian Television should resign due to his bias during the elections.

Journalists on all levels readily collaborate with political masters. The staff of Hungarian Pannon Radio took over the previous location of the station and are broadcasting virulent nationalistic propaganda with the financial and political backing of the extremist MIEP - the Hungarian Justice and Life Party.

The ownership of electronic media is the electoral trump card in most countries in transition. Papers are little read. According to Emil Danielyan in RFE/RL:

"There are several newspapers that are highly critical of the authorities but their impact on public opinion is limited, as their combined daily print run does not exceed 10,000 copies (Armenia's population is just over 3 million)."

In Macedonia, the circulation of "Dnevnik", the country's leading paper, is thought to be c. 20,000 copies on a weekday (its official figures of triple that notwithstanding) - compared to more than 500,000 regular viewers of A1, the dominant independent TV station, owned by business interests. No weekly sells more than 3000 copies in this country of 2 million people.

Foreign ownership of media is still a rarity. Xenophobia and crookedness combine to drive away potential investors. Central European Media Enterprise (CME), an American holding company for central European media properties, endured the most grueling experiences in the late 1990's in the Czech Republic and Slovenia.

Tele5, a new Polish television channel, is owned by Fincast, a Polish subsidiary of Italian Eurocast Italia and more than 70 percent of Poland's regional media are in the hands on two Western companies. The second largest paper, Rzeczpospolia, is owned by a Norwegian firm. But these are the Polish exceptions that only highlight the regional rule.

Poland is atypical on other fronts as well. Poles are avid devourers of broadsheets. More than 20 percent of them feast on the Gazeta Wyborcza every day. Amendments to the existing law prevent the formation of media monopolies by restricting media ownership to one nationwide broadcasting license or one nationwide daily. The Wyborcza would thus be prevented from taking possession of the private Polish TV station, Polsat, one of many.

Adam Michnik, an erstwhile dissident turned influential editor, remarked acidulously to "The Economist":

"Of course (prime minister) Miler (a former senior communist) should know how evil a monopoly can be ... (The government wants to render Wyborcza) cowardly, toothless, and servile. Authoritarian states like such papers, but Polish democracy does not need one."

Admittedly, Poland is not above harassment and intimidation. The managers of Rzeczpospolita - 49 percent owned by the government - were hounded by tax inspectors and their passports were confiscated. "An action usually reserved for big-time criminals" - notes "The Economist" dryly.

The board of the state-owned television is packed with sycophants and cronies. Now, the widely-held theory goes, Miller has his sights on the print media. He wants to force the Norwegians to sell to Trybuna, the little-read mouthpiece of the ex-Communists.

But the media in the post-Communist territories may be simply reaping what they sowed.

In an article published by "Central Europe Review", I summed up the state of the media in Central and Eastern Europe thus:

"What sets the media in the countries in transition apart from its brethren in the West is its lack of (even feigned) professionalism, its venality and its tainted and ulterior motives. In these nether regions, journalism amounts to influence peddling. Journalists are easily bought and sold and their price is ever decreasing. They work in mouthpieces of business interests masquerading as media. They receive their instructions - to lie, to falsify, to ignore, to emphasize, to suppress, to extort, to inform,

to collaborate with the authorities - from their Editor in Chief. They trade news for advertising.

The commercial media - the likes of 'Nova' TV in the Czech Republic - are poor people's imitations of the more derided aspects of American mass culture. Overflowing with lowbrow talk shows, freaks on display, malicious gossip which passes for 'news' and glitzy promos and quizzes - these TV stations and print magazines derive the bulk of their income from advertising. Then there is the mercenary media. These are groups of hired pens and keyboards - so called journalists - who offer their services to the highest bidder. Their price is often pathetic: a lunch a month, one hundred euros, a trip abroad and a dingy hotel room. They collaborate with their editors and share the spoils with them.

The mercenaries often work in 'business-sponsored media outlets'. These are TV stations, daily papers and periodicals owned by the oligarchs of malignant capitalism and used by them to rubbish their opponents and flagrantly and unabashedly further their business interests. This phenomenon used to be most pronounced in Russia, where virtually all the media was once identified with mafia-like interests - before it was taken over by the newly authoritarian state."

According to a poll conducted in May 2002 by a few Russian Web sites in collaboration with radio Ekho Moskvy, more than 57 percent of all respondents in all age groups supported state censorship. The main concerns were overt and excessive violence and pornography.

Aware of this popular mandate, Putin's alma mater, the FSB (formerly known as the KGB) moved to further its hijacking of the media. ITAR-TASS reported that FSB Lieutenant General Aleksandr Zdanovich, former chief spokesman and head of the public relations center of the spy organization, was appointed deputy director of the VGTRK, the state broadcasting company.

Middle Class (in Russia)

A conference held, at the beginning of December 2002, in St. Petersburg, was aptly titled "Middle Class - The Myths and the Reality". Russia is way poorer than Slovenia, the Czech Republic, Hungary, or even Poland. But, as income disparities grow, a group of discriminating consumers with the purchasing power to match, is re-emerging, having been submerged by the 1998 implosion of the financial sector.

The typical salary in the large metropolises is now more than $600 per month - four times the meager national average. Some 20 percent of the workforce in Moscow earns more than $1700 a month, comparable to many members of the European Union. Real average wages across Russia have surpassed the pre-1998 level in May.

Moreover, Russians are unburdened by debt and their utility bills and food are heavily subsidized, though decreasingly so. Few pay taxes - lately dramatically reduced and simplified - and even fewer save. Every rise in disposable income is immediately translated to unadulterated consumption. Takings are understated - Russia's informal economy is probably half as big as its formal sector.

A study, financed by the Carnegie Foundation, found that only 7 percent of Russians qualify as middle class. Another 12 percent or so have some bourgeois characteristics. Sixty percent of them are men, though the Komkon marketing research agency says that the genders are equally represented.

Figures culled from the census conducted this year throughout the Russian Federation - the first since 1989 - are expected to confirm these findings. About one fifth to one quarter of all Russian households earn more than the average monthly income of $150 per person.

Political parties which purport to represent the middle class - such as the Union of the Forces of the Right (SPS) - garnered 10-15 percent of the votes in the 1999 parliamentary elections. Direct action groups of the "third estate" may transform the political landscape in forthcoming elections.

In a recent study by sociologists from the Russian Academy of Sciences' Institute of Philosophy, more than half of all Russians self-flatteringly considered themselves middle class. This is delusional. Even the optimistic research firm Premier-TGI pegs the number at 19 percent at most.

Businesses adapt to these new demands of shifting tastes and preferences. The St. Petersburg-based cellular operator Delta Telecom, owner of the first license to provide wireless-communications services in Russia, intends to test the market among middle class clients.

Ikea, the Swedish home improvement chain, has plunged $200 million into a new shopping center. French, German and Dutch cash-and-carry and do-it-yourself groups are slated to follow. Russian competitors, every bit as sleek, have erupted on the scene. The investment spree has engulfed the provinces as well.

Last month, Citibank opened a retail outlet for affluent individuals in Moscow - though its standards of transparency may yet scare them off, as Gazeta.ru observed astutely. A private cemetery in Samara caters to the needs of the expired newly rich. Opulently-stocked emporiums have sprouted in all urban centers. TV shopping and even online commerce are on the up. According to the Washington Post, Moscow retail space will have tripled by the end of next year from its level at the beginning of 2002.

The Russian Expert magazine says that the middle class, minuscule as it is, accounted last year for a staggering 55 percent of all consumer goods purchased and generates one third of Russia's gross domestic product. The middle class is Russia's most important engine of wealth formation and investment, far outweighing foreign capital.

Russia's post-1998 fledgling middle class is described as young, well-educated, well-traveled, community-orientated, entrepreneurial and suffused with work ethic and a desire for social mobility. It is almost as if the crisis four years ago served as a purgatory, purging sins and sinners alike and creating the conditions for the revival of a healthier, longer-lived, bourgeoisie.

But being middle class is a state of mind more than a measure of wealth. It is an all-encompassing worldview, a set of values, a code of conduct, a list of goals, aspirations, fantasies and preferences and a catalog of moral do's and don'ts. This is where transition, micromanaged by western "experts" failed.

The mere exposure to free markets was supposed to unleash innovation and entrepreneurship in the long-oppressed populations of east Europe. When this prescription - known as "shock therapy" - bombed, the West tried to engender a stable, share-holding, business-owning, middle class by financing small size enterprises. It then proceeded to strengthen and transform indigenous institutions.

None of it worked. Transition had no grassroots support and its prescriptive - and painful - nature caused wide resentment and obstruction. When the dust settled, Russia found itself with a putative - and puny - middle class. But it was an anomalous beast, very different from its ostensible European or American counterparts.

To start with, Russia's new middle class is a distinct minority.

Prism, a publication of the Jamestown Foundation, quoted, in its August 2001 issue, the Serbian author Milorad Pavic as saying that "the Russian middle class is like a young generation whose fathers suffered a severe defeat in a war: with no feeling of guilt and no victorious fathers to boss them around, the children of defeat see no obstacles before them".

But this metaphor is misleading. The Russian middle class is a nascent exception - not an overarching rule. As Akos Rona-Tas, Associate Professor in the Sociology Department at the University of California, San Diego, notes correctly in his paper "Post Communist Transition and the Absent Middle Class in Central East Europe", a middle class that is in the minority is an oxymoron:

"In democracies the middle class is the nation proper. The typical member of a national community is a member of the middle class. When democratic governments need a social group they can address, a universal class that carries the overarching, common interest of the country, they appeal to the middle class. This appeal, while it calls on a common interest, also acknowledges that there are conflicting interests within society. The middle class is not everyone, but it is the majority and it represents what everyone else can become."

Russia has a long way to go to achieve this ubiquity. Its middle class, far from representing the consensus, reifies the growing abyss between haves and haves not. Its members' conspicuous consumption, mostly of imports, does little to support the local economy. Its political might is self-serving. It has no ethos, or distinct morality, no narrative, or ideology. The Russian middle class is at a Hobbesian and primordial stage.

Whether it emerges from its narcissistic cocoon to become a leading and guiding social force, is doubtful. The middle class' youth, urbaneness, cosmopolitanism, polyglotism, mobility, avarice and drive are viewed with suspicion and envy by the great unwashed - the overwhelming majority of Russia's destitute population. Empowered by their wealth, the new bourgeoisie, in turn, regards the "people" with naive admiration, patronizing condescension, or horror.

Granted, this muted, subterranean, interaction is not entirely deleterious. It is the social role of the rich to generate demand by provoking in the poor jealousy and attempts at emulation. The wealthy are the trendsetters, the early adopters, the pioneers, the buzz leaders. They are the engine that engenders social and economic mobility.

A similar dynamic is admittedly evident in Russia - but, again, it is tampered by a curious local phenomenon.

Writing for the Globalist, two Brookings Institution scholars, Carol Graham, a Senior Fellow of Economic Studies and Clifford Gaddy, a Fellow of Foreign Policy and Governance Studies described it thus:

"The eyes of Russia's middle class, on the other hand, are figuratively directed downward, towards the poor. In fact, as poverty in Russia increased dramatically in the 1990s, the middle class's reference norms shifted downward as well. As a result, Russia may be the only country in the world where the 'subjective poverty line' is falling. That is, the amount of money that Russians say that they need in order to stay out of poverty has been steadily falling over the past five years. It is even below the objective poverty line. For the time being, at least, these curious Russian attitudes, along with the existence of the non-monetary virtual economy, have insulated the country against political upheaval."

The list of anomalies is not exhausted.

The new middle class comprises the embryonic legitimate business elite - entrepreneurs, professionals and managers - but not the remnants of the financially strapped intelligentsia. It is brawn with little brains. In dissonance with western Europe, according to a survey published in the last two years by Expert magazine, the majority of its members are nationalistic, authoritarian and xenophobic. Their self-interested economic liberalism is coupled with social and political intolerance. But two thirds of them support some kind of welfare state.

Thus, there are major differences between the middle class in the West and its ostensible counterpart in Russia.

The Russian parvenus - many of them women - do not believe their state, their banks, or their compatriots. They fear a precarious future and its inevitable calamities though they are not risk averse and are rather optimistic in the short run. They keep their money under the proverbial mattress, invest it surreptitiously in their ventures, or smuggle it abroad. They are not - yet - stakeholders in their country's stability and prosperity.

Often bamboozled by other businessmen and fleeced by a rapacious bureaucracy, they are paranoid. Tax evasion is still rampant, though abating. They trust in equity and avoid debt. Some of them have criminal roots or a criminal mindset - or are former members of Russia's shady security services.

Three fifths, according to the Expert-Komkon survey, find it "hard to survive" when "observing all laws". "Strong leaders are better than all sorts of laws" is their motto, quoted by Izvestia. Generally, they are closer to being robbers than barons.

Early capitalism is always unruly. It is transformed into a highly structured edifice by the ownership of land and realty (the prime collateral), the protection of private property, a functioning financial system comprised of both banks and capital markets and the just and expedient application of the rule of law.

Russia has none of these. According to Business Week, bank deposits amount to 4 percent of the country's mid-size GDP - compared to half of GDP in other industrialized countries. Mortgages are unheard of, deposits are not insured and land ownership is a novel proposition. The judiciary is venal and incompetent. Might is still right in vast swathes of the land.

The state and the oligarchs continue to represent a rent-seeking opportunity. Businessmen spend time seeking concessions, permits, exemptions and licenses rather than conducting business. The "civic institutions" they form - chambers of commerce, clubs - are often mere glorified lobbying outfits of special and vested interests. Informal networks of contacts count more than any statute or regulation. In such a mock "modern state" no wonder Russia ended up with a Potemkin "middle class".

Interview granted to The St. Petersburg Times in March 2006

1) In Russia lots of researchers seem to be preoccupied with studying middle class. Why is this topic so important? Is it justifiable to connect middle class with creation of civil society?

A: In the capitalistic system, the middle class fulfills the roles of both skeleton and musculature. Its consumption is the economic engine that drives growth, investment, trade, and development. Where it comprises the professions and the intelligentsia, its political awareness is at the root of tectonic shifts in social and cultural mores, norms, and institutions. Its values are reified by the state and its laws. Modern states, by definition cannot exist without a middle class.

2) Who are the middle class in Russia? What's their socio-economic profile?

A: At least one fifth of Russia's population (and perhaps one half of city dwellers) possess "have some bourgeois characteristics". Women may actually slightly outnumber men (though various studies disagree on the issue of gender distribution). At least one quarter to one third of Russian households earn more than the derisory monthly average income - and these figures do not take into account the informal economy. Belonging to the middle-class is in vogue: three fifths of all Russians classify themselves as members, regardless of their income!

In line with its nascent capitalism, the middle class in Russia is young. The typical parvenus are in their mid-thirties, married or living with a partner and childless or with 1 offspring. They are more likely to care for a pet and they increasingly own the apartments that they live in. Summer and vacation homes abound as do modern appliances, Scandinavian furniture, and cars.

Middle-classers are self-reliant, hard workers, narcissistic, go-getters, workaholic, and devoted to "making it" and "getting ahead". They are largely a-political and far more concerned with their economic welfare than with civil liberties and human rights. Russia's middle-class is well-educated, well-traveled, community-orientated, and entrepreneurial.

Thus, the country's middle-class far outweighs foreign investment in wealth formation. Small as it is, it accounts for two thirds of all consumer goods purchased and generates two fifths of Russia's gross domestic product.

3) What are the differences between Russia's middle class and it's classical Western analogue?

To start with, Russia's new middle class is a distinct minority. Wealth disparities are growing at a dizzying rate. According to Forbes Magazine, Russia's oligarchs nearly doubled their combined wealth (net worth) to a whopping $172 billion between the end of 2004 and the beginning of 2006. Six percent of the richest 500 in the world are Russians and 12 of the richest 100 (up from 5 in 2005). This flies in the face of predictions made the Ministry of Economy as late as December 2004.

As Akos Rona-Tas, Associate Professor in the Sociology Department at the University of California, San Diego, notes correctly in his paper "Post Communist Transition and the Absent Middle Class in Central East Europe", a middle class that is in the minority is an oxymoron:

"In democracies the middle class is the nation proper. The typical member of a national community is a member of the middle class. When democratic governments need a social group they can address, a universal class that carries the overarching, common interest of the country, they appeal to the middle class. This appeal, while it calls on a common interest, also acknowledges that there are conflicting interests within society. The middle class is not everyone, but it is the majority and it represents what everyone else can become."

Russia has a long way to go to achieve this ubiquity. Its middle class, far from representing the consensus, reifies the growing abyss between haves and haves not. Its members' conspicuous consumption, mostly of imports, does little to support the local economy. Its political might is self-serving. It has no ethos, or distinct morality, no narrative, or ideology. The Russian middle class is at a Hobbesian and primordial stage.

Whether it emerges from its narcissistic cocoon to become a leading and guiding social force, is doubtful. The middle class' youth, urbaneness, cosmopolitanism, polyglotism, mobility, avarice and drive are viewed with suspicion and envy by the great unwashed - the overwhelming majority of Russia's destitute population. Empowered by their wealth, the new bourgeoisie, in turn, regards the "people" with naive admiration, patronizing condescension, or horror.

Granted, this muted, subterranean, interaction is not entirely deleterious. It is the social role of the rich to generate demand by provoking in the poor jealousy and attempts at emulation. The wealthy are the trendsetters, the early adopters, the pioneers, the buzz leaders. They are the engine that engenders social and economic mobility.

A similar dynamic is admittedly evident in Russia - but, again, it is tampered by a curious local phenomenon.

Writing for the Globalist, two Brookings Institution scholars, Carol Graham, a Senior Fellow of Economic Studies and Clifford Gaddy, a Fellow of Foreign Policy and Governance Studies described it thus:

"The eyes of Russia's middle class, on the other hand, are figuratively directed downward, towards the poor. In fact, as poverty in Russia increased dramatically in the 1990s, the middle class's reference norms shifted downward as well. As a result, Russia may be the only country in the world where the 'subjective poverty line' is falling. That is, the amount of money that Russians say that they need in order to stay out of poverty has been steadily falling over the past five years. It is even below the objective poverty line. For the time being, at least, these curious Russian attitudes, along with the existence of the non-monetary virtual economy, have insulated the country against political upheaval."

The list of anomalies is not exhausted.

The new middle class comprises the embryonic legitimate business elite - entrepreneurs, professionals and managers - but not the remnants of the financially strapped intelligentsia. It is brawn with little brains. In dissonance with western Europe, according to a survey published in the last two years by Expert magazine, the majority of its members are nationalistic, authoritarian and xenophobic. Their self-interested economic liberalism is coupled with social and political intolerance. But two thirds of them support some kind of welfare state.

Thus, there are major differences between the middle class in the West and its ostensible counterpart in Russia.

The Russian parvenus - many of them women - do not believe their state, their banks, or their compatriots. They fear a precarious future and its inevitable calamities though they are not risk averse and are rather optimistic in the short run. They keep their money under the proverbial mattress, invest it surreptitiously in their ventures, or smuggle it abroad. They are not - yet - stakeholders in their country's stability and prosperity.

Often bamboozled by other businessmen and fleeced by a rapacious bureaucracy, they are paranoid. Tax evasion is still rampant, though abating. They trust in equity and avoid debt. Some of them have criminal roots or a criminal mindset - or are former members of Russia's shady security services.

Three fifths, according to the Expert-Komkon survey, find it "hard to survive" when "observing all laws". "Strong leaders are better than all sorts of laws" is their motto, quoted by Izvestia. Generally, they are closer to being robbers than barons.

Early capitalism is always unruly. It is transformed into a highly structured edifice by the ownership of land and realty (the prime collateral), the protection of private property, a functioning financial system comprised of both banks and capital markets and the just and expedient application of the rule of law.

Russia has none of these. According to Business Week, as late as 2002, bank deposits amounted to a mere 4 percent of the country's mid-size GDP - compared to half of GDP in other industrialized countries. Until recently, mortgages are unheard of, deposits were not insured and land ownership was a novel proposition. The judiciary is venal and incompetent. Might is still right in vast swathes of the land.

The state and the oligarchs continue to represent a rent-seeking opportunity. Businessmen spend time seeking concessions, permits, exemptions and licenses rather than conducting business. The "civic institutions" they form - chambers of commerce, clubs - are often mere glorified lobbying outfits of special and vested interests. Informal networks of contacts count more than any statute or regulation. In such a mock "modern state" no wonder Russia ended up with a Potemkin "middle class".

3) There's an opinion that notion of middle classes are becoming less and less defined in many societies. Do you agree? For example, in the UK, according to some research, the majority of middle class people much prefer to be called working class.

A: What people call themselves is immaterial. The concept of "middle-class" is one of the most researched and best defined in sociological (and political science) literature. Never before in history has the middle-class been more crucially important to the functioning of both polities and economies. Members of the middle-class earn a multiple of the average income, consume, and share the Judeo-Protestant ethos and values of capitalism.

4) Do you agree that the focus of discussion in Russia has finally shifted from whether Russia has its middle class at all to what segments of society constitute it?

A: There can be little doubt now that Russia has a middle-class, albeit an idiosyncratic and anomalous one. But, as you correctly observe, it is ill-defined, dynamic, and amorphous. It will take at least a decade of field studies before anyone can say anything about this phenomenon with any certainty.

Middle East, Economies of

On February 24, 2003, in the Islamic Financial Forum in Dubai, Brad Bourland, chief economist for the Saudi American Bank (SAMBA), breached the embarrassed silence that invariably enshrouds speakers in Middle Eastern get-togethers. He reminded the assembled that despite the decades-long fortuity of opulent oil revenues, the nations of the region - excluding Turkey and Israel - failed to reform their economies, let alone prosper.

Structural weaknesses, imperceptible growth, crippling unemployment and deteriorating government financing confined Arab states to the role of oil-addicted minions. At $540 billion, said Bourland, quoted by Middle East Online, the combined gross domestic product of all the Arab countries is smaller than Mexico's (or Spain's, adds The Economist).

According to the Arab League, the gross national product of all its members amounted to $712 billion or 2 percent of the world's GNP in 2001 - merely double sub-Saharan Africa's.

Even the recent tripling of the price of oil - their main export commodity - did not generate sustained growth equal to the burgeoning population and labor force. Algeria's official unemployment rate is 26.4 percent, Oman's 17.2 percent, Tunisia's 15.6 percent, Jordan's 14.4 percent, Saudi Arabia's 13 percent and Kuwait sports an unhealthy 7.1 percent. Even with 8 percent out of work, Egypt needs to grow by 6 percent annually just to stay put, estimates the World Bank.

But the real figures are way higher. At least one fifth of the Saudi and Egyptian labor forces go unemployed. Only one tenth of Saudi women have ever worked. The region's population has almost doubled in the last quarter century, to 300 million people. Close to two fifths of the denizens of the Arab world are minors.

According to the Iranian news agency, IRNA, the European Commission on the Mediterranean Region estimates that the purchasing power parity income per head in the area is a mere 39 percent of the EU's 2001 average, comparable to many post-communist countries in transition. In nominal terms the figure is 28 percent. These statistics include Israel whose income per capita equals 84 percent of the EU's and the Palestinian Authority where GDP fell by 10 percent in 2000 and by another 15 percent the year after.

Faced with ominously surging social unrest, the Arab regimes - all of them lacking in democratic legitimacy - resort to ever more desperate measures. "Saudisation", for instance, amounts to the expulsion of 3 million foreign laborers to make room for indigenous idlers reluctant to take on these vacated - mostly menial - jobs. About one million, typically Western, expat experts remain untouched.

The national accounts of Arab polities are in tatters. Until the recent surge in oil prices, Saudi Arabia managed to produce a budget surplus only once since 1982. Per capita income in the kingdom plunged from $26,000 in 1981 to $7000 in 2003. Higher oil prices may well continue throughout 2006, further masking the calamitous state of the region's economies. But this would amount to merely postponing the inevitable.

Arab countries are not integrated into the world economy. It is possibly the only part of the globe, bar Africa, to have entirely missed the trains of globalization and technological progress. Charlene Barshefsky was United States Trade Representative from 1997 to 2001. In February 2003, in a column published by the New York Times, she noted that:

"Muslim countries in the region trade less with one another than do African countries, and much less than do Asian, Latin American or European countries. This reflects both high trade barriers ... and the deep isolation Iran, Iraq and Libya have brought on themselves through violence and support for terrorist groups ... The Middle East still depends on oil. Today, the United States imports slightly more than $5 billion worth of manufactured goods and farm products from the 22 members of the Arab League, Afghanistan and Iran combined - or about half our value-added imports from Hong Kong alone."

Indeed, Jewish Israel and secular Turkey aside, 8 of the 11 largest economies of the Middle East have yet to join the World Trade Organization. Only two decades ago, one of every seven dollars in global export revenues and one twentieth of the world's foreign direct investment flowed to Arab pockets.

Today, the Middle East's share of international trade and FDI is less than 1.5 percent - half of it with the European Union. Medium size economies such as Sweden's attract more capital than the entire Middle Eastern Moslem world put together.

Some Arab countries periodically go through spastic reforms only to submerge once more in backwardness and venality. Oil-producers attempted some structural economic adjustments in the 1990s. Jordan and Syria privatized a few marginal state-owned enterprises. Iran and Iraq cut subsidies. Almost everyone - especially Lebanon, Egypt, Iran and Jordan - increased their unhealthy reliance on multilateral loans and foreign aid.

Young King Abdullah II of Jordan, for instance, dabbles in deregulation, liberalization, tax reform, cutting red tape and tariff reductions. Aided by a free trade agreement with America passed by Congress in 2001, Jordan's exports to the United States last year soared from $16 million in 1998 to $400 million in 2002.

A similar nostrum is being administered to Morocco, partly to spite the European Union and its glacial "Barcelona Process" Euro-Mediterranean Partnership. But, as everyone realizes, the region's problems run deeper than any tweaking of the customs code.

The "Arab Human Development Report 2002", published in June 2002 by the United Nations Development Program (UNDP), was composed entirely by Arab scholars. It charts the predictably dismal landscape: one in five inhabitants survives on less than $2 a day; annual growth in income per capita over the last 20 years, at 0.5 percent, exceeded only sub-Saharan Africa's; one in six is unemployed.

The region's three "deficits", laments the report, are freedom, knowledge and manpower. Arab polities and societies are autocratic and intolerant. Illiteracy is still rampant and education poor. Women - half the workforce - are ill-treated and excluded. Pervasive Islamization replaced earlier militant ideologies in stifling creativity and growth.

In an article titled "Middle East Economies: A Survey of Current Problems and Issues", published in the September 1999 issue of the Middle East Review of International Affairs, Ali Abootalebi, assistant professor of political science at the University of Wisconsin, Eau Claire, concluded:

"The Middle East is second only to Africa as the least developed region in the world. It has already lost much of its strategic importance since the Soviet Union's demise ... Most Middle Eastern states ... probably do, possess the necessary technocratic and professional personnel to run state affairs in an efficient and modern manner .... (but not) the willingness or ability of the elites in charge to disengage the old coalitional interests that dominate governments in these countries."

The war with Iraq changed all that. This was the fervent hope of intellectuals throughout the region, even those viscerally opposed to America's high-handed hegemony. But this may well be only another false dawn in many. The inevitable massive postwar damage to the area's fragile economies will spawn added oppression rather than enhance democracy.

According to The Economist, the military buildup has already injected $2 billion into Kuwait's economy, equal to 6 percent of its GDP. Prices of everything - from real estate to cars - are rising fast. The stock exchange index has soared by one third. American largesse extends to Turkey - the recipient of $5 billion in grants, $1 billion in oil and $10 billion in loan guarantees. Egypt and Jordan will reap $1 billion apiece and, possibly, subsidized Saudi oil as well. Israel will abscond with $8 billion in collateral and billions in cash.

But the party may be short-lived, especially since the war did not prove to be as decisive and nippy as the Americans foresaw.

Stratfor, the strategic forecasting consultancy, correctly observes that the United States is likely to encourage American oil companies to boost Iraq's postbellum production. With Venezuela back on line and global tensions eased, deteriorating crude prices may adversely affect oil-dependent countries from Iran to Algeria.

The resulting social and political unrest - coupled with violent, though typically impotent, protests against the war, America and the political leadership - is unlikely to convince panicky tottering regimes to offer greater political openness and participatory democracy. The mock presidential elections in Egypt in 2005 are a case in point.

War also traumatized tourism, another major regional foreign exchange earner. Egypt alone collects $4 billion a year from eager pyramid-gazers - about one ninth of its GDP. Add to that the effects of armed conflict on traffic in the Suez Canal, on investments and on expat remittances - and the country could well become the war's greatest victim.

In a recent economic conference of the Arab League, then Egyptian Minister of State for Foreign Affairs, Faiza Abu el-Naga, pegged the immediate losses to her country at $6-8 billion. More than 200,000 jobs were lost in tourism alone. Egypt's Information and Decision Support Centre (IDSC) distributed a study predicting $900 million in damages to the Jordanian economy and billions more to be incurred by oil-rich Saudi Arabia.

The Arab Bank Federation foresees banking losses of up to $60 billion due to contraction in economic activity both during the war and in its aftermath. This may be too pessimistic. But even the optimists talk about $30 billion in foregone revenues. The reconstruction of Iraq could revitalize the sector - but American and European banks will probably monopolize the lucrative opportunity.

The war, and more so its protracted aftermath, are likely to have a stultifying effect on the investment climate.

Saudi Arabia and Egypt each attract around $1 billion a year in foreign direct investment - double Iran's rising rate. But global FDI was halved between 2000-2002. In 2003, flows reverted merely to 1998 levels. This implosion is likely to affect even increasingly attractive or resurgent destinations such as Israel, Turkey, Iraq and Iran.

Foreign investors will be deterred not only by the fighting but also by a mounting wave of virulent - and increasingly violent - xenophobia. Consumer boycotts are a traditional weapon in the Arab political arsenal. Coca-Cola's sales in these parched lands have plummeted by 10 percent in 2002 alone. Pepsi's overseas sales flattened due to Arabs shunning its elixirs. American-franchised fast food outlets saw their business halved. McDonald's had to close some of its restaurants in Jordan.

Foreign business premises have been vandalized even in the Gulf countries. According to The Economist "in the past year (2002) overall business at western fast-food and drinks firms has dropped by 40% in Arab countries. Trade in American branded goods has shrunk by a quarter."

These are bad news. Multinationals are sizable employers. Coca-Cola alone is responsible for 220,000 jobs in the Middle East. Procter & Gamble invested $100 million in Egypt. Foreign enterprises pay well and transfer technology and management skills to their local joint venture partners.

Nor is foreign involvement confined to retail. The $35 billion Middle Eastern petrochemicals sector is reliant on the kindness of strangers: Indian, Canadian, South Korean and, lately, Chinese. Singapore and Malaysia are eyeing the tourism industry, especially in the Gulf. Their withdrawal from the indigenous economies might prove disastrous.

Nor will these battered nations be saved by geopolitical benefactors.

The economies of the Middle East are off the radar screen of the Bush administration, accuses Edward Gresser of the Progressive Policy Institute in a recently published report titled "Blank Spot on the Map: How Trade Policy is Working Against the War on Terror".

Egypt and most other Moslem countries are heavily dependent on their textile and agricultural exports to the West. But, by 2015, they will face tough competition from nations with contractual trade advantages granted them by the United States, goes the author.

Still, the fault is shared by entrenched economic interest groups in the Middle East . Petrified by the daunting prospect of reforms and the ensuing competitive environment, they block free trade, liberalization and deregulation.

Consider the Persian Gulf, a corner of the world which subsists on trading with partners overseas.

Not surprisingly, most of the members of the Arab Gulf Cooperation Council have joined the World Trade Organization a while back. But their citizens are unlikely to enjoy the benefits at least until 2010 due to obstruction by the club's all-powerful and tentacular business families, international bankers and economists told the Times of Oman.

The rigidity and malignant self-centeredness of the political and economic elite and the confluence of oppression and profiteering are the crux of the region's problems. No external shock - not even war in Iraq - comes close to having the same pernicious and prolonged effects.

Migration (West to East)

The census in Russia, the first since 1989, is expected to find more than 2 million immigrants in residence. The Macedonian Ministry of the Interior, based on initial census figures, estimates that there are well over 20,000 foreigners in this country of 2 million people.

It is a little known fact that the polities of east Europe - let alone central Europe - are the targets of mass immigration from even poorer regions of the earth like India, Bangladesh, Pakistan, Africa and central and east Asia. Wealth is relative, though. Even destitute Macedonia is home to at least 200,000 migrants from the impoverished nether lands of Albania, Kosovo, Serbia and Bosnia.

The denizens of deprived members of the former Soviet bloc - such as Moldova, Ukraine, Belarus, Albania, Yugoslavia (Serbia, Montenegro and Kosovo), Bosnia-Herzegovina, Macedonia, Romania, Bulgaria, or the "stans" of central Asia - flock to the greener pastures of the Czech Republic, Poland, Hungary, Russia, Croatia, Greece, Austria and Germany. Add to these at least 500,000 permanent refugees - mainly from Croatia and Bosnia.

Most of these economic immigrants are unskilled and uneducated. They are employed in menial jobs in agriculture and services. They remit the bulk of their income home, thus contributing little to the local economy. They are ineligible for education, medical treatment, or social benefits and services.

The majority of them being illegal aliens, they rarely pay taxes. They do not enjoy the protection of the law and fall prey to rapacious organized crime gangs and avaricious indigenous policemen, judges and bureaucrats. Child labor, prostitution, drug abuse and other forms of petty delinquency are rampant among them.

Immigrants cause great resentment and consternation among the - always xenophobic - populace in east and central Europe. They compete directly with unskilled and unemployed locals - a sizable portion of the citizenry. Unemployment in the European Union is less than 10 percent compared to almost 20 percent in Poland, 30 percent in Macedonia and twice that in Kosovo.

But east Europe is target to another kind of immigration - from the rich West. Hundreds of thousands of expatriates and their dependants pepper these territories. Most of them are employed by non government organizations (NGOs), multilaterals, or international financial institutions.

They come for stints of a few years. Many stay longer, beyond the call of tenure. They spend their bloated salaries locally. This, usually, is their only input to their newfound domicile - a poisoned chalice driving up prices beyond the means of most inhabitants. These foreigners rarely pay taxes and are beyond the reach of native law. NATO peacekeepers, for instance, can be tried only in their countries of origin where flippant lenience is secured.

There are three categories of Western parvenus in the Wild East: the hustlers, the bureaucrats and the corporates.

The implosion of communism in central and east Europe has immediately sucked in an assortment of foreigners with checkered pasts and shady businesses. They colluded with emerging organized crime in their adopted countries, serving as a vital link to the financial infrastructure of the West. In cahoots with corrupt managers and venal cronies and insiders, they stripped the assets of state-owned enterprises and benefited from speculative bubbles.

Foreigners employed by multilateral organizations - such as the IMF, the World Bank, the Organization for Security and Cooperation in Europe, NATO, the European Union and a veritable avalanche of acronymed NGOs and academic outfits - are notorious throughout the region for their shameless conspicuous consumption and capricious meddling. Some of them have been implicated in corrupt dealings.

Usually with mediocre skills and a poor record back home, they join multilaterals for lack of options rather for any altruistic fervor. They hold in contempt the hapless sovereign hosts in which they serve as the omnipotent procurators of the West. Many of them hail from epitomes of good governance and civil society like Pakistan, Egypt, or India.

These emissaries of rectitude serve as a fig-leaf for the suborned politicians of this region behind which office-bearers hide their thefts and their incompetence. Often, the "international community" (euphemism for the United States and the European Union) turn a blind eye to the egregious looting of the state by pliant and cooperating bigwigs.

But there is a third - and welcome - type of foreigner.

These are advisors and managers who cater to the needs of multinationals and local companies. The market dictates their fees and their continued - or discontinued - employment. Scores of Western consultancies set shop in central, east and southeast Europe - accountancies, law firms, the odd professional.

Western know how on anything from wood processing to canning, from intellectual property to real estate and from publishing to brewing is transferred by these outfits to eager companies and a new cadre of management. The newcomers often assist local firms to obtain finance, construct projects and market products. In due time, foreign managers give way to locally trained ones. This is the real process of transition.

Military Bases, Foreign

The US military spent the first quarter of 2005 evaluating the economic and social impacts of the closure of 425 domestic bases. It seems to have dedicated no second thoughts to the relocation of its foreign outposts. Yet, the effects on local economies and populace can be as devastating and destabilizing - if not more so.

Conflicts in neighboring countries can be a serendipitous affair. Ask Pakistan. Even Macedonia, battered as it was by the war in adjacent Kosovo in 1999, benefited from NATO largesse, later supplanted by KFOR spending. It is estimated that the allied forces expended well over $40 million a month on purchases in the Balkans during the bombing of Serbia. This is a meager percentage of the total cost of the war (c. $34 billion) - but it constituted a major boost to the regional economy. Macedonia's GDP at the time was less than $3 billion.

The phenomenon may be recurring now in the Central Asian former Soviet republics. In its May 4, 2002 issue, "The Economist" estimated that Kyrgyzstan enjoyed an infusion of at least $16 million in American expenditures on fuel, gravel, food, and beds. In return, it allowed the West to use its crumbling infrastructure, both civilian and military - roads, airports, bases and railways. It is now home to a multinational force of 1900 exorbitantly well-paid soldiers, pilots, engineers, and support staff.

Kyrgyzstan is an impoverished country with less than $1.5 billion in GDP. Its authoritarian president, Askar Akaeyv and his ring of cronies own and operate a swathe of businesses. International profligacy is bound to prop up his regime by boosting the local economy and his own pecuniary fortunes.

According to the RIA Novosti Russian news agency, Kyrgyzstan offered to swap its debts to the West for military bases long before the events of September 11. Stratfor, a strategic forecasting firm, says that then Azerbaijani president, Heydar Aliyev, did the same.

President Nursultan Nazarbaev of Kazakhstan hinted - last time this February 2002 - that he, too, may welcome some kind of American military presence on his soil. With more than $12 billion in foreign investment stock in 2001 - one half of which by American oil firms - he may feel vulnerable to Russian attentions.

In March 2002, the White House promised Islam Karimov, the Uzbek president, and America's staunchest newfound ally in the region, $160 million in bilateral aid - mainly for the use of bases in Uzbekistan. More than 1500 US air force personnel are stationed in the Khanabad air base.

The administration's fiscal year 2003, 2004, and 2005 budgets request envisioned an average $19 billion for fighting the war on terrorism abroad. That proved to be inadequate. A supplemental appropriation bill was submitted as early as March 2003. Another $3.5 billion were required for "economic assistance, military equipment and training for front line states". Yet another $121 million were allocated to "anti-terrorism assistance to other states", $4 million for "technical assistance to foreign government's finance ministries to help cut off terrorist funding", and so on.

Foreign military presence in destitute countries has always had a profound effect on both their economies and their politics. It also often substitutes for domestic investments in the military. Even in prosperous Europe, American presence, in the framework of NATO, allowed the Europeans to cut back on defense spending.

In some parts of the world the foreign military and its attendant procurement and consumption are - or used to be - the main economic activity.

The contraction of American forces in Okinawa, Japan, following a series of scandals provoked by crimes committed by American GI's - forced the Japanese government to pour billions of dollars in public works into the local economy to compensate for the loss.

When the Philippines closed down the American Clark air base and Subic naval base in 1992, it lost billions in revenues from long-term lease payments and onshore consumption by military personnel. Moreover, the Philippines regarded the American presence as a security guarantee against the increasingly predatory practices of China. With their protectors gone, the Filipinos had to increase spending on the navy alone by a sorely scarce $6.5 billion in 1997.

Still, some countries are ideologically opposed to foreign military presence on their soil. In protest against what it regards as imperialist occupation, Cuba has cashed only one of the checks it has received from the United States covering the - admittedly symbolic - annual lease payments for the Guantanamo Bay naval base, where more than 150 alleged al-Qaida fighters are currently being interned.

Similarly, Saudis - as opposed to their royal family - decry the presence of American bases on their "sacred land".

Somalis affiliated with the warlord Mohamed Aidid made their views about American naval bases in their country bloodily clear in the battle of Mogadishu in 1993. The US is currently negotiating with the self-declared independent state of Somaliland for rights to use its ports.

According to a Defense Department report quoted by the left-wing "The Monthly Review" on March 2002 and an Army College Study quoted by the "Los Angeles Times" on January 6, 2002 - prior to September 11, more than 60,000 US military personnel were deployed at any given time in more than 100 countries. These figures exclude permanent stationary forces, replete with their dependants, stationed in Germany, Italy, Bosnia-Herzegovina, Kosovo, South Korea, Japan, Saudi Arabia and dozens of other places.

The Defense Department's Base Structure Report, 2001, lists bases and installations in 44 countries and territories - but this excludes many bases with heavy US presence (e.g., within multinational forces).

Average tours of duty abroad lasted on 1996 - 135 days a year in the army, 170 days a year in the navy, and 176 days a year in the air force. Army soldiers were deployed overseas on average once every 14 weeks. The numbers have sharply increased during the wars in Afghanistan and Iraq and in their wake.

By March 2002, the USA has stationed well over 60,000 soldiers in new bases - from Bulgaria to Qatar and from Turkey to Tajikistan. According to the Pentagon, the US now has "status of forces" agreements - which regulate American military presence overseas - with 93 countries.

Such "forward presence" requires massive outlays. The bulk of it is spent at home, with exuberant domestic defense contractors. But even the leftovers disbursed in foreign lands are enough to lift recipient economic from their dismal torpor. This is especially true where the US military is used - implicitly or explicitly - to safeguard unilateral or bilateral economic interests, such as oil pipelines or oil fields - as is the case in the countries bordering the Caspian Sea, or in Colombia.

The New York Times obliquely noted on December 15, 2001, that:

"The State Department is exploring the potential for post-Taliban energy projects in the region, which has more than 6 percent of the world's proven oil reserves and almost 40 percent of its gas reserves."

But the economically beneficial influence of foreign military presence is not limited to emerging or transition economies. According to "The Regional Impact of Defense Expenditure" by Derek Braddon (published in "Handbook of Defense Economics"), during the 1980's, NATO troops and their families stationed in West Germany - a total of 400,000 people - generated $10 billion in expenditures. More than 230,000 people were - directly and indirectly - employed by the bases. A similar number of Soviet troops in East Germany accounted for 1 percent of its industrial output.

THE CASE OF ISRAEL

Clinton's commitment to Israel's security needs included a huge caveat. Security guarantees to Israel, according to the Clinton Parameters, "need not and should not come at the expense of Palestinian sovereignty, or interfere with Palestinian territorial integrity." For example, if Israel needed to retain an early-warning station on a West Bank hilltop, this principle could be used to preclude an Israeli claim. Essentially, it placed Palestinian national sensitivities above Israeli security needs. In contrast, in the Gaza Strip and the West Bank, Bush allows for Israel to continue to control airspace, territorial waters, and land passages, "pending agreements or other arrangements." This includes continuing Israeli control of the Philadelphia corridor between Gaza and Egyptian Sinai."

Security & Defense

July 23, 1952 — Agreement relating to mutual defense assistance.

October 23, 1975 — Agreement regarding payment for tooling costs of accelerated production of M-60A1 tanks.

April 6, 1979 — Agreement concerning construction of air base facilities.

April 6, 1979 — Agreement concerning funding of air base facilities.

December 10, 1982 — General security of information agreement.

November 29, 1983 — Agreement creating the Joint Political Military Group and Joint Security Assistance Program.

December 14, 1987 — Memorandum of Agreement concerning the principles governing mutual cooperation in research and development, scientist and engineer exchange, and procurement and logistic support of defense equipment, with annexes and attachment.

April 21, 1988 — Memorandum of Agreement regarding joint political, security and economic cooperation.

May 24, 1988 — Mutual logistic support agreement.

April 1989 — Memorandum of Agreement between the Strategic Defense Initiative Organization and Israel's Defense Ministry to develop a $35 million computer facility as part of the Arrow missile program.

September 8, 1989 — Memorandum of Understanding regarding transfers of materials, supplies and equipment for cooperative research and development programs.

January 22, 1991 — Agreement on the status of United States personnel.

June 1991 — Agreement pertaining to the Arrow Continuation Experiments (ACES), the second stage of the joint U.S.-Israel Arrow missile program.

October 18, 1991 — Memorandum of Understanding for a loan of a multi-sensor integrate system for the purpose of test and evaluation.

November 28, 1991 — Agreement on cooperation to combat illicit narcotics trafficking and abuse.

April 30, 1996 — Counterterrorism cooperation accord to enhance capabilities to deter, prevent, respond to and investigate international terrorist acts or threats of international terrorist acts against Israel or the United States.

July 18, 1996 — Memorandum of Agreement concerning the tactical high energy laser (THEL) advanced concept technology demonstration (ACTD).

April 30, 1996 — Counterterrorism cooperation accord

September 3, 1996 — Agreement for technology research and development projects.

January 28, 1998 — Treaty on mutual assistance in criminal matters.

February 10, 1998 — Acquisition and cross-servicing agreement with annexes.

Peace

February 27, 1976 — Memorandum of Agreement concerning assurances, consultations and United States policy on matters related to Middle East peace.

February 27, 1976 — Memorandum of Agreement concerning the United States role at any future Geneva peace conference.

March 26, 1979 — Memorandum of Agreement relating to assurances concerning Middle East peace.

March 26, 1979 — Agreement relating to the implementation of the Egyptian-Israeli peace treaty.

October 1, 1982 — Agreement relating to privileges and immunities for United States military members and civilian observers of the Multinational Force and Observers on leave in Israel.

October 31, 1998 — Memorandum of agreement concerning ballistic missile threats.

Mittelstand

According to a survey of German executives by the influential Ifo think tank, German business confidence rose in January 2003 for the first time in eight months - albeit imperceptibly, from 87.3 to 87.4. A poll conducted by ZEW, another brain trust, confirmed these findings. On past form, though, this confidence level heralds a contraction of 5-6 percent in industrial production.

This is consistent with other dismal figures: negligible growth, stiflingly high real interest rates imposed by the European Central Bank, an export-discouraging strong euro and a disheartening surge in unemployment to more than 10 percent. German woes are compounded by a global recession, the evaporation of entire industries (such as telecoms) and a sharp, universal decline in investments.

The main victims are the Mittelstand - the 1.3-3.2 (depending on the definition) million mostly family-owned German small to medium enterprises (SMEs). Of every 1000 German businesses, 997 are Mittelstand by one liberal definition. The real figure is closer to one third. Strict criteria reduce it to one in thirty firms.

These differences of opinion reflect the fuzziness of the concept which has more to do with the style of ownership and management and with a unique historic-cultural background than with objective, economic yardsticks.

The Mittelstanders form the backbone and trusty barometer of the German economy. They engage close to 22 million workers and apprentices as well as well over 3 million "self employed" (owner-employees) - 70 percent of Germany's total active workforce. More than two fifths of all commercial turnover in the country are generated by them as well as half the value added and one third of all exports.

The investment requirements of Mittelstand firms total $20 billion annually. But access to capital is narrowing. Tottering local banks are risk averse, the capital markets are lethargic, private investors are scared and scarce. The Basle 2 capital adequacy requirements will considerably increase the cost of bank loans to risky borrowers, as are most Mittelstand firms.

According to a survey by Kreditanstalt für Wiederaufbau, the German state-owned development bank, one third of all companies found access to bank credits restricted in 2002. In the 12 months to March 2002, German banks approved 7 percent fewer new credits. Listed banks reduced lending by a debilitating one sixth.

According to The Economist, lending to Handwerk (craft) companies declined by half between 1993-2003. Public sector savings banks, hitherto the main source of Mittelstand financing, are hobbled by an increasingly intrusive European Commission. The Neuer Markt, touted as Germany's answer to NASDAQ, slumped by staggering 96 percent and was merged out of existence.

The family is not what it used to be. Less than 40 percent of Mittelstand businesses are handed down the generations nowadays. Many are forced to introduce pesky outside investors and directors, or hired management. The banks are far more inquisitive than they used to be. A traditional long-term, epochal, business horizon gives ground to a quasi-American focus on the tyranny of the bottom line. Capital spending, product development and job security all suffer.

Founders are often to blame, unable as most are to calmly contemplate their own death, or retirement and prepare a plan for orderly succession. It is at these junctions of regime change that most business failures occur, according to Sir Adrian Cadbury, author of "Family Firms and their Governance".

According to Creditreform, quoted by The Economist, a record 37,700 companies went under in 2002. The Financial Times puts the figure at 45,000. And 2003 witness another bumper crop. The figures, according to the Institut für Mittelstandsforschung in Bonn, are even more harrowing. In 2001, 386,000 startups were liquidated and 455,000 formed to yield 69,000 new firms.

New startup formation is at a low ebb. In 1991, net creations amounted to 223,000, in 1995 - 121,000, in 1998 - 100,000. The picture is especially grim in the east. About 129,000 net new startups sprouted there in 1991. But the dilapidated east succeeded to spawn only 6000 a decade later with its bloated and venal construction sector all but wiped out. Again, 2002 was only marginally better.

Half-hearted measures declared by the fragile coalition government on January 6, 2003 - grandiosely titled the

"Mittelstand Offensive" - are unlikely to reverse the tide of red ink. Less red tape, more generous financial support, simplified accounting and a fusion of the country's cumbersome development banks will do little to help the flood ravaged east, for instance, where crumbling domestic demand cripples local entrepreneurship.

Eastern businessmen sorely lack management experience and skills. Their networks of customers and suppliers are thin on the ground. Most of them are single-product outfits. Successes are few and far between and usually involve foreign equity-holders. Luckily, the labor market in the east is more flexible than its ossified and bureaucracy-laden western counterpart. Hourly labor costs - wages plus inanely vertiginous and generous social benefits - are also substantially lower in the eastern Lander.

An arthritic and worker-friendly regulatory framework and a pro-big business tax regime have, indeed, burdened the Mittelstand. Still, if anything, Germany's labor market has been liberalized under Chancellor Schroeder's governments and tax rates went down across the board. One must look elsewhere for the causes of the inexorable deterioration of the country's SMEs.

It is remarkable that the decline of the Mittelstand coincides with an unprecedented surge in small to medium scale entrepreneurship in both developed and developing countries. It would seem that Germany simply spectacularly pioneered what has become, decades later, an economic fad.

Indeed, it is Germany's overwhelming success - its post-war industrial miracle - that harbored the seeds of its decline and fall. Sated, rich people make bad risk-taking entrepreneurs. Germany's unification was its last attempt at rejuvenation. It failed because the west chose to smother the east with an unrealistically priced Deutschmark, a tangle of rules and regulations, an artificial construction bubble and a forced liquidation of its industrial base.

If it ain't broke, don't fix it, goes German folk wisdom. On the surface, everything functions impeccably: German infrastructure is gleaming, its healthcare efficient, its environment pure, its welfare unsurpassed. Why tinker with success? - wonders the average citizen of this regional economic powerhouse. Only lately did a few brave souls admit that the miracle has been consumed and that Germany, unreformed, may be facing a Japanese decade.

Germany's second attempt at revitalization is unfolding outside its borders. The enlargement of the European Union to incorporate countries in central and east Europe is largely a German project. Cheap labor, abundant raw materials, hungry, growing consumer markets in the new members - promise to resuscitate the German industrial sector.

Big German firms have taken note of this repossessed hinterland and moved decisively - but not so the Mittelstand.

Preoccupied by their multidimensional crisis, they failed to colonize the east. Battered by cost pressures, better-informed customers, aggressive international competition, dizzying and costly technological changes, spiraling needs for investment in R&D, vocational training and marketing

- the Mittelstand companies are punch-drunk and more xenophobic and self-destructively "independent" than ever.

One would be hard pressed to find a substantial Mittelstand representation in the German drive to diversify abroad either by establishing a presence in major export markets, or by sourcing from cheaper countries. As the Center for Advanced Studies at Cardiff University notes, Mittelstanders rarely out-source to key suppliers, maintain open-book accounting, engage in simultaneous engineering, sign long-term contracts, or reduce the number of direct suppliers as part of implementing a lean production strategy.

Many SMEs function as family employment agencies rather than as properly governed businesses. From hubs of innovation and early adoption of bleeding edge technologies - the Mittelstanders have lately become the bastion of paralytic conservatism. Most of them support self-interested liberalization and deregulation. But few would know what to do with these poisoned chalices, having become far less competitive than they used to be in the 1970s.

So, is the Mittelstand sector doomed?

Not according to a report published in 2001 by the Institute for Development and Peace at the Gerhard-Mercator University in Duisburg. The authors believe that, despite all the shortcomings of the Mittelstand business model, it could serve as a blueprint for the countries of Latin America and other developing regions.

The Mittelstand have survived largely intact wars and devastation, division and unification. There is no reason why they should not outlive this second round of globalization - they did marvelously in the first round, a century ago. But the government must recognize the Mittelstand's contribution to the economy and reward these struggling firms with a tax, financing and regulatory environment conducive to job creation, innovation, ownership continuity and exports.

The reason for hope is that Germany is finally waking up. Universities offer courses in family-orientated management. Offline and online exchanges - such as EuroLink - connect German SMEs to willing private equity investors, strategic partners and fund managers. Small business service centers and one stop shops proliferate.

An army of consulting and trading firms proffer everything from management skills to networks of contacts. Others peddler seminars, Web design and Internet literacy syllabi. Software companies like SAP, IBM and Sybase maintain special small business departments. Think tanks and scholarly institutes devote increasing resources to the SME phenomenon. There is even an Oscar award for Mittelstand excellence.

Initiatives spring in the most unlikely places. DG Bank teamed up with the German daily "Die Zeit" to "promote small businesses who have innovative ideas". Mittelstand trade fairs (for instance in Nuremberg last year) are well-attended. Venture capitalists, portfolio managers and headhunters monitor developments closely.

The Business Angels Network of Germany (BOUND) is a group of individual investors who also contribute time and management know-how to fledgling technology startups. Lobbying and advocacy groups, specialty publications, public relations firms - all cater to the needs of German SMEs.

It looks less like a funeral than a resurrection.

Mobility

The mobile office is a long established reality. Today's laptops are as powerful as most desktops and have as much memory and as many accessories. One can communicate through them, using faxing and electronic mail software. They can be connected to both mobile and fixed phones. A person can carry his whole office, his home, his life with him. This is the "Turtle Syndrome". Ensconced in virtual shells, we move about, conducting our lives, attending to our businesses, absorbing, processing, creating and emitting information in endless streams of data and voice.

Sectors, which will adapt to this sweeping, potent, trend, will survive. Those, that lag behind are doomed. Naturally, not all types of human activities and endeavours are amenable to the changes needed to endow them with the blessings of increased mobility. It is difficult to engage in manufacturing on the move. Fixed assets are required. Still, the manufacturing process itself can be (and is) distributed. Components are manufactured in different locations and assembled in another. Fleets of trucks and trains by land, ships in sea-lanes and air cruising planes shift them around in a "just in time" fashion. Through the back door, mobility reappears.

Additionally, the exchange of data and its processing (=its transformation to knowledge) has, by now, become an integral and predominant part of all human activities, industrial manufacturing included.

The old worldview (inherited from the Industrial Revolution) of people moving amongst fixed locations, around which their lives revolve and evolve – is in its death throes. It is being replaced by a fascinating, brave, new vision: the locations now revolve around individuals and they both – the locations and the individuals – evolve through interaction. This is no less than Copernican. The Earth moves around the Sun – not the other way around. The more individualistic and democratic the world became – the more the individual acquired its rightful position as the source of all things, the prima causa, the ultimate cause and mover of all there is. In the past, a person would get up in the morning at his home, in the neighbourhood which he inhabited for decades and proceed to go to his workplace which he joined for a lifelong career. Today, people switch places of residence, careers, workplaces, and even families in a dizzying pace. More and more of them work at home, whenever they choose to (flexitime). The workplace comes to them, via modem, via phone, via satellite. When they travel – and they travel often – they take their office with them. These are a virtual office and a virtual home, of course. But the revolution lies in the realization that both office and home were always virtual. Witness the growing divorce rates, on the one hand – and the growing networking (internet and intranet) of the workplace, on the other. People today can and do collaborate in teams regardless of time differences or geographical disparities. Not only distance, but also time barriers are being gradually dismantled. The

Berlin Wall of spatial and temporal separation is being torn down with a vengeance.

One of the more important sub-trends in this forceful trend is evident in banking and finance. Exchanges become more and more ephemeral and virtual – the more computerized they are. Physical pits and trading floors are a relic of a quickly subsiding past. Trading knows no time limits, no geographical boundaries (except those still imposed by Man). Similarly, funds are transferred electronically in minutes. People carry plastic cards that symbolize wealth stored in electronic digits halfway across the world. Ours is a meta-symbolic system. We have taken to consuming and using more and more concentrated forms of symbolism. Land and Cows were replaced by metal, which was replaced by paper, which was replaced by electronic digits, which is partially represented by plastic cards. Chequebooks, credit cards and ATMs (Automatic Teller Machines) represent increased mobility. The bank follows the client. Transactions are concluded outside the premises. Money changes hands in totally automated transactions. The culmination of all this is the smart card. Subject to more clever marketing, home banking will develop to overtake regular banking. The functions of banks might be polarized: low level functions, on the one hand (e.g., check clearing) and high level functions, on the other (e.g., investment banking and private banking).

The borders between social institutions will blur. Home and office will merge. So will the office, the car, the aeroplane and the hotel. Many hotels provide their guests with business centres. Home cinema, video-on-demand and the internet will transform the home and make it an entertainment centre. Traditional functions of the family have already been outsourced: education, health, a big part of the process of socialization. Instead of moving among rigidly defined, well separated, both spatially and temporally, realms of living – modern Man will flow, in an almost seamless flux, between one "definition" and another. This is mirrored in the attempts to provide global seamless roaming in wireless telecommunications (pagers and mobile phones) and to eliminate the question of "origin" and route in the internet (the first truly global phenomenon).

One of the grandest revolutions within this sub-trend of "blurring" is the functional merger of banks and retail outlets. On the face of it, this should have constituted no surprise. After all, banks are nothing but retail outlets: they buy and sell money the same way that a grocery store buys and sells bread. Any difference was psychological: banking was thought more respectable because it was considered to be a more intellectual pursuit (which it is not). The truth is that banks came to monopolize the flow of money and, later on, became one of the main money creators (together with the Central Bank – a glorified version of its more regular cousin). This power generated awe and respect.

In the last two decades, major retailers tried their hand in banking activities – not too successfully. Money is as specific a commodity as any and necessitates the availability of both expertise and vast historical databases. The true value added by banks to the economy is precisely in the accumulation and preservation of these data: the financial history, credit worthiness and consumption predilections of each and every one of us. Thus it would have made sense for the banks to relegate the low-level, low margin activities to outside agents in return for sharing the banks' information with them. A typical collaboration involves a retail outlet and a bank. The retail outlet invoices the customers, collects the money, charges the credit card, collects the slips and deposits them in the bank. This is work normally done by bank clerks and tellers. The bank, on the other hand, guarantees the payment. The retail outlet pays the bank (and the credit card issuing company) a commission against this guarantee. It does not charge the bank for the work that it does – which saves the bank a lot of money. This asymmetry of payments is a result, on the one hand, of the abundance of cheap transaction processing venues (computerized and human) in the world (some banks do their processing overnight in developing countries, such as India). On the other hand, information (especially the information provided by the bank) is scarce and valuable.

It is easier for the bank to guaranty the payment because it holds, stores, analyses and evaluates all the information regarding the customer. The guarantee is issued in the form of a plastic (credit or debit) card with strict spending limits and authorization procedures. The retail outlet has to follow a simple procedure to obtain the information that it requires in order to engage in the transaction.

Until recently, the information was available only verbally. The credit card companies and the banks operated big call centres. The retail outlet would call in, provide the details of the client and the card, wait for an authorization (which took from 3-5 minutes per transaction) and only then proceed with the sale. This was time consuming, nerve wrecking, expensive and counter-productive. Hence the development of EFTPOS (Electronic Fund Transfer through Points of Sale).

An apparatus is installed in each retail outlet which can "read" the data embedded in the magnetic strips of credit cards, debit cards, loyalty cards and smart cards. It then proceeds to verify (within 10 seconds, on average) that the card is registered in the relevant database, that it is valid (not cancelled, not stolen, not lost) and what are the limitations applicable to the card (or its special features). The information flows (via phone lines and modems or by radio RF waves) between the POS apparatus and a host computer (server) of the bank, the credit card company, or the retail chain which issued the card. A sub-host can interpose between the point of sale and the main host computer, in order to address the more routine tasks and to alleviate possible bottlenecks or errors.

The advantages are immediately evident: time savings, increased efficiency and better use of resources, minimization of losses due to fraud, more secure data handling, a control of all the stages of the financial transaction in particular and of the finances of the retail outlet, in general. Suffice it to mention the ability to generate reports and statistics, which is greatly enhanced.

The same principles apply to vehicle fleet management, telemetry, service engineering and much more. In all these cases, technology allows us to make the world revolve around us, around our requirements, our money and our plans. Technology is only the way that we respond to deep-seated psychological needs. It is really the need to grow up, to mature, to finally feel at ease in this world of ours that drives this meshing of old social establishments.

Money

The "paper" notes we use to pay for goods and services (which, together with coins, constitute "money" or "tender") are made of a blend of cotton and linen.

Throughout history, numerous objects served as money: seashells, stones, whales' teeth, cattle and manillas (ornamental jewelry). The word "salary" reflects the fact that Roman soldiers were paid in salt. As recently as 1932, in Tenino, Washington, USA, notes of $1, $5 and $10 denominations were printed on wood.

Money comes in all sizes, shapes and forms. One meter long and half a meter wide copper plates were used in Alaska in the 1850s. They weighed 40 kilograms.

Money Laundering

If you shop with a major bank, chances are that all the transactions in your account are scrutinized by AML (Anti Money Laundering) software. Billions of dollars are being invested in these applications. They are supposed to track suspicious transfers, deposits, and withdrawals based on overall statistical patterns. Bank directors, exposed, under the Patriot Act, to personal liability for money laundering in their establishments, swear by it as a legal shield and the holy grail of the on-going war against financial crime and the finances of terrorism.

Quoted in Wired.com, Neil Katkov of Celent Communications, pegs future investments in compliance-related activities and products by American banks alone at close to $15 billion in the next 3 years (2005-2008). The United State's Treasury Department's Financial Crimes Enforcement Network (finCEN) received c. 15 million reports in each of the years 2003 and 2004.

But this is a drop in the seething ocean of illicit financial transactions, sometimes egged on and abetted even by the very Western governments ostensibly dead set against them.

Israel has always turned a blind eye to the origin of funds deposited by Jews from South Africa to Russia. In Britain it is perfectly legal to hide the true ownership of a company. Underpaid Asian bank clerks on immigrant work permits in the Gulf states rarely require identity documents from the mysterious and well-connected owners of multi-million dollar deposits.

Hawaladars continue plying their paperless and trust-based trade - the transfer of billions of US dollars around the world. American and Swiss banks collaborate with dubious correspondent banks in off shore centres. Multinationals shift money through tax free territories in what is euphemistically known as "tax planning". Internet gambling outfits and casinos serve as fronts for narco-dollars. British Bureaux de Change launder up to 2.6 billion British pounds annually.

The 500 Euro note makes it much easier to smuggle cash out of Europe. A French parliamentary committee accused the City of London of being a money laundering haven in a 400 page report. Intelligence services cover the tracks of covert operations by opening accounts in obscure tax havens, from Cyprus to Nauru. Money laundering, its venues and techniques, are an integral part of the economic fabric of the world. Business as usual?

Not really. In retrospect, as far as money laundering goes, September 11 may be perceived as a watershed as important as the precipitous collapse of communism in

1989. Both events have forever altered the patterns of the global flows of illicit capital.

What is Money Laundering?

Strictly speaking, money laundering is the age-old process of disguising the illegal origin and criminal nature of funds (obtained in sanctions-busting arms sales, smuggling, trafficking in humans, organized crime, drug trafficking, prostitution rings, embezzlement, insider trading, bribery, and computer fraud) by moving them untraceably and investing them in legitimate businesses, securities, or bank deposits. But this narrow definition masks the fact that the bulk of money laundered is the result of tax evasion, tax avoidance, and outright tax fraud, such as the "VAT carousel scheme" in the EU (moving goods among businesses in various jurisdictions to capitalize on differences in VAT rates). Tax-related laundering nets between 10-20 billion US dollars annually from France and Russia alone. The confluence of criminal and tax averse funds in money laundering networks serves to obscure the sources of both.

The Scale of the Problem

According to a 1996 IMF estimate, money laundered annually amounts to 2-5% of world GDP (between 800 billion and 2 trillion US dollars in today's terms). The lower figure is considerably larger than an average European economy, such as Spain's.

The System

It is important to realize that money laundering takes place within the banking system. Big amounts of cash are spread among numerous accounts (sometimes in free economic zones, financial off shore centers, and tax havens), converted to bearer financial instruments (money orders, bonds), or placed with trusts and charities. The money is then transferred to other locations, sometimes as bogus payments for "goods and services" against fake or inflated invoices issued by holding companies owned by lawyers or accountants on behalf of unnamed beneficiaries. The transferred funds are re-assembled in their destination and often "shipped" back to the point of origin under a new identity. The laundered funds are then invested in the legitimate economy. It is a simple procedure - yet an effective one. It results in either no paper trail - or too much of it. The accounts are invariably liquidated and all traces erased.

Why is It a Problem?

Criminal and tax evading funds are idle and non-productive. Their injection, however surreptitiously, into the economy transforms them into a productive (and cheap) source of capital. Why is this negative?

Because it corrupts government officials, banks and their officers, contaminates legal sectors of the economy, crowds out legitimate and foreign capital, makes money supply unpredictable and uncontrollable, and increases cross-border capital movements, thereby enhancing the volatility of exchange rates.

A multilateral, co-ordinated, effort (exchange of information, uniform laws, extra-territorial legal powers) is required to counter the international dimensions of money laundering. Many countries opt in because money laundering has also become a domestic political and economic concern. The United Nations, the Bank for International Settlements, the OECD's FATF (Financial Action Task Force), the EU, the Council of Europe, the Organisation of American States, all published anti-money laundering standards. Regional groupings were formed (or are being established) in the Caribbean, Asia, Europe, southern Africa, western Africa, and Latin America.

Money Laundering in the Wake of the September 11 Attacks

Regulation

The least important trend is the tightening of financial regulations and the establishment or enhancement of compulsory (as opposed to industry or voluntary) regulatory and enforcement agencies.

New legislation in the US which amounts to extending the powers of the CIA domestically and of the DOJ extra-territorially, was rather xenophobically described by a DOJ official, Michael Chertoff, as intended to "make sure the American banking system does not become a haven for foreign corrupt leaders or other kinds of foreign organized criminals."

Privacy and bank secrecy laws have been watered down. Collaboration with off shore "shell" banks has been banned. Business with clients of correspondent banks was curtailed. Banks were effectively transformed into law enforcement agencies, responsible to verify both the identities of their (foreign) clients and the source and origin of their funds. Cash transactions were partly criminalized. And the securities and currency trading industry, insurance companies, and money transfer services are subjected to growing scrutiny as a conduit for "dirty cash".

Still, such legislation is highly ineffective. The American Bankers' Association puts the cost of compliance with the laxer anti-money-laundering laws in force in 1998 at 10 billion US dollars - or more than 10 million US dollars per obtained conviction. Even when the system does work, critical alerts drown in the torrent of reports mandated by the regulations. One bank actually reported a suspicious transaction in the account of one of the September 11 hijackers - only to be ignored.

The Treasury Department established Operation Green Quest, an investigative team charged with monitoring charities, NGO's, credit card fraud, cash smuggling, counterfeiting, and the Hawala networks. This is not without precedent. Previous teams tackled drug money, the biggest money laundering venue ever, BCCI (Bank of Credit and Commerce International), and ... Al Capone. The more veteran, New-York based, El-Dorado anti money laundering Task Force (established in 1992) will lend a hand and share information.

More than 150 countries promised to co-operate with the US in its fight against the financing of terrorism - 81 of which (including the Bahamas, Argentina, Kuwait, Indonesia, Pakistan, Switzerland, and the EU) actually froze assets of suspicious individuals, suspected charities, and dubious firms, or passed new anti money laundering laws and stricter regulations (the Philippines, the UK, Germany).

A EU directive now forces lawyers to disclose incriminating information about their clients' money laundering activities. Pakistan initiated a "loyalty scheme", awarding expatriates who prefer official bank channels to the much maligned (but cheaper and more efficient) Hawala, with extra baggage allowance and special treatment in airports.

The magnitude of this international collaboration is unprecedented. But this burst of solidarity may yet fade. China, for instance, refuses to chime in. As a result, the statement issued by APEC in November 2001 on measures to stem the finances of terrorism was lukewarm at best. And, protestations of close collaboration to the contrary, Saudi Arabia has done nothing to combat money laundering "Islamic charities" (of which it is proud) on its territory.

Still, a universal code is emerging, based on the work of the OECD's FATF (Financial Action Task Force) since 1989 (its famous "40 recommendations") and on the relevant UN conventions. All countries are expected by the West, on pain of possible sanctions, to adopt a uniform legal platform (including reporting on suspicious transactions and freezing assets) and to apply it to all types of financial intermediaries, not only to banks. This is likely to result in...

The Decline of off Shore Financial Centres and Tax Havens

By far the most important outcome of this new-fangled juridical homogeneity is the acceleration of the decline of off shore financial and banking centres and tax havens. The distinction between off-shore and on-shore will vanish. Of the FATF's "name and shame" blacklist of 19 "black holes" (poorly regulated territories, including Israel, Indonesia, and Russia) - 11 have substantially revamped their banking laws and financial regulators.

Coupled with the tightening of US, UK, and EU laws and the wider interpretation of money laundering to include political corruption, bribery, and embezzlement - this would make life a lot more difficult for venal politicians and major tax evaders. The likes of Sani Abacha (late President of Nigeria), Ferdinand Marcos (late President of the Philippines), Vladimiro Montesinos (former, now standing trial, chief of the intelligence services of Peru), or Raul Salinas (the brother of Mexico's President) - would have found it impossible to loot their countries to the same disgraceful extent in today's financial environment. And Osama bin Laden would not have been able to wire funds to US accounts from the Sudanese Al Shamal Bank, the "correspondent" of 33 American banks.

Quo Vadis, Money Laundering?

Crime is resilient and fast adapting to new realities. Organized crime is in the process of establishing an alternative banking system, only tangentially connected to the West's, in the fringes, and by proxy. This is done by purchasing defunct banks or banking licences in territories with lax regulation, cash economies, corrupt politicians, no tax collection, but reasonable infrastructure.

The countries of Eastern Europe - Yugoslavia (Montenegro and Serbia), Macedonia, Ukraine, Moldova, Belarus, Albania, to mention a few - are natural targets. In some cases, organized crime is so all-pervasive and local politicians so corrupt that the distinction between criminal and politician is spurious.

Gradually, money laundering rings move their operations to these new, accommodating territories. The laundered funds are used to purchase assets in intentionally botched privatizations, real estate, existing businesses, and to finance trading operations. The wasteland that is Eastern Europe craves private capital and no questions are asked by investor and recipient alike.

The next frontier is cyberspace. Internet banking, Internet gambling, day trading, foreign exchange cyber transactions, e-cash, e-commerce, fictitious invoicing of the launderer's genuine credit cards - hold the promise of the future. Impossible to track and monitor, ex-territorial, totally digital, amenable to identity theft and fake identities - this is the ideal vehicle for money launderers. This nascent platform is way too small to accommodate the enormous amounts of cash laundered daily - but in ten years time, it may. The problem is likely to be exacerbated by the introduction of smart cards, electronic purses, and payment-enabled mobile phones.

In its "Report on Money Laundering Typologies" (February 2001) the FATF was able to document concrete and suspected abuses of online banking, Internet casinos, and web-based financial services. It is difficult to identify a customer and to get to know it in cyberspace, was the alarming conclusion. It is equally complicated to establish jurisdiction.

Many capable professionals - stockbrokers, lawyers, accountants, traders, insurance brokers, real estate agents, sellers of high value items such as gold, diamonds, and art

- are employed or co-opted by money laundering operations. Money launderers are likely to make increased use of global, around the clock, trading in foreign currencies and derivatives. These provide instantaneous transfer of funds and no audit trail.

The underlying securities involved are susceptible to market manipulation and fraud. Complex insurance policies (with the "wrong" beneficiaries), and the securitization of receivables, leasing contracts, mortgages, and low grade bonds are already used in money laundering schemes. In general, money laundering goes well with risk arbitraging financial instruments.

Trust-based, globe-spanning, money transfer systems based on authentication codes and generations of commercial relationships cemented in honour and blood - are another wave of the future. The Hawala and Chinese networks in Asia, the Black Market Peso Exchange (BMPE) in Latin America, other evolving courier systems in Eastern Europe (mainly in Russia, Ukraine, and Albania) and in Western Europe (mainly in France and Spain).

In conjunction with encrypted e-mail and web anonymizers, these networks are virtually impenetrable. As emigration increases, diasporas established, and transport and telecommunications become ubiquitous, "ethnic banking" along the tradition of the Lombards and the Jews in medieval Europe may become the the preferred venue of money laundering. September 11 may have retarded world civilization in more than one way.

Moral Hazard

Risk transfer is the gist of modern economies. Citizens pay taxes to ever expanding governments in return for a variety of "safety nets" and state-sponsored insurance schemes. Taxes can, therefore, be safely described as insurance premiums paid by the citizenry. Firms extract from consumers a markup above their costs to compensate them for their business risks.

Profits can be easily cast as the premiums a firm charges for the risks it assumes on behalf of its customers - i.e., risk transfer charges. Depositors charge banks and lenders charge borrowers interest, partly to compensate for the hazards of lending - such as the default risk. Shareholders expect above "normal" - that is, risk-free - returns on their investments in stocks. These are supposed to offset trading liquidity, issuer insolvency, and market volatility risks.

The reallocation and transfer of risk are booming industries. Governments, capital markets, banks, and insurance companies have all entered the fray with ever-evolving financial instruments. Pundits praise the virtues of the commodification and trading of risk. It allows entrepreneurs to assume more of it, banks to get rid of it, and traders to hedge against it. Modern risk exchanges liberated Western economies from the tyranny of the uncertain - they enthuse.

But this is precisely the peril of these new developments. They mass manufacture moral hazard. They remove the only immutable incentive to succeed - market discipline and business failure. They undermine the very fundaments of capitalism: prices as signals, transmission channels, risk and reward, opportunity cost. Risk reallocation, risk transfer, and risk trading create an artificial universe in which synthetic contracts replace real ones and third party and moral hazards replace business risks.

Moral hazard is the risk that the behaviour of an economic player will change as a result of the alleviation of real or perceived potential costs. It has often been claimed that IMF bailouts, in the wake of financial crises - in Mexico, Brazil, Asia, and Turkey, to mention but a few - created moral hazard.

Governments are willing to act imprudently, safe in the knowledge that the IMF is a lender of last resort, which is often steered by geopolitical considerations, rather than merely economic ones. Creditors are more willing to lend and at lower rates, reassured by the IMF's default-staving safety net. Conversely, the IMF's refusal to assist Russia in 1998 and Argentina in 2002 - should reduce moral hazard.

The IMF, of course, denies this. In a paper titled "IMF Financing and Moral Hazard", published June 2001, the authors - Timothy Lane and Steven Phillips, two senior IMF economists - state:

"... In order to make the case for abolishing or drastically overhauling the IMF, one must show ... that the moral hazard generated by the availability of IMF financing overshadows any potentially beneficial effects in mitigating crises ... Despite many assertions in policy discussions that moral hazard is a major cause of financial crises, there has been astonishingly little effort to provide empirical support for this belief."

Yet, no one knows how to measure moral hazard. In an efficient market, interest rate spreads on bonds reflect all the information available to investors, not merely the existence of moral hazard. Market reaction is often delayed, partial, or distorted by subsequent developments.

Moreover, charges of "moral hazard" are frequently ill-informed and haphazard. Even the venerable Wall Street Journal fell in this fashionable trap. It labeled the Long Term Capital Management (LTCM) 1998 salvage - "$3.5 billion worth of moral hazard". Yet, no public money was used to rescue the sinking hedge fund and investors lost most of their capital when the new lenders took over 90 percent of LTCM's equity.

In an inflationary turn of phrase, "moral hazard" is now taken to encompass anti-cyclical measures, such as interest rates cuts. The Fed - and its mythical Chairman, Alan Greenspan - stand accused of bailing out the bloated stock market by engaging in an uncontrolled spree of interest rates reductions.

In a September 2001 paper titled "Moral Hazard and the US Stock Market", the authors - Marcus Miller, Paul Weller, and Lei Zhang, all respected academics - accuse the Fed of creating a "Greenspan Put". In a scathing commentary, they write:

"The risk premium in the US stock market has fallen far below its historic level ... (It may have been) reduced by one-sided intervention policy on the part of the Federal Reserve which leads investors into the erroneous belief that they are insured against downside risk ... This insurance - referred to as the Greenspan Put - (involves) exaggerated faith in the stabilizing power of Mr. Greenspan."

Moral hazard infringes upon both transparency and accountability. It is never explicit or known in advance. It is always arbitrary, or subject to political and geopolitical considerations. Thus, it serves to increase uncertainty rather than decrease it. And by protecting private investors and creditors from the outcomes of their errors and misjudgments - it undermines the concept of liability.

The recurrent rescues of Mexico - following its systemic crises in 1976, 1982, 1988, and 1994 - are textbook examples of moral hazard. The Cato Institute called them, in a 1995 Policy Analysis paper, "palliatives" which create "perverse incentives" with regards to what it considers to be misguided Mexican public policies - such as refusing to float the peso.

Still, it can be convincingly argued that the problem of moral hazard is most acute in the private sector. Sovereigns can always inflate their way out of domestic debt. Private foreign creditors implicitly assume multilateral bailouts and endless rescheduling when lending to TBTF or TITF ("too big or too important to fail") countries. The debt of many sovereign borrowers, therefore, is immune to terminal default.

Not so with private debtors. In remarks made by Gary Stern, President of the Federal Reserve Bank of Minneapolis, to the 35th Annual Conference on Bank Structure and Competition, on May 1999, he said:

"I propose combining market signals of risk with the best aspects of current regulation to help mitigate the moral hazard problem that is most acute with our largest banks ... The actual regulatory and legal changes introduced over the period-although positive steps-are

inadequate to address the safety net's perversion of the risk/return trade-off."

This observation is truer now than ever. Mass-consolidation in the banking sector, mergers with non-banking financial intermediaries (such as insurance companies), and the introduction of credit derivatives and other financial innovations - make the issue of moral hazard all the more pressing.

Consider deposit insurance, provided by virtually every government in the world. It allows the banks to pay to depositors interest rates which do not reflect the banks' inherent riskiness. As the costs of their liabilities decline to unrealistic levels -banks misprice their assets as well. They end up charging borrowers the wrong interest rates or, more common, financing risky projects.

Badly managed banks pay higher premiums to secure federal deposit insurance. But this disincentive is woefully inadequate and disproportionate to the enormous benefits reaped by virtue of having a safety net. Stern dismisses this approach:

"The ability of regulators to contain moral hazard directly is limited. Moral hazard results when economic agents do not bear the marginal costs of their actions. Regulatory reforms can alter marginal costs but they accomplish this task through very crude and often exploitable tactics. There should be limited confidence that regulation and supervision will lead to bank closures before institutions become insolvent. In particular, reliance on lagging regulatory measures, restrictive regulatory and legal norms, and the ability of

banks to quickly alter their risk profile have often resulted in costly failures."

Stern concludes his remarks by repeating the age-old advice: caveat emptor. Let depositors and creditors suffer losses. This will enhance their propensity to discipline market players. They are also likely to become more selective and invest in assets which conform to their risk aversion.

Both outcomes are highly dubious. Private sector creditors and depositors have little leverage over delinquent debtors or banks. When Russia - and trigger happy Russian firms - defaulted on their obligations in 1998, even the largest lenders, such as the EBRD, were unable to recover their credits and investments.

The defrauded depositors of BCCI are still chasing the assets of the defunct bank as well as litigating against the Bank of England for allegedly having failed to supervise it. Discipline imposed by depositors and creditors often results in a "run on the bank" - or in bankruptcy. The presumed ability of stakeholders to discipline risky enterprises, hazardous financial institutions, and profligate sovereigns is fallacious.

Asset selection within a well balanced and diversified portfolio is also a bit of a daydream. Information - even in the most regulated and liquid markets - is partial, distorted, manipulative, and lagging. Insiders collude to monopolize it and obtain a "first mover" advantage.

Intricate nets of patronage exclude the vast majority of shareholders and co-opt ostensible checks and balances - such as auditors, legislators, and regulators. Enough to mention Enron and its accountants, the formerly much vaunted firm, Arthur Andersen.

Established economic theory - pioneered by Merton in 1977 - shows that, counterintuitively, the closer a bank is to insolvency, the more inclined it is to risky lending. Nobuhiko Hibara of Columbia University demonstrated this effect convincingly in the Japanese banking system in his November 2001 draft paper titled "What Happens in Banking Crises - Credit Crunch vs. Moral Hazard".

Last but by no means least, as opposed to oft-reiterated wisdom - the markets have no memory. Russia has egregiously defaulted on its sovereign debt a few times in the last 100 years. Only seven years ago - in 1998 - it thumbed its nose with relish at tearful foreign funds, banks, and investors. Six years later, President Vladimir Putin dismantled Yukos, the indigenous oil giant and confiscated its assets, in stark contravention of the property rights of its shareholders.

Yet, Russia is besieged by investment banks and a horde of lenders begging it to borrow at concessionary rates. The same goes for Mexico, Argentina, China, Nigeria, Thailand, other countries, and the accident-prone banking system in almost every corner of the globe.

In many places, international aid constitutes the bulk of foreign currency inflows. It is severely tainted by moral hazard. In a paper titled "Aid, Conditionality and Moral Hazard", written by Paul Mosley and John Hudson, and presented at the Royal Economic Society's 1998 Annual Conference, the authors wrote:

"Empirical evidence on the effectiveness of both overseas aid and the 'conditionality' employed by donors to increase its leverage suggests disappointing results over the past thirty years ... The reason for both failures is the same: the risk or 'moral hazard' that aid will be used to replace domestic investment or adjustment efforts, as the case may be, rather than supplementing such efforts."

In a May 2001 paper, tellingly titled "Does the World Bank Cause Moral Hazard and Political Business Cycles?" authored by Axel Dreher of Mannheim University, he responds in the affirmative:

"Net flows (of World Bank lending) are higher prior to elections ... It is shown that a country's rate of monetary expansion and its government budget deficit (are) higher the more loans it receives ... Moreover, the budget deficit is shown to be larger the higher the interest rate subsidy offered by the (World) Bank."

Thus, the antidote to moral hazard is not this legendary beast in the capitalistic menagerie, market discipline. Nor is it regulation. Nobel Prize winner Joseph Stiglitz, Thomas Hellman, and Kevin Murdock concluded in their 1998 paper - "Liberalization, Moral Hazard in Banking, and Prudential Regulation":

"We find that using capital requirements in an economy with freely determined deposit rates yields ... inefficient outcomes. With deposit insurance, freely determined deposit rates undermine prudent bank behavior. To induce a bank to choose to make prudent investments, the bank must have sufficient franchise value at risk ... Capital requirements also have a perverse effect of

increasing the bank's cost structure, harming the franchise value of the bank ... Even in an economy where the government can credibly commit not to offer deposit insurance, the moral hazard problem still may not disappear."

Moral hazard must be balanced, in the real world, against more ominous and present threats, such as contagion and systemic collapse. Clearly, some moral hazard is inevitable if the alternative is another Great Depression. Moreover, most people prefer to incur the cost of moral hazard. They regard it as an insurance premium.

Depositors would like to know that their deposits are safe or reimbursable. Investors would like to mitigate some of the risk by shifting it to the state. The unemployed would like to get their benefits regularly. Bankers would like to lend more daringly. Governments would like to maintain the stability of their financial systems.

The common interest is overwhelming - and moral hazard seems to be a small price to pay. It is surprising how little abused these safety nets are - as Stephane Pallage and Christian Zimmerman of the Center for Research on Economic Fluctuations and Employment in the University of Quebec note in their paper "Moral Hazard and Optimal Unemployment Insurance".

Martin Gaynor, Deborah Haas-Wilson, and William Vogt, cast in doubt the very notion of "abuse" as a result of moral hazard in their NBER paper titled "Are Invisible Hands Good Hands?":

"Moral hazard due to health insurance leads to excess consumption, therefore it is not obvious that competition

is second best optimal. Intuitively, it seems that imperfect competition in the healthcare market may constrain this moral hazard by increasing prices. We show that this intuition cannot be correct if insurance markets are competitive.

A competitive insurance market will always produce a contract that leaves consumers at least as well off under lower prices as under higher prices. Thus, imperfect competition in healthcare markets can not have efficiency enhancing effects if the only distortion is due to moral hazard."

Whether regulation and supervision - of firms, banks, countries, accountants, and other market players - should be privatized or subjected to other market forces - as suggested by the likes of Bert Ely of Ely & Company in the Fall 1999 issue of "The Independent Review" - is still debated and debatable. With governments, central banks, or the IMF as lenders and insurer of last resort - there is little counterparty risk. Or so investors and bondholders believed until Argentina thumbed its nose at them in 2003-5 and got away with it.

Private counterparties are a whole different ballgame. They are loth and slow to pay. Dismayed creditors have learned this lesson in Russia in 1998. Investors in derivatives get acquainted with it in the 2001-2 Enron affair. Mr. Silverstein was agonizingly introduced to it in his dealings with insurance companies over the September 11 World Trade Center terrorist attacks.

We may more narrowly define moral hazard as the outcome of asymmetric information - and thus as the result of the rational conflicts between stakeholders (e.g., between shareholders and managers, or between "principals" and "agents"). This modern, narrow definition has the advantage of focusing our moral outrage upon the culprits - rather than, indiscriminately, upon both villains and victims.

The shareholders and employees of Enron may be entitled to some kind of safety net - but not so its managers. Laws - and social norms - that protect the latter at the expense of the former, should be altered post haste. The government of a country bankrupted by irresponsible economic policies should be ousted - its hapless citizens may deserve financial succor. This distinction between perpetrator and prey is essential.

The insurance industry has developed a myriad ways to cope with moral hazard. Co-insurance, investigating fraudulent claims, deductibles, and incentives to reduce claims are all effective. The residual cost of moral hazard is spread among the insured in the form of higher premiums. No reason not to emulate these stalwart risk traders. They bet their existence of their ability to minimize moral hazard - and hitherto, most of them have been successful.

Mortality and Immortality

The noted economist, Julian Simon, once quipped: "Because we can expect future generations to be richer than we are, no matter what we do about resources, asking us to refrain from using resources now so that future generations can have them later is like asking the poor to make gifts to the rich."

Roberto Calvo Macias, a Spanish author and thinker, once wrote that it is impossible to design a coherent philosophy of economics not founded on our mortality. The Grim Reaper permeates estate laws, retirement plans, annuities, life insurance and much more besides.

The industrial revolution taught us that humans are interchangeable by breaking the process of production down to minute - and easily learned - functional units. Only the most basic skills were required. This led to great alienation. Motion pictures of the period ("Metropolis", "Modern Times") portray the industrial worker as a nut in a machine, driven to the verge of insanity by the numbing repetitiveness of his work.

As technology evolved, training periods have lengthened, and human capital came to outweigh the physical or monetary kinds. This led to an ongoing revolution in economic relations. Ironically, dehumanizing totalitarian regimes, such as fascism and communism, were the first to grasp the emerging prominence of scarce and expensive human capital among other means of production. What makes humans a scarce natural resource is their mortality.

Though aware of their finitude, most people behave as though they are going to live forever. Economic and social institutions are formed to last. People embark on long term projects and make enduring decisions - for instance, to invest money in stocks or bonds - even when they are very old.

Childless octogenarian inventors defend their fair share of royalties with youthful ferocity and tenacity. Businessmen amass superfluous wealth and collectors bid in auctions regardless of their age. We all - particularly economists - seem to deny the prospect of death.

Examples of this denial abound in the dismal science:

Consider the invention of the limited liability corporation. While its founders are mortals – the company itself is immortal. It is only one of a group of legal instruments - the will and the estate, for instance - that survive a person's demise. Economic theories assume that humans - or maybe humanity - are immortal and, thus, possessed of an infinite horizon.

Valuation models often discount an infinite stream of future dividends or interest payments to obtain the present value of a security. Even in the current bear market, the average multiple of the p/e - price to earnings - ratio is 45. This means that the average investor is willing to wait more than 60 years to recoup his investment (assuming capital gains tax of 35 percent).

Standard portfolio management theory explicitly states that the investment horizon is irrelevant. Both long-term and short-term magpies choose the same bundle of assets and, therefore, the same profile of risk and return. As John Campbell and Luis Viceira point in their "Strategic Asset Allocation", published this year by Oxford University Press, the model ignores future income from work which tends to dwindle with age. Another way to look at it is that income from labor is assumed to be constant - forever!

To avoid being regarded as utterly inane, economists weigh time. The present and near future are given a greater weight than the far future. But the decrease in weight is a straight function of duration. This uniform decline in weight leads to conundrums. "The Economist" - based on the introduction to the anthology "Discounting and Intergenerational Equity", published by the Resources for the Future think tank - describes one such predicament:

"Suppose a long-term discount rate of 7 percent (after inflation) is used, as it typically is in cost-benefit analysis. Suppose also that the project's benefits arrive 200 years from now, rather than in 30 years or less. If global GDP grew by 3 percent during those two centuries, the value of the world's output in 2200 will be $8 quadrillion ... But in present value terms, that stupendous sum would be worth just $10 billion. In other words, it would not make sense ... to spend any more than $10 billion ... today on a measure that would prevent the loss of the planet's entire output 200 years from now."

Traditional cost-benefit analysis falters because it implicitly assumes that we possess perfect knowledge regarding the world 200 years hence - and, insanely, that we will survive to enjoy ad infinitum the interest on capital we invest today. From our exalted and privileged position in the present, the dismal science appears to suggest, we judge the future distribution of income and wealth and the efficiency of various opportunity-cost calculations. In the abovementioned example, we ask ourselves whether we prefer to spend $10 billion now - due to our "pure impatience" to consume - or to defer present expenditures so as to consume more 200 years hence!

Yet, though their behavior indicates a denial of imminent death - studies have demonstrated that people intuitively and unconsciously apply cost-benefit analyses to decisions with long-term outcomes. Moreover, contrary to current economic thinking, they use decreasing utility rates of discount for the longer periods in their calculations. They are not as time-consistent as economists would have them be. They value the present and near future more than they do the far future. In other words, they take their mortality into account.

This is supported by a paper titled "Doing it Now or Later", published in the March 1999 issue of the American Economic Review. In it the authors suggest that over-indulgers and procrastinators alike indeed place undue emphasis on the near future. Self-awareness surprisingly only exacerbates the situation: "why resist? I have a self-control problem. Better indulge a little now than a lot later."

But a closer look exposes an underlying conviction of perdurability.

The authors distinguish sophisticates from naifs. Both seem to subscribe to immortality. The sophisticate refrains from procrastinating because he believes that he will live to pay the price. Naifs procrastinate because they believe that they will live to perform the task later. They also try to delay overindulgence because they assume that they will live to enjoy the benefits. Similarly, sophisticated folk overindulge a little at present because they believe that, if they don't, they will overindulge a lot in future. Both types believe that they will survive to experience the outcomes of their misdeeds and decisions.

The denial of the inevitable extends to gifts and bequests. Many economists regard inheritance as an accident. Had people accepted their mortality, they would have consumed much more and saved much less. A series of working papers published by the NBER in the last 5 years reveals a counter-intuitive pattern of intergenerational shifting of wealth.

Parents gift their off-spring unequally. The richer the child, the larger his or her share of such largesse. The older the parent, the more pronounced the asymmetry. Post-mortem bequests, on the other hand, are usually divided equally among one's progeny.

The avoidance of estate taxes fails to fully account for these patterns of behavior. A parental assumption of immortality does a better job. The parent behaves as though it is deathless. Rich children are better able to care for ageing and burdensome parents. Hence the uneven distribution of munificence. Unequal gifts - tantamount to insurance premiums - safeguard the rich scions' sustained affection and treatment. Still, parents are supposed to love their issue equally. Hence the equal allotment of bequests.

Mortgage (Financed Construction)

The Buyers

1. The Buyers of residential property form an Association.

2. The Buyers’ Association signs a contract with a construction company chosen by open and public tender.

3. The contract with the construction company is for the construction of residential property to be owned by the Buyers.

4. The Buyers secure financing from the Bank (see below).

5. The Buyers then pay the construction company 25% of the final value of the property to be constructed in advance (=Buyer's Equity). This money is the Buyers' own funds, out of pocket – NOT received from the Banks.

6. The Buyers Association together with the Banks appoints supervisors to oversee the work done by the construction company: its quality and adherence to schedule.

The Banks

1. The government provides a last resort guarantee to the commercial banks. This guarantee can be used ONLY AFTER the banks have exhausted all other legal means of materializing a collateral or seizing the assets of a delinquent debtor in default.

2. Against this guarantee, the commercial banks issue 10 years mortgages (=lend money with a repayment period of 120 months) to the private Buyers of residential property.

3. The money lent to the Buyers (=the mortgages) REMAINS in the bank. It is NOT be given to the Buyers.

4. The mortgage loan covers a maximum of 75% of the final value of the property to be constructed according to appraisals by experts.

5. A lien in favour of the bank is placed on the land and property on it – to be built using the Bank's money and the Buyers' equity. Each Buyer pledges only HIS part of the property (for instance, ONLY the apartment being constructed for HIM). This lien is an inseparable part of the mortgage (loan) contract each and every buyer signs. It is registered in the Registrar of Mortgages and the Courts.

The Construction Company

1. The construction companies use the advance of 25% to start the construction of the residential property – to buy the land, lay the foundations and start the skeleton. All the property belongs to the BUYERS and is registered solely to their names. The Banks have a lien of the property, as per above.

2. When the advance-money is finished, the construction company notifies the BUYERS.

3. The Buyers then approach the Bank for additional money to be taken from the mortgage loans deposited at the Bank (=the money that the Bank lent the Buyers).

4. The Bank verifies that the construction is progressing according to schedule and according to quality standards set in the construction contract.

5. If everything is according to contract, the Bank releases the next tranche (lot) of financing to the

Buyers, who then forward it to the construction firm.

6. The funds that the Buyers borrowed from the Banks are released in a few tranches according to the progress of the construction work. When the construction is finished – the funds should be completely exhausted (=used).

When the Construction is Finished

1. The construction company will have received 100% of the price agreed in the contract.

2. The Buyers can move into the apartments.

3. The Buyers go on repaying the mortgage loans to the Banks.

4. As long as the mortgage loan is not fully paid – the lien on the property in favour of the Bank remains. It is lifted (=cancelled) once the mortgage loan and the interest and charges thereof has been fully repaid by the Buyers.

While the Mortgage Loan is Being Repaid…

1. The Buyers can rent the apartment.

2. The Buyers can live in the apartment.

3. The Buyers can sell the apartment only with the agreement of the Bank – or if they pre-pay the remaining balance of the mortgage loan to the Bank.

4. The Banks can securitize the mortgage pool and sell units or mortgage backed bonds to the public. This means that the Banks can sell to the public pass through certificates - securities backed by an underlying pool of mortgages of various maturities and interest rates. This way the Banks can replenish their capital stock and re-enter the mortgage market.

Moslems (in Europe)

They inhabit self-imposed ghettoes, subject to derision and worse, the perennial targets of far-right thugs and populist politicians of all persuasions. They are mostly confined to menial jobs. They are accused of spreading crime, terrorism and disease, of being backward and violent, of refusing to fit in.

Their religion, atavistic and rigid, insists on ritual slaughter and male circumcision. They rarely mingle socially or inter-marry. Most of them - though born in European countries - are not allowed to vote. Brown-skinned and with a marked foreign accent, they are subject to police profiling and harassment and all manner of racial discrimination.

They are the new Jews of Europe - its Muslim minorities.

Muslims - especially Arab youths from North Africa - are, indeed, disproportionately represented in crime, including hate crime, mainly against the Jews. Exclusively Muslim al-Qaida cells have been discovered in many West European countries. But this can be safely attributed to ubiquitous and trenchant long-term unemployment and to stunted upward mobility, both social and economic due largely to latent or expressed racism.

Moreover, the stereotype is wrong. The incidence of higher education and skills is greater among Muslim immigrants than in the general population - a phenomenon known as "brain drain". Europe attracts the best and the brightest - students, scholars, scientists, engineers and intellectuals - away from their destitute, politically dysfunctional and backward homelands.

The Economist surveys the landscape of friction and withdrawal:

"Indifference to Islam has turned first to disdain, then to suspicion and more recently to hostility ... (due to images of) petro-powered sheikhs, Palestinian terrorists, Iranian ayatollahs, mass immigration and then the attacks of September 11th, executed if not planned by western-based Muslims and succored by an odious regime in Afghanistan ... Muslims tend to come from poor, rural areas; most are ill-educated, many are brown. They often encounter xenophobia and discrimination, sometimes made worse by racist politicians. They speak the language of the wider society either poorly or not at all, so they find it hard to get jobs. Their children struggle at school. They huddle in poor districts, often in state-supplied housing ... They tend to withdraw into their own world, (forming a) self-sufficient, self-contained community."

This self-imposed segregation has multiple dimensions. Clannish behavior persists for decades. Marriages are still arranged - reluctant brides and grooms are imported from the motherland to wed immigrants from the same region or village. The "parallel society", in the words of a British government report following the Oldham riots two years ago, extends to cultural habits, religious practices and social norms.

Assimilation and integration has many enemies.

Remittances from abroad are an important part of the gross national product and budgetary revenues of countries such as Bangladesh and Pakistan. Hence their frantic efforts to maintain the cohesive national and cultural identity of the expats. DITIB is an arm of the Turkish government's office for religious affairs. It discourages the assimilation or social integration of Turks in Germany. Turkish businesses - newspapers, satellite TV, foods, clothing, travel agents, publishers - thrive on ghettoization.

There is a tacit confluence of interests between national governments, exporters and Islamic organizations. All three want Turks in Germany to remain as Turkish as possible. The more nostalgic and homebound the expatriate - the larger and more frequent his remittances, the higher his consumption of Turkish goods and services and the more prone he is to resort to religion as a determinant of his besieged and fracturing identity.

Muslim numbers are not negligible. Two European countries have Muslim majorities - Bosnia-Herzegovina and Albania. Others - in both Old Europe and its post-communist east - harbor sizable and growing Islamic minorities. Waves of immigration and birth rates three times as high as the indigenous population increase their share of the population in virtually every European polity - from Russia to Macedonia and from Bulgaria to Britain. One in seven Russians is Muslim - over 20 million people.

According to the March-April issue of Foreign Policy, the non-Muslim part of Europe will shrink by 3.5 percent by 2015 while the Muslim populace will likely double. There are 3 million Turks in Germany and another 12 million Muslims - Algerians, Moroccans, Pakistanis, Bangladeshis, Egyptians, Senegalese, Malis, or Tunisians - in the rest of the European Union.

This is two and one half times the number of Muslims in the United States. Even assuming - wrongly - that all of them occupy the lowest decile of income, their combined annual purchasing power would amount to a whopping $150 billion. Furthermore, recent retroactive changes to German law have naturalized over a million immigrants and automatically granted its much-coveted citizenship to the 160,000 Muslims born in Germany every year.

Between 2-3 million Muslims in France - half their number - are eligible to vote. Another million - one out of two - cast ballots in Britain. These numbers count at the polls and are not offset by the concerted efforts of a potent Jewish lobby - there are barely a million Jews in Western Europe.

Muslims are becoming a well-courted swing vote. They may have decided the last election in Germany, for instance. Recognizing their growing centrality, France established - though not without vote-rigging - a French Council of the Islamic Faith, the equivalent of Napoleon's Jewish Consistory. Two French cabinet members are Muslims. Britain has a Muslim Council.

Both Vladimir Putin, Russia's president and Yuri Luzhkov, Moscow's mayor, now take the trouble to greet the capital's one million Muslims on the occasion of their

Feast of Sacrifice. They also actively solicit the votes of the nationalist and elitist Muslims of the industrialized Volga - mainly the Tatars, Bashkirs and Chuvash. Even the impoverished, much-detested and powerless Muslims of the northern Caucasus - Chechens, Circassians and Dagestanis - have benefited from this newfound awareness of their electoral power.

Though divided by their common creed - Shiites vs. Sunnites vs. Wahabbites and so on - the Muslims of Europe are united in supporting the Palestinian cause and in opposing the Iraq war. This - and post-colonial guilt feelings, especially manifest in France and Britain - go a long way toward explaining Germany's re-discovered pacifistic spine and France's anti-Israeli (not to say anti-Semitic) tilt.

Moreover, the Muslims have been playing an important economic role in the continent since the early 1960s. Europe's postwar miracle was founded on these cheap, plentiful and oft-replenished Gastarbeiter - "guest workers". Objective studies have consistently shown that immigrants contribute more to their host economies - as consumers, investors and workers - than they ever claw back in social services and public goods. This is especially true in Europe, where an ageing population of early retirees has been relying on the uninterrupted flow of pension contributions by younger laborers, many of them immigrants.

Business has been paying attention to this emerging market. British financial intermediaries - such as the West Bromwich Building Society - have recently introduced "Islamic" (interest-free) mortgages. According to market research firm, Datamonitor, gross advances in the UK alone could reach $7 billion in 2006 - up from $60 million today. The Bank of England is in the throes of preparing regulations to accommodate the pent-up demand.

Yet, their very integration, however hesitant and gradual, renders the Muslims in Europe vulnerable to the kind of treatment the old continent meted out to its Jews before the holocaust. Growing Muslim presence in stagnating job markets within recessionary economies inevitably generated a backlash, often cloaked in terms of Samuel Huntington's 1993 essay in Foreign Affairs, "Clash of Civilizations".

Even tolerant Italy was affected. Last year, the Bologna archbishop, Cardinal Giacomo Biffi, cast Islam as incompatible with Italian culture. The country's prime minister suggested, in a visit to Berlin two years ago, that Islam is an inherently inferior civilization.

Oriana Fallaci, a prominent journalist, published last year an inane and foul-mouthed diatribe titled "The Rage and the Pride" in which she accused Muslims of "breeding like rats", "shitting and pissing" (sic!) everywhere and supporting Osama bin-Laden indiscriminately.

Young Muslims reacted - by further radicalizing and by refusing to assimilate - to both escalating anti-Islamic rhetoric in Europe and the "triumphs" of Islam elsewhere, such as the revolution in Iran in 1979. Tutored by preachers trained in the most militant Islamist climates in Saudi Arabia, Yemen, Somalia, Pakistan and Iran, praying in mosques financed by shady Islamic charities - these youngsters are amenable to recruiters from every fanatical grouping.

The United Kingdom suffered some of the worst race riots in half a century in the past two years. France is terrorized by an unprecedented crime wave emanating from the banlieux - the decrepit, predominantly Muslim, housing estates in suburbia. September 11 only accelerated the inevitable conflict between an alienated minority and hostile authorities throughout the continent. Recent changes in European - notably British - legislation openly profile and target Muslims.

This is a remarkable turnaround. Europe supported the Muslim Bosnian cause against the Serbs, Islamic Chechnya against Russia, the Palestinians against the Israelis and Muslim Albanian insurgents against both Serbs and Macedonians. Nor was this consistent pro-Islamic orientation a novelty.

Britain's Commission for Racial Equality which caters mainly to the needs of Muslims, was formed 37 years ago. Its Foreign Office has never wavered from its pro-Arab bias. Germany established a Central Council for Muslims. Both anti-Americanism and the more veteran anti-Israeli streak helped sustain Europe's empathy with Muslim refugees and "freedom fighters" throughout the 1960s, 70s and 80s.

September 11 put paid to this amity. The danger is that the brand of "Euro-Islam" that has begun to emerge lately may be decimated by this pervasive and sudden mistrust. Time Magazine described this blend as "the traditional Koran-based religion with its prohibitions against alcohol and interest-bearing loans now indelibly marked by the 'Western' values of tolerance, democracy and civil liberties."

Such "enlightened" Muslims can serve as an invaluable bridge between Europe and Russia, the Middle East, Asia, including China and other places with massive Muslim majorities or minorities. As most world conflicts today involve Islamist militants, global peace and a functioning "new order" critically depend on the goodwill and communication skills of Muslims.

Such a benign amalgam is the only realistic hope for reconciliation. Europe is ageing and stagnating and can be reinvigorated only by embracing youthful, dynamic, driven immigrants, most of whom are bound to be Muslim. Co-existence is possible and the clash of civilization not an inevitability unless Huntington's dystopic vision becomes the basic policy document of the West.

N

Narcissism, Corporate

The perpetrators of the recent spate of financial frauds in the USA acted with callous disregard for both their employees and shareholders - not to mention other stakeholders. Psychologists have often remote-diagnosed them as "malignant, pathological narcissists".

Narcissists are driven by the need to uphold and maintain a false self - a concocted, grandiose, and demanding psychological construct typical of the narcissistic personality disorder. The false self is projected to the world in order to garner "narcissistic supply" - adulation, admiration, or even notoriety and infamy. Any kind of attention is usually deemed by narcissists to be preferable to obscurity.

The false self is suffused with fantasies of perfection, grandeur, brilliance, infallibility, immunity, significance, omnipotence, omnipresence, and omniscience. To be a narcissist is to be convinced of a great, inevitable personal destiny. The narcissist is preoccupied with ideal love, the construction of brilliant, revolutionary scientific theories, the composition or authoring or painting of the greatest work of art, the founding of a new school of thought, the attainment of fabulous wealth, the reshaping of a nation or a conglomerate, and so on. The narcissist never sets realistic goals to himself. He is forever preoccupied with fantasies of uniqueness, record breaking, or breathtaking achievements. His verbosity reflects this propensity.

Reality is, naturally, quite different and this gives rise to a "grandiosity gap". The demands of the false self are never satisfied by the narcissist's accomplishments, standing, wealth, clout, sexual prowess, or knowledge. The narcissist's grandiosity and sense of entitlement are equally incommensurate with his achievements.

To bridge the grandiosity gap, the malignant (pathological) narcissist resorts to shortcuts. These very often lead to fraud.

The narcissist cares only about appearances. What matters to him are the facade of wealth and its attendant social status and narcissistic supply. Witness the travestied extravagance of Tyco's Denis Kozlowski. Media attention only exacerbates the narcissist's addiction and makes it incumbent on him to go to ever-wilder extremes to secure uninterrupted supply from this source.

The narcissist lacks empathy - the ability to put himself in other people's shoes. He does not recognize boundaries - personal, corporate, or legal. Everything and everyone are to him mere instruments, extensions, objects unconditionally and uncomplainingly available in his pursuit of narcissistic gratification.

This makes the narcissist perniciously exploitative. He uses, abuses, devalues, and discards even his nearest and dearest in the most chilling manner. The narcissist is utility- driven, obsessed with his overwhelming need to reduce his anxiety and regulate his labile sense of self-worth by securing a constant supply of his drug - attention. American executives acted without compunction when they raided their employees' pension funds - as did Robert Maxwell a generation earlier in Britain.

The narcissist is convinced of his superiority - cerebral or physical. To his mind, he is a Gulliver hamstrung by a horde of narrow-minded and envious Lilliputians. The dotcom "new economy" was infested with "visionaries" with a contemptuous attitude towards the mundane: profits, business cycles, conservative economists, doubtful journalists, and cautious analysts.

Yet, deep inside, the narcissist is painfully aware of his addiction to others - their attention, admiration, applause, and affirmation. He despises himself for being thus dependent. He hates people the same way a drug addict hates his pusher. He wishes to "put them in their place", humiliate them, demonstrate to them how inadequate and imperfect they are in comparison to his regal self and how little he craves or needs them.

The narcissist regards himself as one would an expensive present, a gift to his company, to his family, to his neighbours, to his colleagues, to his country. This firm conviction of his inflated importance makes him feel entitled to special treatment, special favors, special outcomes, concessions, subservience, immediate gratification, obsequiousness, and lenience. It also makes him feel immune to mortal laws and somehow divinely protected and insulated from the inevitable consequences of his deeds and misdeeds.

The self-destructive narcissist plays the role of the "bad guy" (or "bad girl"). But even this is within the traditional social roles cartoonishly exaggerated by the narcissist to attract attention. Men are likely to emphasise intellect, power, aggression, money, or social status. Narcissistic women are likely to emphasise body, looks, charm, sexuality, feminine "traits", homemaking, children and childrearing.

Punishing the wayward narcissist is a veritable catch-22.

A jail term is useless as a deterrent if it only serves to focus attention on the narcissist. Being infamous is second best to being famous - and far preferable to being ignored. The only way to effectively punish a narcissist is to withhold narcissistic supply from him and thus to prevent him from becoming a notorious celebrity.

Given a sufficient amount of media exposure, book contracts, talk shows, lectures, and public attention - the narcissist may even consider the whole grisly affair to be emotionally rewarding. To the narcissist, freedom, wealth, social status, family, vocation - are all means to an end. And the end is attention. If he can secure attention by being the big bad wolf - the narcissist unhesitatingly transforms himself into one. Lord Archer, for instance, seems to be positively basking in the media circus provoked by his prison diaries.

The narcissist does not victimise, plunder, terrorise and abuse others in a cold, calculating manner. He does so offhandedly, as a manifestation of his genuine character. To be truly "guilty" one needs to intend, to deliberate, to contemplate one's choices and then to choose one's acts. The narcissist does none of these.

Thus, punishment breeds in him surprise, hurt and seething anger. The narcissist is stunned by society's insistence that he should be held accountable for his deeds and penalized accordingly. He feels wronged, baffled, injured, the victim of bias, discrimination and injustice. He rebels and rages.

Depending upon the pervasiveness of his magical thinking, the narcissist may feel besieged by overwhelming powers, forces cosmic and intrinsically ominous. He may develop compulsive rites to fend off this "bad", unwarranted, persecutory influences.

The narcissist, very much the infantile outcome of stunted personal development, engages in magical thinking. He feels omnipotent, that there is nothing he couldn't do or achieve if only he sets his mind to it. He feels omniscient - he rarely admits to ignorance and regards his intuitions and intellect as founts of objective data.

Thus, narcissists are haughtily convinced that introspection is a more important and more efficient (not to mention easier to accomplish) method of obtaining knowledge than the systematic study of outside sources of information in accordance with strict and tedious curricula. Narcissists are "inspired" and they despise hamstrung technocrats.

To some extent, they feel omnipresent because they are either famous or about to become famous or because their product is selling or is being manufactured globally. Deeply immersed in their delusions of grandeur, they firmly believe that their acts have - or will have - a great influence not only on their firm, but on their country, or even on Mankind. Having mastered the manipulation of their human environment - they are convinced that they will always "get away with it". They develop hubris and a false sense of immunity.

Narcissistic immunity is the (erroneous) feeling, harboured by the narcissist, that he is impervious to the consequences of his actions, that he will never be effected by the results of his own decisions, opinions, beliefs, deeds and misdeeds, acts, inaction, or membership of certain groups, that he is above reproach and punishment, that, magically, he is protected and will miraculously be saved at the last moment. Hence the audacity, simplicity, and transparency of some of the fraud and corporate looting in the 1990's. Narcissists rarely bother to cover their traces, so great is their disdain and conviction that they are above mortal laws and wherewithal.

What are the sources of this unrealistic appraisal of situations and events?

The false self is a childish response to abuse and trauma. Abuse is not limited to sexual molestation or beatings. Smothering, doting, pampering, over-indulgence, treating the child as an extension of the parent, not respecting the child's boundaries, and burdening the child with excessive expectations are also forms of abuse.

The child reacts by constructing false self that is possessed of everything it needs in order to prevail: unlimited and instantaneously available Harry Potter-like powers and wisdom. The false self, this Superman, is indifferent to abuse and punishment. This way, the child's true self is shielded from the toddler's harsh reality.

This artificial, maladaptive separation between a vulnerable (but not punishable) true self and a punishable (but invulnerable) false self is an effective mechanism. It isolates the child from the unjust, capricious, emotionally dangerous world that he occupies. But, at the same time, it fosters in him a false sense of "nothing can happen to me, because I am not here, I am not available to be punished, hence I am immune to punishment".

The comfort of false immunity is also yielded by the narcissist's sense of entitlement. In his grandiose delusions, the narcissist is sui generis, a gift to humanity, a precious, fragile, object. Moreover, the narcissist is convinced both that this uniqueness is immediately discernible - and that it gives him special rights. The narcissist feels that he is protected by some cosmological law pertaining to "endangered species".

He is convinced that his future contribution to others - his firm, his country, humanity - should and does exempt him from the mundane: daily chores, boring jobs, recurrent tasks, personal exertion, orderly investment of resources and efforts, laws and regulations, social conventions, and so on.

The narcissist is entitled to a "special treatment": high living standards, constant and immediate catering to his needs, the eradication of any friction with the humdrum and the routine, an all-engulfing absolution of his sins, fast track privileges (to higher education, or in his encounters with bureaucracies, for instance). Punishment, trusts the narcissist, is for ordinary people, where no great loss to humanity is involved.

Narcissists are possessed of inordinate abilities to charm, to convince, to seduce, and to persuade. Many of them are gifted orators and intellectually endowed. Many of them work in in politics, the media, fashion, show business, the arts, medicine, or business, and serve as religious leaders.

By virtue of their standing in the community, their charisma, or their ability to find the willing scapegoats, they do get exempted many times. Having recurrently "got away with it" - they develop a theory of personal immunity, founded upon some kind of societal and even cosmic "order" in which certain people are above punishment.

But there is a fourth, simpler, explanation. The narcissist lacks self-awareness. Divorced from his true self, unable to empathise (to understand what it is like to be someone else), unwilling to constrain his actions to cater to the feelings and needs of others - the narcissist is in a constant dreamlike state.

To the narcissist, his life is unreal, like watching an autonomously unfolding movie. The narcissist is a mere spectator, mildly interested, greatly entertained at times. He does not "own" his actions. He, therefore, cannot understand why he should be punished and when he is, he feels grossly wronged.

So convinced is the narcissist that he is destined to great things - that he refuses to accept setbacks, failures and punishments. He regards them as temporary, as the outcomes of someone else's errors, as part of the future mythology of his rise to power/brilliance/wealth/ideal love, etc. Being punished is a diversion of his precious energy and resources from the all-important task of fulfilling his mission in life.

The narcissist is pathologically envious of people and believes that they are equally envious of him. He is paranoid, on guard, ready to fend off an imminent attack. A punishment to the narcissist is a major surprise and a nuisance but it also validates his suspicion that he is being persecuted. It proves to him that strong forces are arrayed against him.

He tells himself that people, envious of his achievements and humiliated by them, are out to get him. He constitutes a threat to the accepted order. When required to pay for his misdeeds, the narcissist is always disdainful and bitter and feels misunderstood by his inferiors.

Cooked books, corporate fraud, bending the (GAAP or other) rules, sweeping problems under the carpet, over-promising, making grandiose claims (the "vision thing") - are hallmarks of a narcissist in action. When social cues and norms encourage such behaviour rather than inhibit it - in other words, when such behaviour elicits abundant narcissistic supply - the pattern is reinforced and become entrenched and rigid. Even when circumstances change, the narcissist finds it difficult to adapt, shed his routines, and replace them with new ones. He is trapped in his past success. He becomes a swindler.

But pathological narcissism is not an isolated phenomenon. It is embedded in our contemporary culture. The West's is a narcissistic civilization. It upholds narcissistic values and penalizes alternative value-systems. From an early age, children are taught to avoid self-criticism, to deceive themselves regarding their capacities and attainments, to feel entitled, and to exploit others.

As Lilian Katz observed in her important paper, "Distinctions between Self-Esteem and Narcissism: Implications for Practice", published by the Educational Resources Information Center, the line between enhancing self-esteem and fostering narcissism is often blurred by educators and parents.

Both Christopher Lasch in "The Culture of Narcissism" and Theodore Millon in his books about personality disorders, singled out American society as narcissistic. Litigiousness may be the flip side of an inane sense of entitlement. Consumerism is built on this common and communal lie of "I can do anything I want and possess everything I desire if I only apply myself to it" and on the pathological envy it fosters.

Not surprisingly, narcissistic disorders are more common among men than among women. This may be because narcissism conforms to masculine social mores and to the prevailing ethos of capitalism. Ambition, achievements, hierarchy, ruthlessness, drive - are both social values and narcissistic male traits. Social thinkers like the aforementioned Lasch speculated that modern American culture - a self-centred one - increases the rate of incidence of the narcissistic personality disorder.

Otto Kernberg, a notable scholar of personality disorders, confirmed Lasch's intuition: "Society can make serious psychological abnormalities, which already exist in some percentage of the population, seem to be at least superficially appropriate."

In their book ***"Personality Disorders in Modern Life"***, Theodore Millon and Roger Davis state, as a matter of fact, that pathological narcissism was once the preserve of "the royal and the wealthy" and that it "seems to have gained prominence only in the late twentieth century". Narcissism, according to them, may be associated with "higher levels of Maslow's hierarchy of needs ...

Individuals in less advantaged nations .. are too busy trying (to survive) ... to be arrogant and grandiose".

They - like Lasch before them - attribute pathological narcissism to "a society that stresses individualism and self-gratification at the expense of community, namely the United States." They assert that the disorder is more prevalent among certain professions with "star power" or respect. "In an individualistic culture, the narcissist is 'God's gift to the world'. In a collectivist society, the narcissist is 'God's gift to the collective."

Millon quotes Warren and Caponi's ***"The Role of Culture in the Development of Narcissistic Personality Disorders in America, Japan and Denmark"***:

"Individualistic narcissistic structures of self-regard (in individualistic societies) ... are rather self-contained and independent ... (In collectivist cultures) narcissistic configurations of the we-self ... denote self-esteem derived from strong identification with the reputation and honor of the family, groups, and others in hierarchical relationships."

Still, there are malignant narcissists among subsistence farmers in Africa, nomads in the Sinai desert, day laborers in east Europe, and intellectuals and socialites in Manhattan. Malignant narcissism is all-pervasive and independent of culture and society. It is true, though, that the ***way*** pathological narcissism manifests and is experienced is dependent on the particulars of societies and cultures.

In some cultures, it is encouraged, in others suppressed. In some societies it is channeled against minorities - in others it is tainted with paranoia. In collectivist societies, it may be projected onto the collective, in individualistic societies, it is an individual's trait.

Yet, can families, organizations, ethnic groups, churches, and even whole nations be safely described as "narcissistic" or "pathologically self-absorbed"? Can we talk about a "corporate culture of narcissism"?

Human collectives - states, firms, households, institutions, political parties, cliques, bands - acquire a life and a character all their own. The longer the association or affiliation of the members, the more cohesive and conformist the inner dynamics of the group, the more persecutory or numerous its enemies, competitors, or adversaries, the more intensive the physical and emotional experiences of the individuals it is comprised of, the stronger the bonds of locale, language, and history - the more rigorous might an assertion of a common pathology be.

Such an all-pervasive and extensive pathology manifests itself in the behavior of each and every member. It is a defining - though often implicit or underlying - mental structure. It has explanatory and predictive powers. It is recurrent and invariable - a pattern of conduct melding distorted cognition and stunted emotions. And it is often vehemently denied.

Nation Branding and Place Marketing

I. The Marketing Plan

In the decades since World War II, economics prowess replaced military power as the crucial geopolitical determinant. The resilience of a country is measured by its inflows of foreign investment and by the balance of its current account - not by the number of its tanks and brigades.

Inevitably, polities the world over - regions, states, countries, and multinational clubs - behave as only commercial businesses once did. They actively market themselves, their relative advantages, their history and culture, their endowments and assets, their mentality and affiliations. In short, they aggressively promote their brand names ("brands" throughout this article).

To cast countries in the role of brands implies that they act as "producers" to some "consumers" out there. But what do countries - as distinct from firms - produce? And who are the consumers enticed by said statal brand placement and regional location marketing? And how does the process of exchange take place - who gives what to whom and where?

Few governments know the answers to these economically crucial questions. Ministers of finance and industry the world over religiously repeat the mantras of "attracting foreign direct investment" and "encouraging entrepreneurship". They recite the list of advantages proffered by their country to the lucky investor, manager, scientist, expatriate, or businessman. But they lack a deep understanding of the process and meaning of nation branding.

Few countries - Britain being the notable exception in the past decade - conduct serious market research and bang heads together in think tanks or inter-ministerial committees to redesign the national brand. Even fewer maintain long-term, sustained branding campaigns supported by proper advertising. Only recently did a few pioneering polities hire the services of nation branding experts. None has in place the equivalent of a corporate "brand manager".

One of the critical mistakes of countries the world over is the self-centered lack of emphasis on customer satisfaction. Meeting and exceeding the "client's" expectations is merely an afterthought - rather than the axis around which the planning, evaluation, control, and revision of the marketing mix revolve. At best, countries concentrate on concluding specific transactions instead of on the development and cultivation of long-term relationships with their "clients".

It is as though countries arrogantly refuse to acknowledge their dependence on the goodwill of individuals and firms the world over. The traditional and impregnable supremacy of the sovereign nation-state has gone the way of the dodo - but decision-makers still have to be appraised of this startling development. Most countries - and nowadays there is a surfeit of sovereigns - are nothing more than bit players in the global marketplace. It takes getting used to. Many politicians mentally equate self-marketing with humiliating mendicancy.

Instead, decision makers should hire marketing (and, more specifically, brand name) experts to prepare a thorough and comprehensive place marketing and nation branding plan for them:

Strategic Marketing Analysis

I. Identify what needs and whose needs can the country meet and satisfy. What preference groups (of investors, for instance) or even market niches (e.g., stem cell scientists) should be targeted to optimize economic outcomes?

II. Compile databases of past clients of the state, its resources, offerings, laws, regulations, international treaties, and economic opportunities (e.g., state companies to be privatized). These allow for micro-branding (or segment branding as opposed to mass branding): tweaking the national brand to suit the preferences, likes, dislikes, and wishes of specific target groups, down to single, important, individuals.

III. Position the country in relation to its competitors, emphasizing its natural and human endowments and its relative advantages. The process of positioning aims to identify the nation with an image, perception, concept, or trait which capture its essence and further its appeal to the clients it had identified in stage I above (investors, other countries, diplomats, scientists, and so on). Great care should be taken to align the positioning messages with realities on the ground. Anything perceived by the preference groups as being a lie or an exaggeration will backfire.

IV. Marketing is about optimal allocation of resources in view of objectives and opportunities.

The classic STP model calls for:

I. ***Segmentation*** - Identify potential customers - for instance, foreign direct investors, or expatriates and the diaspora.

II. ***Targeting*** - Concentrate on those "clients" you can serve most effectively, to whom you are most valuable and thus can "charge" the most for your offerings

III. ***Positioning*** - Communicate effectively the main benefits you offer to the targeted group.

The marketing mix comprises 4 P's which are perfectly applicable to nations as they are to businesses:

Product - Your "products" as a country being tax incentives, infrastructure, natural endowments, human resources, a geographic vantage point, helpful laws and regulations (or absence thereof), etc.

Price - Demonstrate a relative or absolute advantage in terms of return on investment

Place - Facilitate the unhindered exchange of goods, services, and capital (tax holidays, free processing zones, no red tape, double taxation treaties and free trade agreements with other countries, etc.)

Promotion - The advertising and dissemination of news and information, lobbying, public relations, media campaigns, etc.

But what products do countries offer and market and how are they tailored to the needs of specific market segments?

II. The Product

What products do countries offer and market and how are they tailored to the needs of specific market segments?

In a marketing mix, the first and foremost element is the product. No amount of savvy promotion and blitz advertising can disguise the shortcomings of an inferior offering.

Contrary to entrenched misinformation, the role of marketing precedes the development of the product. The marketer gathers information regarding the expectations of the target market (the customers). In the case of a country, its clients are its citizens, investors (both foreign and domestic), tourists, export destinations, multilateral organizations (the international community), non-governmental organizations (NGOs), and neighboring nations-states.

The marketer communicates to statal decision-makers what features and benefits does each of these disparate groups desire and suggests how to reconcile their competing and often contradictory needs, interests, preferences, priorities, and wishes.

The marketer or brand manager then proceeds to participate in the design of the country's "products": its branding and public relations campaigns both within and without its borders, its investment laws and regulations, the development and presentation of its tourist attractions, the trumpeting of the competitive or unique qualities of its export products, the tailoring and monitoring of its mutually-beneficial relationships with neighbors, NGOs, and international organizations.

In designing its "products" and, thus, in acquiring a brand name, a country makes use of and leverages several factors:

1. Natural Endowments

The country's history, geographical location, tourism sites, climate, national "mentality" (hard working, forward looking, amicable, peaceful, etc.)

2. Acquired Endowments, Public Goods, and Externalities

Level of education, knowledge of foreign languages, quality of infrastructure, the court, banking, and public health systems

3. Risk Mitigation

International standing and the resolution of extant conflicts (political risk), the country's laws, regulations, and favorable international treaties, its credit history, insurance available to investors and exporters

4. Economic Prowess

Growth promoting policies, monetary stability, access to international credit, the emergence of new industries

Governments can influence many of these factors. Granted, there is little they can do about the country's past history or climate - but pretty much all the rest is up for grabs. Aided by input from its brand managers and marketers, a country can educate its population to meet the requirements of investors and exporters. It can improve infrastructure, reform the court system, pass growth-promoting laws, cut down red tape, support monetary stability, resolve conflicts with the international community and so on.

It is important to understand that the "products" and brand name of a country are not God-given, unalterable quantities. They can and should be tailored to optimize the results of the marketing and branding campaigns.

Maintaining the country's brand name and promoting its products are ongoing tasks - not one off assignments. They require a constant infusion of financial and human resources to conduct research and development to evaluate the shifting sentiments of the country's clients. States and regions are no different to corporate entities. They, too, must gauge and study their markets and customers at every turn and respond with alacrity.

Exactly like commercial outfits, political entities seek to extract a price for their offerings and products. Increasingly, the price they can obtain is settled by highly efficient global markets in perceptions, goods, and services. As competition stiffens and the number of state-players increases, the barriers to entry become more formidable.

III. The Price

A product's price reflects the shifting balance between supply and demand (scarcity) as well as the value of inputs, the product's quality, and its image as conveyed and fostered by marketing and advertising campaigns (positioning). Price is, therefore, a packet of compressed information exchanged between prospective buyers and interested sellers.

In principle, countries "price" themselves no differently.

But, first, we should see how the price mechanism comes into play in the global marketplace of sovereigns and their offerings.

The "price" of a country is comprised of two elements:

(i) The average (internal rate of) return on investments in its infrastructure, human capital, goods, and services - adjusted for (ii) The risks associated with doing business there.

The first component takes into account the costs of conducting business in the territory - everything from outlays on inputs to taxation. The second component considers the country's political risk, volatility (as measured, for instance, by fluctuations in the prices of its financial assets and obligations), quality of governance, transparency or lack thereof, dysfunctional institutions, stability of policies and legislation, and other hazards.

A country should strive to maximize it price and, thus, create an aura of quality and prosperity. "Selling oneself cheap" communicates desperation and compromised standards. The way to attract investors, tourists, and other clients is to project a kind of "promised land" but without resorting to exaggerations, confabulations, or outright lies.

The message should be relayed both directly (though not obtrusively) and subtly (though not incomprehensibly or deviously). The country should enumerate and emphasize its natural and human endowments, capital stock and infrastructure, favorable tax and regulative regime, political stability, good governance, transparency, functioning institutions, and so on. It should also appear to be substantial, sophisticated, forward-looking, pleasant, welcoming and so forth.

As an increasing number of people around the world "buy" the country's self-perception (where it stands now) and its vision (about its future) - its price keeps climbing and its value is enhanced.

It is much debated whether countries should engage in negative marketing and discount pricing. "Negative marketing" is the disparagement of sovereign competitors and their products and services which are comparable to the country's own offerings or substitute for them. Discount pricing is the strategy of providing at a discount products and services identical to those offered by the country's sovereign competitors.

An example of negative marketing would be to point to a neighboring country's uneducated and expensive labor as a reason not to do business there. An example of discount pricing is to offer tax holidays and rent-free facilities to a relocating multinational.

From my experiences, both practices diminish the country's perceived value and hence, its price. In the long run, the damage to its image far outweighs any dubious economic benefits engendered by these unsavory practices.

Still, some countries are geographically disadvantaged. Recent studies have shown that being landlocked or having a tropical climate carry a hefty price tag in terms of reduced economic growth. These unfavorable circumstances can be described as "natural discounts" to a country's price.

What can be done to overcome such negative factor endowments?

IV. The Place

Some countries are geographically disadvantaged. Recent studies have demonstrated how being landlocked or having a tropical climate carry a hefty price tag in terms of reduced economic growth. These unfavorable circumstances can be described as "natural discounts" to a country's price.

What can be done to overcome such negative factor endowments?

In classical microeconomics, the element of "place" in the marketing plan used to refer to the locus of delivery of the product or service. Well into the 19th century, the "place" was identical to the region where the product was manufactured or the service rendered. In other words, textiles weaved in India were rarely sold in Britain. American accountants were unlikely to practice in Russia. Distribution was a local affair and networks of dissemination and marketing were geographically confined.

A host of historical and technological developments drastically altered the scene and frayed the straitjacket of geography.

The violent disintegration of the old system of geopolitical alliances led to the formation of massive, multiplayer trading blocs within which and among which the movement of goods and, increasingly, services is friction-free.

The vast increase in the world's population - matched by the exponential rise in purchasing power - created a global marketplace of unprecedented wealth and a corresponding hunger for goods and services. The triumph of liberal capitalism compounded this beneficial effect.

The advent of mass media, mass transport, and mass communications reduced transaction costs and barriers to entry. The world shrank to become a veritable "global village".

The value of knowledge (processed information) has fast risen to surpass that of classical (physical) goods and services. Information has some of the properties of a public good (for instance, nonrivalry) - coupled with all the incentives of a private good (e.g., profit-making).

Thus, the very nature of distribution had been irrevocably changed. The distribution channel, the path from producer to consumer (in our case, from country to foreign investor or tourist, for example) is less encumbered by topography than it used to be.

Even the poorest, most remote, landlocked, arid, and disadvantaged country can nowadays leverage air flight, the Internet, television, cell phones, and other miracles of technology to promote itself and its unique offerings (knowledge, plant and animal species, scenery, history, minerals, cheap and educated manpower, cuisine, textiles, software, and so on).

The key to success is in a mix of both direct and indirect marketing. Nowadays, countries can (and do) appeal directly to consumers (ads targeted at tourists or road shows aimed at investors). They present themselves and what they have to offer, circumventing brokers and agents of all kinds (disintermediation). Still, they should not fail to cultivate more traditional marketing channels such as investment banks, travel agents, multilateral organizations, or trade associations.

With many of the physical obstacles to marketing removed in the last few decades, with the very concept of "place" rendered obsolete, promotion emerged as the most critical facet of nation branding and place marketing.

V. Promotion, Sales, Public Relations, Marketing, and Advertising

Advantages have to be communicated to potential customers if they are not to remain unrealized potentials. Moreover, communication alone - the exchange of information - is not enough. Clients have to be influenced and motivated to visit a country, invest in it, or trade with it.

This is where promotion comes in. Not to be confused with marketing, it is concerned with setting up a trained sales force, and with advertising, sales, and public relations.

We deal with sales forces at length in our next installment. Suffice to say, at this stage, that poor countries will be hard pressed to cater to the pecuniary needs of high-level and, therefore, expensive, salespersons. Setting up a body of volunteers under the supervision, guidance, and training of seasoned sales personnel maybe a more suitable solution.

Advertising is a different ballgame. There is no substitute for a continued presence in the media. The right mix of paid ads and sponsored promotions of products, services, and ideas can work miracles for a country's image as a preferred destination.

Clever, targeted, advertising also ties in with sales promotion. Together they provide the customer with both motivation and incentive to "buy" what the country has on offer. Brand switching is common in the global arena. Investors and tourists, let alone exporters and importers, are fickle and highly mobile. This inherent disloyalty is a boon to new and emerging markets.

An interesting and related question is whether countries constitute similar or dissimilar brands. In other words, are countries interchangeable (fungible) as investment, tourism, and trade destinations? Is cost the only determining factor? If countries are, indeed, mere variants on given themes, acquiring and sustaining permanent market shares (inducing a market shift) may prove to be a problem.

The answer is that the issue is largely irrelevant. Specialization and brand differentiation may be crucial inside countries - in domestic markets - but, they are not very important in the global arena.

Why is that?

Because the global marketplace is far less fractionated than national markets. Niche investors, off-the-beaten-track tourists, and boutique traders are rarities. Multinationals, organized package tours, and commodity traders rule the Earth and they have pretty similar tastes and uniform demands. Catering to these tastes and demands makes or breaks the external sector of a country's economy.

Enter public relations.

While advertising and sales promotion try to access and influence the masses - public relations focuses on opinion-leaders, decision-makers, first-movers, and tipping points. Public relations is also concerned with the country's partners, suppliers, and investors. It directly appeals to major tour operators, foreign legislators, multinationals, and important non-government organizations (NGOs), as well as regional and international forums.

As the name implies, public relations is about follow-up (monitoring) and relationships. This is especially true in the country's dealings with the news media and with specialized publications. Press conferences, presentations, contests, road shows, one-on-one meetings or briefings, seminars, lobbying, and community events - are all tools of the twin trades of marketing public relations and image management.

A recent offshoot of the discipline of public relations - which may be of particular relevance and importance where countries are concerned - is crisis management. Public awareness of crises - from civil wars to environmental disasters - can be manipulated within limits of propriety and veracity. Governments would do well to appoint "public policy and image advisors" to tackle the periodic flare-ups that are an inevitable part of the political and the economic dimensions of an increasingly complex world.

Yet, even governments are bottom-line orientated nowadays. How should a country translate its intangible assets into dollars and cents (or euros)?

VI. The Sales Force and Marketing Implementation Oversight

How should a country translate its intangible assets into dollars and cents (or euros)?

Enter its Sales force and marketing intermediaries.

Even poor countries should allocate funds to train and maintain a skilled sales force and pay its wages, expenses, and perks. Salespeople are the human face of the country's promotion efforts. They tailor to individual listeners (potential customers) the message the country wishes to convey about itself, its advantages, and its prospects.

As their title implies, salespersons personalize the sales pitch and enliven the sales process. They are as indispensable in mass-attendance road shows and in retail marketing (e.g., of tourism packages) as they are in one-on-one meetings with important decision-makers and investors.

The country's sales force should be trained to make presentations, respond to queries and objections, close deals, and cope with account growth. Its work should be tightly integrated with other promotional efforts such as mass mailings, telemarketing, media releases, and direct offers. Sales personnel should work hand in hand with marketing intermediaries such as travel agents, financial firms, investment funds, and corporate buyers.

Marketing intermediaries are at least as crucial to the country's success as its sales force. They are trusted links to investors, tourists, businessmen, and other "clients". They constitute repositories of expertise as well as venues of communication, both formal and informal. Though usually decried by populist and ignorant politicians, their role in smoothing the workings of the marketplace is crucial. Countries should nurture and cultivate brokers and go-betweens.

A marketing expert - preferably a former salesperson with relevant experience in the field - should head the country's marketing implementation oversight board or committee. The Marketing Implementation Oversight Board should include representatives of the various state bureaucracies, the country's branding and advertising consultants and agents, its sales force - and collaborating marketing intermediaries.

This body's task is to harmonize and coordinate the country's various efforts at branding, advertising, publicity, and promotion. It is the state's branding headquarters and should enjoy wide supervisory as well as executive powers.

In other words, marketing implementation is about ensuring that the country's message is both timely (synergetic) and coherent and, thus, both credible (consistent) and efficient. Scarce resources are better allocated and deployed if the left hand consults the right one before it moves.

But how can a country judge the efficacy of its attempts to brand or re-brand itself and, consequently, to attract customers?

VII. Marketing Implementation, Evaluation, and Control

How can a country (region, state, city, municipality, or other polity) judge the efficacy of its attempts to brand or re-brand itself and, consequently, to attract customers (investors, tourism operators, bankers, traders, and so on)?

Marketing is not a controlled process in an insulated lab. It is prone to mishaps, last minute changes, conceptual shifts, political upheavals, the volatility of markets, and, in short, to the vagaries of human nature and natural disasters. Some marketing efforts are known to have backfired. Others have yielded lukewarm results. Marketing requires constant fine tuning and adjustments to reflect and respond to the kaleidoscopic environment of our times.

But maximum benefits (under the circumstances) are guaranteed if the client (the country, for instance) implements a rigorous Marketing Implementation, Evaluation, and Control (MIEV) plan.

The first task is to set realistic quantitative and qualitative interim and final targets for the marketing program - and then to constantly measure its actual performance and compare it to the hoped for outcomes. Even nation branding and place marketing require detailed projections of expenditures vs. income (budget and pr-forma financial statements) for monitoring purposes.

The five modules of MIEV are:

1. Annual plan control

This document includes all the government's managerial objectives and (numerical) goals. It is actually a breakdown of the aforementioned pro-forma financial statements into monthly and quarterly figures of "sales" (in terms of foreign direct investment, income from tourism, trade figures, etc.) and profitability.

It comprises at least five performance gauging tools:

I. ***Sales analysis*** (comparing sales targets to actual sales and accounting for discrepancies).

II. ***Market-share analysis*** (comparing the country's "sales" with those of its competitors). The country should also compare its own sales to the total sales in the global market and to sales within its "market segment" (neighboring countries, countries which share its political ambience, same-size countries, etc.).

III. ***Expense-to-sales analysis*** demonstrates the range of costs - both explicit and hidden (implicit) - of achieving the country's sales goals.

IV. ***Financial analysis*** calculates various performance ratios such as profits to sales (profit margin), sales to assets (asset turnover), profits to assets (return on assets), assets to worth (financial leverage), and, finally, profits to worth (return on net worth of infrastructure).

V. ***Customer satisfaction*** is the ultimate indicator of tracking goal achievement. The country should actively seek, facilitate, and encourage feedback, both positive and negative by creating friendly and ubiquitous complaint and suggestion systems. Frequent satisfaction and customer loyalty surveys should form an integral part of any marketing drive.

Regrettably, most acceptable systems of national accounts sorely lack the ability to cope with place marketing and nation branding campaigns. Intangibles such as enhanced reputation or investor satisfaction are excluded. There is no clear definition as to what constitute the assets of a country, its "sales", or its "profits".

2. Profitability control

There is no point in squandering scarce resources on marketing efforts that guarantee nothing except name recognition. Sales, profits, and expenditures should count prominently in any evaluation (and re-evaluation) of on-going campaigns. The country needs to get rid of prejudices, biases, and misconceptions and clearly identify what products and consumer groups yield the most profits (have the highest relative earnings-capacity). Money, time, and manpower should be allocated to cater to the needs and desires of these top-earners.

3. Efficiency control

The global picture is important. An overview of the marketing and sales efforts and their relative success (or failure) is crucial. But a micro-level analysis is indispensable. What is the sales force doing, where, and how well? What are the localized reactions to the advertising, sales promotion, and distribution drives? Are there appreciable differences between the reactions of various market niches and consumer types?

4. Strategic control

The complement of efficiency control is strategic control. It weighs the overall and long-term marketing plan in view of the country's basic data: its organization, institutions, strengths, weaknesses, and market opportunities. It is recommended to compare the country's self-assessment (marketing-effectiveness rating review) with an analysis prepared by an objective third party.

The marketing-effectiveness rating review incorporates privileged information such as input and feedback from the country's "customers" (investors, tourist operators, traders, bankers, etc.), internal reports regarding the adequacy and efficiency of the country's marketing information, operations, strengths, strategies, and integration (of various marketing, branding, and sales tactics).

5. Marketing audit

The marketing audit is, in some respects, the raw material for the strategic control. Its role is to periodically make sure that the marketing plan emphasizes the country's strengths in ways that are compatible with shifting market sentiments, current events, fashions, preferences, needs, and priorities of relevant market players. This helps to identify marketing opportunities and new or potential markets.

The Encyclopedia Britannica (2005 edition) describes the marketing audit thus:

"... (I)t covers all aspects of the marketing climate (unlike a functional audit, which analyzes one marketing activity), looking at both macro-environment factors (demographic, economic, ecological, technological, political, and cultural) and micro- or task-environment factors (markets, customers, competitors, distributors, dealers, suppliers, facilitators, and publics). The audit includes analyses of the company's marketing strategy, marketing organization, marketing systems, and marketing productivity. It must be systematic in order to provide concrete conclusions based on these analyses. To ensure objectivity, a marketing audit is best done by a person, department, or organization that is independent of the company or marketing program. Marketing audits should be done not only when the value of a company's current marketing plan is in question; they must be done periodically in order to isolate and solve problems before they arise."

VIII. The Psychology and Demographics of the Consumer

The country's "customers" are its investors, tourists, traders, market intermediaries, NGOs, and office-holders in other countries and in multilateral institutions. Understanding their psychology and demographics is crucial. Their interactions with one another take place in a complex environment, affected by governments, social forces, cultural factors, and markets.

The country must clearly identify its clientele: who are they, what motivates them, what do they do and buy (and how, where and when), what are their decision-making processes and priorities, who influences these and how. It is important to remember that people and institutions buy goods and services to satisfy needs. Nation branding is tantamount to casting the country as the superior if not exclusive answer to those needs it can cater to or even create.

The country's brand manager would do well to analyze the purchasing process: how, when, and where transactions are concluded. Understanding consumption and investment habits and patterns allows for better targeting and education of relevant market segments in order to influence and alter the behavior of target customers.

The brand manager must distinguish consumer customers from business customers and from institutional customers.

Consumer customers purchase goods and services from the country for their own consumption. Tourists are consumer customers.

Business customers buy goods and services from the country on behalf of third parties. Tour operators are business customers.

Institutional customers assemble information about the country and analyze it in order to make or to influence political and credit decisions. Banks, governments, NGOs, and lenders evaluate and finance tourism projects based on such data.

Business customers operate on a large scale and are, therefore, less numerous and less dispersed than consumer customers. Consequently, it is easier to foster long-term and close relationships with them. But, being dependent as they are on end-users, theirs is a volatile, demand-driven market. Moreover, business customers are tough negotiators (though some of them seek quality rather than price advantage).

To attract these movers and shakers, the country's brand manager must constantly monitor the global economy as well as the economies of the nation's main partners. Everything, from monetary policy to regulatory and fiscal developments affect purchasing and investment decisions.

The Encyclopedia Britannica 2005 Edition mentions some additional considerations:

"... Organizational factors, which include the objectives, policies, procedures, structures, and systems that characterize any particular company... Interpersonal factors are more salient among business customers, because the participants in the buying process—perhaps representing several departments within a company—often have different interests, authority, and persuasiveness. Furthermore, the factors that affect an individual in the business buying process are related to the participant's role in the organization. These factors include job position, risk attitudes, and income."

Consumer customers are the hardest to predict and "manipulate" because they are influenced not merely by hard-nosed intelligence - but also by rumors, age, education, stage in one's life-cycle, occupation, lifestyle, self-conception, past experiences, pecuniary circumstances, personal predilections and prejudices, as well as by a variety of cultural and social factors such as one's values, perceptions, preferences, one's status, reference groups, family, and role models. Thus, the customer's idiosyncratic background largely determines the economic outcome.

It is here that branding has an often decisive role. The more costly, infrequent, and risky the purchase, the higher the consumer's emotional involvement in the buying task. The more differentiated the country's brand, the less the anxiety provoked by the need to commit resources irrevocably.

New Economic Policy (NEP)

Mikhail Gorbachev (1931-) was not the first to introduce Perestroika - the economic liberalization of the communist system along capitalistic lines.

During the Russian civil war (1918-1922) the Bolsheviks implemented what they called "War Communism" (1917-1921), the militarization of the economy. Between 1916 and 1920, industrial output plunged by more than four fifths. Grain harvests in both 1920 and 1921 disastrously dwindled, leading to widespread famine, claiming five million lives. A series of rebellions of sailors broke out, most famously in the Krohnstadt naval base.

To counter the party's loosening grip on power, Vladimir Lenin (1870-1924) introduced the New Economic Policy (NEP). Trade was liberalized, as were industrial and agricultural production. Peasants were allowed to sell surplus produce on the open market and taxes were made proportional to net output.

In stark departure from communist ideology, farmers could lease land and hire laborers. The state embarked on an ambitious privatization program of small and medium-size enterprises, though it maintained control of the finance, transportation, heavy industry, and foreign trade sectors (the "commanding heights", as they were called at the time).

In 1921-2, Lenin re-introduced money to re-monetize the economy which consisted of barter, quotas, and centrally issued economic directives. Within less than 7 years, production in many parts of the economy reverted to pre-revolutionary levels. Nor did the NEP die with Lenin. It continued for 4 years after his death in 1924.

But the policy was not without its faults.

NEP was characterized by inflation and the need to cap the prices of non-agricultural goods. Peasants hoarded grain for speculation purposes. A black market in goods was developed by Nepmen - private traders. Communist party General Secretary Joseph Stalin (1879-1953), reinstated agricultural production quotas in 1929, collectivized all arable land, and criminalized private trading in 1930. In 1928, he promulgated the first Five-Year Plan (1928-1932) and central planning replaced market mechanisms. The NEP was dead.

New Rich (Nouveau Riche)

They are the object of thinly disguised envy. They are the raw materials of vulgar jokes and the targets of popular aggression. They are the Newly Rich. Perhaps they should be dealt with more appropriately within the academic discipline of psychology, but then economics in a branch of psychology. To many, they represent a psychopathology or a sociopathology.

The Newly Rich are not a new phenomenon. Every generation has them. They are the upstarts, those who seek to undermine the existing elite, to replace it and, ultimately to join it. Indeed, the Newly Rich can be classified in accordance with their relations with the well-entrenched Old Rich. Every society has its veteran, venerable and aristocratic social classes. In most cases, there was a strong correlation between wealth and social standing. Until the beginning of this century, only property owners could vote and thus participate in the political process. The land gentry secured military and political positions for its off spring, no matter how ill equipped they were to deal with the responsibilities thrust upon them. The privileged access and the insiders mentality ("old boys network" to use a famous British expression) made sure that economic benefits were not spread evenly. This skewed distribution, in turn, served to perpetuate the advantages of the ruling classes.

Only when wealth was detached from the land, was this solidarity broken. Land – being a scarce, non-reproducible resource – fostered a scarce, non-reproducible social elite. Money, on the other hand, could be multiplied, replicated, redistributed, reshuffled, made and lost. It was democratic in the truest sense of a word, otherwise worn thin. With meritocracy in the ascendance, aristocracy was in descent. People made money because they were clever, daring, fortunate, visionary – but not because they were born to the right family or married into one. Money, the greatest of social equalizers, wedded the old elite. Blood mixed and social classes were thus blurred. The aristocracy of capital (and, later, of entrepreneurship) – to which anyone with the right qualifications could belong – trounced the aristocracy of blood and heritage. For some, this was a sad moment. For others, a triumphant one.

The New Rich chose one of three paths: subversion, revolution and emulation. All three modes of reaction were the results of envy, a sense of inferiority and rage at being discriminated against and humiliated.

Some New Rich chose to undermine the existing order. This was perceived by them to be an inevitable, gradual, slow and "historically sanctioned" process. The transfer of wealth (and the power associated with it) from one elite to another constituted the subversive element. The ideological shift (to meritocracy and democracy or to mass- democracy as y Gasset would have put it) served to justify the historical process and put it in context. The successes of the new elite, as a class, and of its members, individually, served to prove the "justice" behind the tectonic shift. Social institutions and mores were adapted to reflect the preferences, inclinations, values, goals and worldview of the new elite. This approach – infinitesimal, graduated, cautious, all accommodating but also inexorable and all pervasive – characterizes Capitalism. The Capitalist Religion, with its temples (shopping malls and banks), clergy (bankers, financiers, bureaucrats) and rituals – was created by the New Rich. It had multiple aims: to bestow some divine or historic importance and meaning upon processes which might have otherwise been perceived as chaotic or threatening. To serve as an ideology in the Althusserian sense (hiding the discordant, the disagreeable and the ugly while accentuating the concordant, conformist and appealing). To provide a historical process framework, to prevent feelings of aimlessness and vacuity, to motivate its adherents and to perpetuate itself and so on.

The second type of New Rich (also known as "Nomenclature" in certain regions of the world) chose to violently and irreversibly uproot and then eradicate the old elite. This was usually done by use of brute force coated with a thin layer of incongruent ideology. The aim was to immediately inherit the wealth and power accumulated by generations of elitist rule. There was a declared intention of an egalitarian redistribution of wealth and assets. But reality was different: a small group – the new elite – scooped up most of the spoils. It amounted to a surgical replacement of one hermetic elite by another. Nothing changed, just the personal identities. A curious dichotomy has formed between the part of the ideology, which dealt with the historical process – and the other part, which elucidated the methods to be employed to facilitate the transfer of wealth and its redistribution. While the first was deterministic, long-term and irreversible (and, therefore, not very pragmatic) – the second was an almost undisguised recipe for pillage and looting of other people' property. Communism and the Eastern European (and, to a lesser extent, the Central European) versions of Socialism suffered from this inherent poisonous seed of deceit. So did Fascism. It is no wonder that these two sister ideologies fought it out in the first half of the twentieth century. Both prescribed the unabashed, unmitigated, unrestrained, forced transfer of wealth from one elite to another. The proletariat enjoyed almost none of the loot.

The third way was that of emulation. The Newly Rich, who chose to adopt it, tried to assimilate the worldview, the values and the behaviour patterns of their predecessors. They walked the same, talked the same, clad themselves in the same fashion, bought the same status symbols, ate the same food. In general, they looked as pale imitations of the real thing. In the process, they became more catholic than the Pope, more Old Rich than the Old Rich. They exaggerated gestures and mannerisms, they transformed refined and delicate art to kitsch, their speech became hyperbole, their social associations dictated by ridiculously rigid codes of propriety and conduct. As in similar psychological situations, patricide and matricide followed. The Newly Rich rebelled against what they perceived to be the tyranny of a dying class. They butchered their objects of emulation – sometimes, physically. Realizing their inability to be what they always aspired to be, the Newly Rich switched from frustration and permanent humiliation to aggression, violence and abuse. These new converts turned against the founders of their newly found religion with the rage and conviction reserved to true but disappointed believers.

Regardless of the method of inheritance adopted by the New Rich, all of them share some common characteristics. Psychologists know that money is a love substitute. People accumulate it as a way to compensate themselves for past hurts and deficiencies. They attach great emotional significance to the amount and availability of their money. They regress: they play with toys (fancy cars, watches, laptops). They fight over property, territory and privileges in a Jungian archetypal manner. Perhaps this is the most important lesson of all: the New Rich are children, aspiring to become adults. Having been deprived of love and possessions in their childhood – they turn to money and to what it can buy as a (albeit poor because never fulfilling) substitute. And as children are – they can be cruel, insensitive, unable to delay the satisfaction of their urges and desires. In many countries (the emerging markets) they are the only capitalists to be found. There, they spun off a malignant, pathological, form of crony capitalism. As time passes, these immature New Rich will become tomorrow's Old

Rich and a new class will emerge, the New Rich of the future. This is the only hope – however inadequate and meagre – that developing countries have.

New Trade Theory and Paul Krugman

The Royal Swedish Academy of Sciences has decided to award the 2008 Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel to Professor Paul Robin Krugman (born 1953).

Krugman belongs to a generation of "activist" economists, such as Larry Summers, Glen Hubbard, and Ben Bernanke: scholars who held or hold senior positions in various American administrations. As opposed to them, Krugman is more of an intellectual: he constructs mathematical models of real-life economic phenomena and writes and publishes profusely in the media. He is a cherished teacher and author of a textbook on international economics.

When asked why he was never offered a high-ranking job, he answered: ***"I'm temperamentally unsuited for that kind of role. You have to be very good at people skills, biting your tongue when people say silly things."***

His main contributions to the discipline deal with international economics. Currency crises, he postulated, are the inevitable and rational outcomes of misguided government policies. Consumers appreciate diversity and variety of goods and services.

And, most famously:

Economies of scale in manufacturing provide countries with a comparative advantage in international trade that is every bit as important as the comparative advantage gained from technological advances and from access to resources (natural endowments, labor, or capital). This "New Trade Theory" made his name and won him the coveted Nobel Prize.

New Trade theory also forms the foundation of the discipline of "New Economic Geography". In the words of the prize committee, Krugman's work helps explain ***"(w)hy do increasing numbers of people flock to large cities, while rural areas become depopulated? (W)hat goods are produced where ... (What are) the forces whereby labor and capital become located in certain places and not others."***

New Economic Geography teaches us that workers in countries with large populations enjoy higher real wages. This is because the costs of producing goods are lower due to economies of scale. Prices are cheaper and diversity of good higher. This state of enhanced welfare attracts immigrants which makes production even cheaper. Firms invest in such countries, as they balance benefits from economies of scale against transportation costs.

Krugman is a great prognosticator: he predicted literally every major currency crisis in the past 10 years. He has an intuitive grasp of policy options. Thus, he understood early on that the "Asian Miracle" of the 1980s was merely the result of massive capital and labor infusions. He was among the first to foresee the gravity and scope of the current fiasco in the global financial system. He strongly believes in globalization and free trade, but is among the foremost critics of the corrupt confluence of multinationals with "cooked" books, special-interest groups, and political parties.

Krugman made no bones about his anti-Bush stance. He blamed the administration for all conceivable economic ills: from the widening income inequality in the United States to the unsustainable public sector deficits. The venerable (but conservative) magazine "The Economist" criticized him harshly:

"A glance through his past columns reveals a growing tendency to attribute all the world's ills to George Bush ...Even his economics is sometimes stretched...Overall, the effect is to give lay readers the illusion that Mr Krugman's perfectly respectable personal political beliefs can somehow be derived empirically from economic theory."

It is a good sign, therefore, that he is equally decried by Obama supporters. Being attacked by both sides literally guarantees his place as an honest and objective - and prescient - observer of our particularly turbulent times. Krugman is my favorite political-economic columnist precisely because he cannot be safely claimed by any party.

NGOs (Non-Governmental Organizations)

Their arrival portends rising local prices and a culture shock. Many of them live in plush apartments, or five star hotels, drive SUV's, sport $3000 laptops and PDA's. They earn a two figure multiple of the local average wage. They are busybodies, preachers, critics, do-gooders, and professional altruists.

Always self-appointed, they answer to no constituency. Though unelected and ignorant of local realities, they confront the democratically chosen and those who voted them into office. A few of them are enmeshed in crime and corruption. They are the non-governmental organizations, or NGO's.

Some NGO's - like Oxfam, Human Rights Watch, Medecins Sans Frontieres, or Amnesty - genuinely contribute to enhancing welfare, to the mitigation of hunger, the furtherance of human and civil rights, or the curbing of disease. Others - usually in the guise of think tanks and lobby groups - are sometimes ideologically biased, or religiously-committed and, often, at the service of special interests.

NGO's - such as the International Crisis Group - have openly interfered on behalf of the opposition in the last parliamentary elections in Macedonia. Other NGO's have done so in Belarus and Ukraine, Zimbabwe and Israel, Nigeria and Thailand, Slovakia and Hungary - and even in Western, rich, countries including the USA, Canada, Germany, and Belgium.

The encroachment on state sovereignty of international law - enshrined in numerous treaties and conventions - allows NGO's to get involved in hitherto strictly domestic affairs like corruption, civil rights, the composition of the media, the penal and civil codes, environmental policies, or the allocation of economic resources and of natural endowments, such as land and water. No field of government activity is now exempt from the glare of NGO's. They serve as self-appointed witnesses, judges, jury and executioner rolled into one.

Regardless of their persuasion or modus operandi, all NGO's are top heavy with entrenched, well-remunerated, extravagantly-perked bureaucracies. Opacity is typical of NGO's. Amnesty's rules prevent its officials from publicly discussing the inner workings of the organization - proposals, debates, opinions - until they have become officially voted into its Mandate. Thus, dissenting views rarely get an open hearing.

Contrary to their teachings, the financing of NGO's is invariably obscure and their sponsors unknown. The bulk of the income of most non-governmental organizations, even the largest ones, comes from - usually foreign - powers. Many NGO's serve as official contractors for governments.

NGO's serve as long arms of their sponsoring states - gathering intelligence, burnishing their image, and promoting their interests. There is a revolving door between the staff of NGO's and government bureaucracies the world over. The British Foreign Office finances a host of NGO's - including the fiercely "independent" Global Witness - in troubled spots, such as Angola. Many host governments accuse NGO's of - unwittingly or knowingly - serving as hotbeds of espionage.

Very few NGO's derive some of their income from public contributions and donations. The more substantial NGO's spend one tenth of their budget on PR and solicitation of charity. In a desperate bid to attract international attention, so many of them lied about their projects in the Rwanda crisis in 1994, recounts "The Economist", that the Red Cross felt compelled to draw up a ten point mandatory NGO code of ethics. A code of conduct was adopted in 1995. But the phenomenon recurred in Kosovo.

All NGO's claim to be not for profit - yet, many of them possess sizable equity portfolios and abuse their position to increase the market share of firms they own. Conflicts of interest and unethical behavior abound.

Cafedirect is a British firm committed to "fair trade" coffee. Oxfam, an NGO, embarked, three years ago, on a campaign targeted at Cafedirect's competitors, accusing them of exploiting growers by paying them a tiny fraction of the retail price of the coffee they sell. Yet, Oxfam owns 25% of Cafedirect.

Large NGO's resemble multinational corporations in structure and operation. They are hierarchical, maintain large media, government lobbying, and PR departments, head-hunt, invest proceeds in professionally-managed portfolios, compete in government tenders, and own a variety of unrelated businesses. The Aga Khan Fund for Economic Development owns the license for second mobile phone operator in Afghanistan - among other businesses. In this respect, NGO's are more like cults than like civic organizations.

Many NGO's promote economic causes - anti-globalization, the banning of child labor, the relaxing of intellectual property rights, or fair payment for agricultural products. Many of these causes are both worthy and sound. Alas, most NGO's lack economic expertise and inflict damage on the alleged recipients of their beneficence. NGO's are at times manipulated by - or collude with - industrial groups and political parties.

It is telling that the denizens of many developing countries suspect the West and its NGO's of promoting an agenda of trade protectionism. Stringent - and expensive - labor and environmental provisions in international treaties may well be a ploy to fend off imports based on cheap labor and the competition they wreak on well-ensconced domestic industries and their political stooges.

Take child labor - as distinct from the universally condemnable phenomena of child prostitution, child soldiering, or child slavery.

Child labor, in many destitute locales, is all that separates the family from all-pervasive, life threatening, poverty. As national income grows, child labor declines. Following the outcry provoked, in 1995, by NGO's against soccer balls stitched by children in Pakistan, both Nike and Reebok relocated their workshops and sacked countless women and 7000 children. The average family income - anyhow meager - fell by 20 percent.

This affair elicited the following wry commentary from economists Drusilla Brown, Alan Deardorif, and Robert Stern:

"While Baden Sports can quite credibly claim that their soccer balls are not sewn by children, the relocation of their production facility undoubtedly did nothing for their former child workers and their families."

This is far from being a unique case. Threatened with legal reprisals and "reputation risks" (being named-and-shamed by overzealous NGO's) - multinationals engage in preemptive sacking. More than 50,000 children in Bangladesh were let go in 1993 by German garment factories in anticipation of the American never-legislated Child Labor Deterrence Act.

Former Secretary of Labor, Robert Reich, observed:

"Stopping child labor without doing anything else could leave children worse off. If they are working out of necessity, as most are, stopping them could force them into prostitution or other employment with greater personal dangers. The most important thing is that they be in school and receive the education to help them leave poverty."

NGO-fostered hype notwithstanding, 70% of all children work within their family unit, in agriculture. Less than 1 percent are employed in mining and another 2 percent in construction. Again contrary to NGO-proffered panaceas, education is not a solution. Millions graduate every year in developing countries - 100,000 in Morocco alone. But unemployment reaches more than one third of the workforce in places such as Macedonia.

Children at work may be harshly treated by their supervisors but at least they are kept off the far more menacing streets. Some kids even end up with a skill and are rendered employable.

"The Economist" sums up the shortsightedness, inaptitude, ignorance, and self-centeredness of NGO's neatly:

"Suppose that in the remorseless search for profit, multinationals pay sweatshop wages to their workers in developing countries. Regulation forcing them to pay higher wages is demanded... The NGOs, the reformed multinationals and enlightened rich-country governments propose tough rules on third-world factory wages, backed up by trade barriers to keep out imports from countries that do not comply. Shoppers in the West pay more - but willingly, because they know it is in a good cause. The NGOs declare another victory. The companies, having shafted their third-world competition and protected their domestic markets, count their bigger profits (higher wage costs notwithstanding). And the third-world workers displaced from locally owned factories explain to their children why the West's new deal for the victims of capitalism requires them to starve."

NGO's in places like Sudan, Somalia, Myanmar, Bangladesh, Pakistan, Albania, and Zimbabwe have become the preferred venue for Western aid - both humanitarian and financial - development financing, and emergency relief. According to the Red Cross, more money goes through NGO's than through the World Bank. Their iron grip on food, medicine, and funds rendered them an alternative government - sometimes as venal and graft-stricken as the one they replace.

Local businessmen, politicians, academics, and even journalists form NGO's to plug into the avalanche of Western largesse. In the process, they award themselves and their relatives with salaries, perks, and preferred access to Western goods and credits. NGO's have evolved into vast networks of patronage in Africa, Latin America, and Asia.

NGO's chase disasters with a relish. More than 200 of them opened shop in the aftermath of the Kosovo refugee crisis in 1999-2000. Another 50 supplanted them during the civil unrest in Macedonia a year later. Floods, elections, earthquakes, wars - constitute the cornucopia that feed the NGO's.

NGO's are proponents of Western values - women's lib, human rights, civil rights, the protection of minorities, freedom, equality. Not everyone finds this liberal menu palatable. The arrival of NGO's often provokes social polarization and cultural clashes. Traditionalists in Bangladesh, nationalists in Macedonia, religious zealots in Israel, security forces everywhere, and almost all politicians find NGO's irritating and bothersome.

The British government ploughs well over $30 million a year into "Proshika", a Bangladeshi NGO. It started as a women's education outfit and ended up as a restive and aggressive women empowerment political lobby group with budgets to rival many ministries in this impoverished, Moslem and patriarchal country.

Other NGO's - fuelled by $300 million of annual foreign infusion - evolved from humble origins to become mighty coalitions of full-time activists. NGO's like the Bangladesh Rural Advancement Committee (BRAC) and the Association for Social Advancement mushroomed even as their agendas have been fully implemented and their goals exceeded. It now owns and operates 30,000 schools.

This mission creep is not unique to developing countries. As Parkinson discerned, organizations tend to self-perpetuate regardless of their proclaimed charter. Remember NATO? Human rights organizations, like Amnesty, are now attempting to incorporate in their ever-expanding remit "economic and social rights" - such as the rights to food, housing, fair wages, potable water, sanitation, and health provision. How insolvent countries are supposed to provide such munificence is conveniently overlooked.

"The Economist" reviewed a few of the more egregious cases of NGO imperialism.

Human Rights Watch lately offered this tortured argument in favor of expanding the role of human rights NGO's: "The best way to prevent famine today is to secure the right to free expression - so that misguided government policies can be brought to public attention and corrected before food shortages become acute." It blatantly ignored the fact that respect for human and political rights does not fend off natural disasters and disease. The two countries with the highest incidence of AIDS are Africa's only two true democracies - Botswana and South Africa.

The Centre for Economic and Social Rights, an American outfit, "challenges economic injustice as a violation of international human rights law". Oxfam pledges to support the "rights to a sustainable livelihood, and the rights and capacities to participate in societies and make positive changes to people's lives". In a poor attempt at emulation, the WHO published an inanely titled document - "A Human Rights Approach to Tuberculosis".

NGO's are becoming not only all-pervasive but more aggressive. In their capacity as "shareholder activists", they disrupt shareholders meetings and act to actively tarnish corporate and individual reputations. Friends of the Earth worked hard four years ago to instigate a consumer boycott against Exxon Mobil - for not investing in renewable energy resources and for ignoring global warming. No one - including other shareholders - understood their demands. But it went down well with the media, with a few celebrities, and with contributors.

As "think tanks", NGO's issue partisan and biased reports. The International Crisis Group published a rabid attack on the then incumbent government of Macedonia, days before an election, relegating the rampant corruption of its predecessors - whom it seemed to be tacitly supporting - to a few footnotes. On at least two occasions - in its reports regarding Bosnia and Zimbabwe - ICG has recommended confrontation, the imposition of sanctions, and, if all else fails, the use of force. Though the most vocal and visible, it is far from being the only NGO that advocates "just" wars.

The ICG is a repository of former heads of state and has-been politicians and is renowned (and notorious) for its prescriptive - some say meddlesome - philosophy and tactics. "The Economist" remarked sardonically: "To say (that ICG) is 'solving world crises' is to risk underestimating its ambitions, if overestimating its achievements."

NGO's have orchestrated the violent showdown during the trade talks in Seattle in 1999 and its repeat performances throughout the world. The World Bank was so intimidated by the riotous invasion of its premises in the NGOchoreographed "Fifty Years is Enough" campaign of 1994, that it now employs dozens of NGO activists and let NGO's determine many of its policies.

NGO activists have joined the armed - though mostly peaceful - rebels of the Chiapas region in Mexico. Norwegian NGO's sent members to forcibly board whaling ships. In the USA, anti-abortion activists have murdered doctors. In Britain, animal rights zealots have both assassinated experimental scientists and wrecked property.

Birth control NGO's carry out mass sterilizations in poor countries, financed by rich country governments in a bid to stem immigration. NGO's buy slaves in Sudan thus encouraging the practice of slave hunting throughout sub-Saharan Africa. Other NGO's actively collaborate with "rebel" armies - a euphemism for terrorists.

NGO's lack a synoptic view and their work often undermines efforts by international organizations such as the UNHCR and by governments. Poorly-paid local officials have to contend with crumbling budgets as the funds are diverted to rich expatriates doing the same job for a multiple of the cost and with inexhaustible hubris.

This is not conducive to happy co-existence between foreign do-gooders and indigenous governments. Sometimes NGO's seem to be an ingenious ploy to solve Western unemployment at the expense of down-trodden natives. This is a misperception driven by envy and avarice.

But it is still powerful enough to foster resentment and worse. NGO's are on the verge of provoking a ruinous backlash against them in their countries of destination. That would be a pity. Some of them are doing indispensable work. If only they were a wee more sensitive and somewhat less ostentatious. But then they wouldn't be NGO's, would they?

Interview granted to Revista Terra, Brazil, September 2005

Q. NGOs are growing quickly in Brazil due to the discredit politicians and governmental institutions face after decades of corruption, elitism etc. The young people feel they can do something concrete working as activists in a NGOs. Isn't that a good thing? What kind of dangers someone should be aware before enlisting himself as a supporter of a NGO?

A. One must clearly distinguish between NGOs in the sated, wealthy, industrialized West - and (the far more numerous) NGOs in the developing and less developed countries.

Western NGOs are the heirs to the Victorian tradition of "White Man's Burden". They are missionary and charity-orientated. They are designed to spread both aid (food, medicines, contraceptives, etc.) and Western values. They closely collaborate with Western governments and institutions against local governments and institutions. They are powerful, rich, and care less about the welfare of the indigenous population than about "universal" principles of ethical conduct.

Their counterparts in less developed and in developing countries serve as substitutes to failed or dysfunctional state institutions and services. They are rarely concerned with the furthering of any agenda and more preoccupied with the well-being of their constituents, the people.

Q. Why do you think many NGO activists are narcissists and not altruists? What are the symptoms you identify on them?

A. In both types of organizations - Western NGOs and NGOs elsewhere - there is a lot of waste and corruption, double-dealing, self-interested promotion, and, sometimes inevitably, collusion with unsavory elements of society. Both organizations attract narcissistic opportunists who regards NGOs as venues of upward social mobility and self-enrichment. Many NGOs serve as sinecures, "manpower sinks", or "employment agencies" - they provide work to people who, otherwise, are unemployable. Some NGOs are involved in political networks of patronage, nepotism, and cronyism.

Narcissists are attracted to money, power, and glamour. NGOs provide all three. The officers of many NGOs draw exorbitant salaries (compared to the average salary where the NGO operates) and enjoy a panoply of work-related perks. Some NGOs exert a lot of political influence and hold power over the lives of millions of aid recipients. NGOs and their workers are, therefore, often in the limelight and many NGO activists have become minor celebrities and frequent guests in talk shows and such. Even critics of NGOs are often interviewed by the media (laughing).

Finally, a slim minority of NGO officers and workers are simply corrupt. They collude with venal officials to enrich themselves. For instance: during the Kosovo crisis in 1999, NGO employees sold in the open market food, blankets, and medical supplies intended for the refugees.

Q. How can one choose between good and bad NGOs?

A. There are a few simple tests:

1. What part of the NGO's budget is spent on salaries and perks for the NGO's officers and employees? The less the better.

2. Which part of the budget is spent on furthering the aims of the NGO and on implementing its promulgated programs? The more the better.

3. What portion of the NGOs resources is allocated to public relations and advertising? The less the better.

4. What part of the budget is contributed by governments, directly or indirectly? The less the better.

5. What do the alleged beneficiaries of the NGO's activities think of the NGO? If the NGO is feared, resented, and hated by the local denizens, then something is wrong!

6. How many of the NGO's operatives are in the field, catering to the needs of the NGO's ostensible constituents? The more the better.

7. Does the NGO own or run commercial enterprises? If it does, it is a corrupt and compromised NGO involved in

conflicts of interest.

Q. The way you describe, many NGO are already more powerful and politically influential than many governments. What kind of dangers this elicits? Do you think they are a pest that need control? What kind of control would that be?

A. The voluntary sector is now a cancerous phenomenon. NGOs interfere in domestic politics and take sides in election campaigns. They disrupt local economies to the detriment of the impoverished populace. They impose alien religious or Western values. They justify military interventions. They maintain commercial interests which compete with indigenous manufacturers. They provoke unrest in many a place. And this is a partial list.

The trouble is that, as opposed to most governments in the world, NGOs are authoritarian. They are not elected institutions. They cannot be voted down. The people have no power over them. Most NGOs are ominously and tellingly secretive about their activities and finances.

Light disinfects. The solution is to force NGOs to become both democratic and accountable. All countries and multinational organizations (such as the UN) should pass laws and sign international conventions to regulate the formation and operation of NGOs.

NGOs should be forced to democratize. Elections should be introduced on every level. All NGOs should hold "annual stakeholder meetings" and include in these gatherings representatives of the target populations of the NGOs. NGO finances should be made completely transparent and publicly accessible. New accounting standards should be developed and introduced to cope with the current pecuniary opacity and operational double-speak of NGOs.

Q. It seems that many values carried by NGO are typically modern and Western. What kind of problems this creates in more traditional and culturally different countries?

A. Big problems. The assumption that the West has the monopoly on ethical values is undisguised cultural chauvinism. This arrogance is the 21st century equivalent of the colonialism and racism of the 19th and 20th century. Local populations throughout the world resent this haughty presumption and imposition bitterly.

As you said, NGOs are proponents of modern Western values - democracy, women's lib, human rights, civil rights, the protection of minorities, freedom, equality. Not everyone finds this liberal menu palatable. The arrival of NGOs often provokes social polarization and cultural clashes.

Nuclear Waste

On May 11, 2005, Romania will host a two-day exercise simulating a nuclear accident. It will be conducted at the Cernavoda nuclear power plant. But the real radiological emergency is already at hand and unfolding.

Nuclear waste is both an environmental problem and an economic solution in the countries of east Europe and central Asia. Kazakhstan announced in November 2002 that it plans to import other countries' nuclear waste - and get paid for its shoddy disposal-by-burial, contrary to international conventions.

Ironically, the money thus generated is earmarked for ridding of Kazakhstan of its own pile of fissionable trash. This emulates a similar scheme floated five years ago in Russia. The Atomic Energy Ministry planned to import 20,000 tons of nuclear waste to earn $21 billion in the process.

The collapse of the Warsaw Pact left many countries in the former Soviet block with an ageing and prohibitively expensive to maintain nuclear arsenal. Dismantling the war heads - often with American and European Union Euratom funding - yielded mounds of lethal radioactive materials.

Abandoned nuclear test sites - such as the USSR's central facility in Semipalatinsk, Kazakhstan - contain thousands of tons of radioactive leftovers. Add to this the network of decrepit, Chernobyl-like, reactors strewn throughout the region and their refuse and the gargantuan dimensions of the threat emerge.

Take, again, Kazakhstan. According to Mukhtar Dzakishev, then president of Kazatomprom, the country's national nuclear agency, the country is immersed in 230,000 tons of waste. It would cost more than $1 billion to clean. The country should earn this amount in a single year of imports of nuclear litter.

The going rate in Europe is c. $3-5000 per 200-liter barrel, only a fifth of which is spent on its burial in old mines or specially constructed depositories. This translates to a profit of $80-140 per cubic meter of uranium buried - compared to less than $10 per cubic meter of uranium extracted. The countries of east Europe have entered the fray with relish. In 2001, president Putin rushed through the Duma a much-debated law that allows for the importation and disposal of nuclear waste.

Getting rid of nuclear waste and dismantling nuclear facilities - both military and peacetime - do not come cheap.

According to the ELTA news agency, Lithuania's decommissioning of the Ignalina Nuclear Power Plant would require 30 years and should cost $90 million in 2008 alone. In October 2002, Russia's Atomic Energy Minister Yevgeny Adamov pegged the cost of a USA-Russian agreement to dispose of 34 tons of weapons-grade plutonium at $750 million. Russia plans to resell the end product, mixed oxide (MOX), to various countries in Europe and to Japan. MOX can be used to fuel specially-fitted power plants.

The European Commissions, alarmed by these developments in its backyard, announced, according to EUObserver.com, that it "gives priority to geological burial of dangerous material as the safest disposal method to date. Member states will be required to establish national burial sites for the disposal of radioactive waste by 2018. Research for waste management will also be stepped up."

Even private NGO's got into the act. In August 2002, Russia reclaimed from the Vinca Institute of Nuclear Sciences in Belgrade, Yugoslavia 45 kilograms of highly enriched uranium. The Nuclear Threat Initiative (NTI), a Washington-based NGO established by Ted Turner of

CNN fame and former Senator Sam Nunn, was instrumental in arranging the air transport of the sensitive substance. According to Radio Free Europe/Radio Liberty, the Vinca Institute conditioned its surrender of the uranium rods on financial aid to dispose of 2.5 tons of spent nuclear fuel. NTI provided the $5 million needed to accomplish the cleanup.

A donor conference, in the framework of the Northern Dimension Environmental partnership (NDEP) pledged in November 2002 c. $110 million to tackle environmental and nuclear waste in northwest Russia. This fund will supplement loans from international financial institutions. Yet, according to the BBC, of the twelve priority projects worth $1.3 billion that have been agreed - not one concerns atomic trash.

The NDEP, set up in 1997, is a partnership of the European Commission, Russia, the European Regional Development Bank, the European Investment Bank, the Nordic Bank and the World Bank. But it is predicated on a crucial document - the Multilateral Nuclear Environment Programme in Russia (MNEPR) - which Russia for long evaded signing.

The sorry state of underfunded efforts to cope with the aftermath of nuclear power and weaponry and the blatant venality that often accompanies shady waste deals provoked a green backlash throughout the otherwise docile region. The Guardian quoted courageous Kazakh environmental activists as saying:

"The same is repeated again and again. It is just another money-making venture ... The World Bank is worried about corruption in Kazakhstan. In our current situation

there is no guarantee of public safety, no system for compensation, no confidence in the ability of customs to deal with these cargoes. Everyone has a human right to a safe environment - but apparently not here."

Similar sentiments are expressed by groups in Russia, Romania, Bulgaria, Yugoslavia, Ukraine, the Czech Republic, Poland and elsewhere. Being "environmentally correct" is so important that Tanjug, the Yugoslav news agency, in its relentless campaign against NATO, implausibly accused Germany of storing its waste in the mines of Kosovo.

A prime example of activism involved a Russian scientific expedition which found a nuclear submarine dumped, with spent radioactive fuel, in the northern Kara Sea. According to news agencies, quoting environmental groups, dumping nuclear waste, hundreds of submarines and decommissioned nuclear reactors into Arctic waters was common practice in the Soviet Union.

In late 2002, the governor of the Murmansk region, bordering on Norway, has announced a 6-year cleansing program of the Kola peninsula, designed to assuage the worried Scandinavians. The Norwegians built a waste recycling facility in the area, constructed a special train to ferry the waste away and invested in renovating a storage dump.

Many east European countries do not store nuclear waste but serve merely as transit routes. The waste the Kazakhs plan to dispose of, for instance, should cross Russian territory. Yet, the Russians are the easy part. In 1998, they have agreed to continue to store in east Siberia fission by-products from Bulgaria's controversial Soviet-built

Kozloduy nuclear power plant. Russia also stores waste from Slovakia, Hungary, the Czech Republic and Lithuania. Waste disposal was part of the standard construction contracts of Soviet reactors abroad.

But getting the waste to Russia often requires permission from other, a lot less forthcoming, countries such as Moldova, Ukraine and Romania. By the beginning of 2003, according to the Bulgarian reactor's management, the old storage pits were exhausted and the plant had to close down.

According to the Regional Environmental Center, the transit countries cite ill-equipped railways, antiquated containers and other environmental concerns as the reasons for their reluctance. In reality, they are under pressure by the European Union and the USA to collaborate with waste transport and disposal companies in the West, such as British Nuclear Fuels (BNFL), or Cogema. In the wastelands that constitute large swathes of the post-communist world, nuclear waste, it seems, is a growth industry.

O

Offest, Barter, and Countertrade

In December 2002, Poland decided to purchase 48 F-16 Falcons from Lockheed Martin Corporation - an American defense contractor. Pegged at $3.5 billion, this is the biggest defense order ever issued by an east or central European country. The financial package includes soft loans and a massive offset program - purchases from Polish manufacturers that more than erase the costs of the deal in foreign exchange.

Offset in all its forms - including co-production, licensing, subcontracting, and joint ventures - is not uncommon in the defense industry. It is being offered even to far richer clients such as Israel. But in central and east Europe it is more prevalent than the West realizes.

According to numerous studies, barter-like arrangements (known throughout the region as "compensation") constitute between 20 and 40 percent of all transactions in the economies of the former Soviet bloc. Corporate debts to suppliers, payments for goods and services, even taxes - all have a non-cash component or are entirely demonetized.

The implosion of communism led to a rapid shrinking of the manufacturing base and the evaporation of the agricultural and mining sectors in many countries in transition. Export-derived earnings in hard currency collapsed even as millions lost their jobs and their purchasing power. Unemployment affects one fifth of the population in Poland, one third in Macedonia and three fifths in Kosovo, for instance.

Rather than remonetize these cash-bleeding economies, the IMF imposed strict austerity programs on the entire area, further eroding disposable incomes and intra-regional trade. Countertrade, barter, buyback, offset, clearing, technology transfer and other non-cash dealings flourished.

Moreover, the clearing system of the now defunct eastern trade bloc, COMECON - the Council of Mutual Economic Assistance (CMEA), was based on effective barter and the use of a fictitious "wooden" ruble. From Hungary to Cuba, communist countries were coerced into outlandish terms of trade, often beneficial to the Soviet Union or to a member in need. Mounting debts led to the disintegration of the entire edifice and Russia was reduced to giving east European countries aircraft and other weapons systems in lieu of cash disbursements.

Russia reimburses Kazakhstan with (shoddy) goods for leasing the Baikonur Cosmodrome. Until 2000, it was common practice in the Russian Federation to pay wage arrears, inter-enterprise debt and back taxes in kind. Russia and Turkmenistan accept food and other commodities, semi-finished products and construction services from Ukraine, Armenia and Belarus in exchange for their gas debts and, in Russia's case, for disposing of Ukraine's nuclear waste.

The recipients often complain of the quality of the products or services they receive - and of recurrent breaches of delivery schedules and quantities. But they have little choice. Ukraine is one of Turkmenistan's major export clients, for instance. Nor are these exchanges post-communist phenomena. Canadian firms, led by AECL - Atomic Energy of Canada Limited - were forced to accept Romanian goods for their nuclear reactors throughout the late 1980s.

There is a general misconception that barter is a thing of the past. Far from it. In the last six months of 2002, payments-in-kind to Gazprom, the Russian energy behemoth, have tripled due to an increase in its tariffs. The use of "veksels" (mostly corporate promissory notes) surged 60 percent. Hence the rise to prominence of barter experts, such as Igor Makarov, who, as general manager of Itera, oversaw Gazprom's sales of gas throughout the Commonwealth of Independent States.

As prices are adjusted to reflect waning state subsidies, consumers' purchasing power diminishes and countertrade transactions burgeon. A global recession coupled with the woes specific to transition from communism to capitalism herald an era of unmanageable inter-corporate debt. In tiny Macedonia, it is thought to have surpassed $600 million in 2001 - close to one fifth of GDP. The bulk of such debt is ultimately settled by barter.

Proponents of barter trade - mainly a proliferation of Western consultancies, financial boutiques and trading companies - count their advantages thus (from the Export911.com Web site):

"Countertrade provides a means of trade with countries using a blocked currency - currency that is not readily convertible into other currencies - or lacking the foreign

exchange, thus removing the difficulties and risks in a trade financing and paving the way for a successful deal that otherwise would fail. Countertrade also provides a means to preserve foreign exchange reserves by eliminating the use of hard currency."

The US Embassy in Moscow counters by describing the nefarious effects of barter on the Russian economy:

"In Russia, the barter system is used for various reasons: monetary risk, lack of money, illicit enrichment, tax evasion and to continue business operations beyond viable economic life. The system creates numerous negative effects, namely: low tax receipts, price distortions, oversupply of products, ineffective monetary policy instruments, imprecise economic measurements, and, as a consequence, poor public policy decisions. Barter is tolerated and sustained because of short-term management perspectives, its value as a social safety valve and poor application of bankruptcy laws."

The demonetization of the economy and the distortion of the price signal (which ensures the proper allocation of economic resources) are not the only pernicious effects of non-cash business.

Barter transactions tend to enhance the militarization of the region. No one wants Russian TV sets or Ukrainian stockings. But MiG fighter planes and Kalkan and Grif patrol boats are in great demand. Turkmenistan, for instance, has built an entire Caspian Sea coast guard out of its gas-for-goods agreement with Ukraine signed last year.

Non-cash transactions are an integral part of the informal sector of the economy, estimated to constitute at least one third of the region's total gross domestic product. They are impossible to track, let alone tax. They are conducive to capital flight and offshore stashing of export proceeds. Technically, barter deals are a kind of non-tariff barrier as they interfere with the free market by binding specific buyers to given sellers. Hence the recent Russian-Chinese agreement to ban non-cash transactions in their border areas.

Countertrade deals are complex and multi-phased. If improperly structured, they leave a lot of space for corruption and worse. Radio Free Europe/Radio Liberty reported that the military court of the Moscow garrison sentenced in April 2002 the former head of the Defense Ministry's Main Directorate of Military Budget and Finances, Colonel-General Georgi Oleinik, to three years in prison.

In a typical scam - oft-repeated in Chechnya - Oleinik absconded in 1996-1997 with some $450 million. The money belonged to Ukrainian firms and was paid out in the framework of a multistage barter deal. It was earmarked for the purchase of materiel for the Russian army. Interestingly, in his defense, Oleinik insisted that the deal was authorized by former Finance Minister Andrei Vavilov and other senior officials.

Still, in the long-run, barter is doomed. As more former Soviet satellites either divert their trade towards the European Union or join it as members, countertrade will be restricted to the financially backward economies of the former Soviet Bloc. In time, even these laggards will have to face market realities - especially the use of cash as the foundation of the price mechanism and the optimal allocation of scarce economic resources.

Put vernacularly, the citizens of barter-addicted countries will inevitably grow disenchanted with shoddy and shabby goods delivered late. Imports from and exports to cash paying destinations will surge. "Ghost" factories will close down, releasing capacity to more productive entrants. Cash-starved governments will deepen and widen tax collection. A foreign-owned banking system will do a better job of matching savings to investments. Barter will be reduced to a marginal, last resort, activity.

Offshoring and Outsourcing, Case Study

The Organisation for Economic Cooperation and Development (OECD) tried and failed to find proof or traces of widespread outsourcing and offshoring. “There is little hard evidence of the extent of international outsourcing and offshoring, despite widespread media attention.” - its baffled analysts conclude in a June 2005 report.

Outsourcing is the performance of the business functions and competencies of the firm (call or data processing, software engineering, manufacturing, research and development, customer services, payroll management) by an outside contractor. Offshoring is outsourcing beyond the borders of the firm's domicile, to a foreign supplier abroad or to the firm's overseas or cross-border subsidiaries.

Outsourcing and, even more so, offshoring are perceived as a threat to job security in the West, where wages are much higher and job perks more numerous and expensive to provide. Foreign data processing firms gain access to sensitive data. Facilities in hostile countries or potential geopolitical rivals, such as China and India, may compromise national security.

Even the OECD admits that, in the words of The Economist, "close to 20% of total employment in the 15 pre-expansion EU countries, America, Canada and Australia could 'potentially be affected' by the international sourcing of services activities."

In a May 2005 report, titled "The Emerging Global Labor Market", McKinsey Global Institute estimated that in 2003 there were a mere 1.5 million outsourced service jobs. The number is projected to soar to 4.1 million in 2008. But even this is a tiny drop in a massive ocean. In the USA, note the authors, in the year to March 2005, more than 4.6 million people start in new jobs - monthly!

Offshoring is a growth industry not only in India. Export of business services has recently mushroomed in Ireland, Estonia, and Sweden - all European Union members.

Even places such a Jamaica, not exactly a hotbed of innovation and technology, benefit.

OverDrive - an e-commerce, software conversion and e-publishing applications leader - has expanded an e-book technology centre by adding 200 e-book editors. This happened in Montego Bay, Jamaica - one of the less privileged spots on earth. The centre now provides a vertical e-publishing service - from manuscript editing to conversion to Quark (for POD), Adobe, and MS Reader ebook formats. Thus, it is not confined to the classic sweatshop cum production centre so common in Less

Developed Countries (LDC's). It is a full fledged operation with access to cutting edge technology.

The Jamaican OverDrive is the harbinger of things to come and the outcome of a confluence of a few trends.

First, there is the insatiable appetite big publishers (such as McGraw-Hill, Random House, and Harper Collins) have developed to converting their hitherto inertial backlists into e-books. Gone are the days when e-books were perceived as merely a novel form of packaging. Publishers understood the cash potential this new distribution channel offers and the value added to stale print tomes in the conversion process. This epiphany is especially manifest in education and textbook publishing.

Then there is the maturation of industry standards, readers and audiences. Both the supply side (title lists) and the demand side (readership) have increased. Giants like Microsoft have successfully entered the fray with new e-book reader applications, clearer fonts, and massive marketing. Retailers - such as Amazon - opened their gates to e-books. A host of independent publishers make good use of the negligible-cost distribution channel that the Internet is. Competition and positioning are already fierce - a good sign.

The Internet used to be an English, affluent middle-class, white collar, male phenomenon. It has long lost these attributes. The digital divides that opened up with the early adoption of the Net by academe and business - are narrowing. Already there are more women than men users and English is the language of less than half of all web sites. The wireless Net grants developing countries the chance to catch up.

Astute entrepreneurs are bound to take advantage of the business-friendly profile of the manpower and investment-hungry governments of some developing countries. It is not uncommon to find a mastery of English, a college degree in the sciences, readiness to work outlandish hours at a fraction of wages in Germany or the USA - all combined in one employee in these deprived countries. India has sprouted a whole industry based on these competitive endowments.

Here is how Steve Potash, OverDrive's CEO, explained his daring move in OverDrive's press release dated May 22, 2001:

"Everyone we are partnering with in the US and worldwide has been very excited and delighted by the tremendous success and quality of eBook production from OverDrive Jamaica. Jamaica has tremendous untapped talent in its young people. Jamaica is the largest English-speaking nation in the Caribbean and their educational and technical programs provide us with a wealth of quality candidates for careers in electronic publishing. We could not have had this success without the support and responsiveness of the Jamaican government and its agencies. At every stage the agencies assisted us in opening our technology centre and staffing it with trained and competent eBook professionals. OverDrive Jamaica will be pioneering many of the advances for extending books, reference materials, textbooks, literature and journals into new digital channels - and will shortly become the foremost centre for eBook automation serving both US and international markets."

Druanne Martin, OverDrive's Director of publishing services elaborated:

"With Jamaica and Cleveland, Ohio sharing the same time zone (EST), we have our US and Jamaican production teams in sync. Jamaica provides a beautiful and warm climate, literally, for us to build long-term partnerships and to invite our publishing and content clients to come and visit their books in production."

Then Jamaican Minister of Industry, Commerce and Technology, the Hon. Phillip Paulwell reciprocated:

"We are proud that OverDrive has selected Jamaica to extend its leadership in eBook technology. OverDrive is benefiting from the investments Jamaica has made in developing the needed infrastructure for IT companies to locate and build skilled workforces here."

There is nothing new in outsourcing back office work (insurance claims processing, air ticket reservations, medical records maintenance) to third world countries, such as (the notable example) India. Research and Development is routinely farmed out to aspiring first world countries such as Israel and Ireland.

But OverDrive's Jamaican facility is an example of something more sophisticated and more durable. Western firms are discovering the immense pools of skills, talent, innovation, and top notch scientific and other education often offered even by the poorest of nations. These multinationals entrust the locals now with more than keyboarding and responding to customer queries using fake names.

The Jamaican venture is a business partnership. In a way, it is a topsy-turvy world. Digital animation is produced in India and consumed in the States. The low compensation of scientists attracts the technology and R&D arms of the likes of General Electric to Asia and Intel to Israel. In other words, there are budding signs of a reversing brain drain - from West to East.

E-publishing is at the forefront of software engineering, e-consumerism, intellectual property technologies, payment systems, conversion applications, the mobile Internet, and, basically, every important trend in network and computing and digital content. Its migration to warmer and cheaper climates may be inevitable. OverDrive sounds happy enough.

Oil, Price of

How is the price of oil determined and how important it is to the global economy?

Hedging

The price of oil is no longer an important determinant of the economic health of the West.

Today, there are forward contracts, which allow one to fix the price of purchased oil well in advance. There are options contracts which can be used to limit one's risks as a result of trading in such forward contracts.

In other words:

If one loses money on the forward contract because the purchase price fixed in the contract is higher than the market price at the time of delivery (=one must pay more than the market price according to one's obligation in the contract) - one makes a profit on the options contract that is similar to the loss on the forward contract.

Thus, if one uses forwards plus options - one fixes a price in the future that can be not too far from the market price at the time of delivery. Such financial positions require sophisticated management and day to day maintenance of the forwards and options positions, though.

Fixing Oil Prices Inside Countries

Most countries in the world have three systems of fixing prices inside their markets:

1. The price of oil and its derivatives is fixed entirely by market forces, supply and demand, usually through specialized exchanges (e.g., the Rotterdam Exchange). The market is totally deregulated - exports and imports are totally allowed and free.

2. The price is fixed by a committee of representatives of the government, the oil industry, the biggest consumers of oil, and representatives of households and agricultural consumers.

3. The prices are fixed every 3 or 6 months based on the cost of oil at a certain port of delivery. In Israel, for instance, the price of oil fluctuates every three months according to the price of oil delivered in certain Italian ports (where Israel gets most of its oil delivered). This is an AUTOMATIC adjustment.

4. In other countries the prices are fixed by the competent Ministry in accordance to the ACTUAL costs of the oil (importing, processing and distribution) + a fixed percentage (usually 15%). This is called a COST PLUS basis pricing method.

The Price Trends of Oil

The international price of oil is determined by the following factors:

(NEGATIVE=depresses prices, POSITIVE=increases prices)

a. The weather. Cold weather increases consumption. The world is getting hotter. The 14 hottest years in history have been in the last 25 years. The warmer the climate - the less oil is consumed for heating. NEGATIVE.

b. Economic growth - The stronger the growth, the more oil is consumed (mostly for industrial purposes). POSITIVE.

c. Wars increases oil consumption by all parties involved. POSITIVE.

d. Oil exploration budgets are growing and new contracts have just been signed in the Gulf area (including Iraq). The more exploration, the more reserves are discovered and exploited, thereby increasing the supply side of the oil equation. NEGATIVE.

e. Lifting of sanction from Iraq, Iran and Libya will increase the supply of oil. NEGATIVE.

f. Oil reserves throughout the world are at a record high. This tends to depress demand for newly produced oil. NEGATIVE.

g. The economic crisis of certain oil producers (Russia, Nigeria, Venezuela, Iraq) forces them to sell oil cheaply, sometimes in defiance of the OPEC quotas. NEGATIVE.

h. OPEC agreements to restrict or increase output and support price levels should be closely scrutinized. OPEC is not reliable and its members are notorious for reneging on their obligations.

i. Ecological concerns and economic considerations lead to the development of alternative fuels and the enhanced consumption of LNG (gas) and coal, at oil's expense. Even nuclear energy is reviving. NEGATIVE.

j. New oil exploration technology and productivity gains allow producers to turn a profit even on cheaper oil. So, they are not likely to refrain from selling oil even if its price declines to 5 US dollars a barrel. NEGATIVE.

k. Privatization and deregulation of oil industries (mainly in Latin America and, much more hesitantly, in the Gulf) increases supply. NEGATIVE.

l. Hedge funds and other derivatives induced price volatility has increased lately. But financial players have no preference which way he price goes, so they are NEUTRAL.

Oligarchs (Chubais)

Anatoly Chubais, head of Russia's electricity monopoly, survived an assassination attempt on March 17, 2005. A roadside charge, followed by a hail of automatic gunfire, failed to remove him from the scene.

Even by the imperceptible standards of eastern Europe, the crony-infested Russian version of "privatization" was remarkable for its audacity and scope. Assets now worth some $25 billion were sold for c. $1 billion. A later loans-for-shares plunder was micromanaged by Anatoly Chubais, head of the State Property Committee, then heralded by the West as a "true reformer". Chubais enjoyed casting himself as the lonely champion of the rule of law and private property fighting an uphill battle against shady oligarchs and a resurgent communists.

Ever since then, Chubais has been entangled in a series of scandals. In 1997 alone, his name was robustly linked to two. One revolved around an outlandish $450,000 advance paid to Chubais and two co-authors by a publishing firm later taken over by a bank, Uneximbank, one of the main beneficiaries of Chubais' privatization shenanigans.

The second outrage involved the now-defunct Harvard Institute of International Development (HIID), headed by the much-interviewed Jeffrey Sachs. The Institute enjoyed well over $60 million in USAID funds as it worked hand in glove in the early 1990s with Chubais to shock Russia into economic "therapy" through the Russian Privatization Center. The outcome has been calamitous. It took Russia almost a decade to recover from the involvement of these "experts" in its economy.

Moreover, often, practice and preaching were far apart. In a bout of puzzling honesty, Chubais admitted, in an interview to the Russian business daily Kommersant, later published also by the Los Angeles Times, to defrauding multilateral lending organizations and their Western masters. He said: "In such situations, the authorities have to (lie). We ought to. The financial institutions understand, despite the fact that we conned them out of $20 billion, that we had no other way out."

Andrei Shleifer and Jonathan Hay, two Harvard professors, were caught, as a $120 million lawsuit filed by the American authorities, under the False Claims Act, in September 2000, alleges, "abusing the trust of the U.S. government by using personal relationships...for private gain", purportedly shared with Chubais and his crew.

It is a sad testimony to both Russia's dearth of honest talent and to the murkiness of its public life that Chubais is as strong as ever and manages the giant electricity utility, UES. In the dismal landscape of Russian business, Chubais is a managerial star and role model. With a self-declared annual salary of a mere $4,000, this job is, apparently, yet another personal sacrifice of many.

As the Moscow Times recounts, Chubais plans to split the current inefficient electricity giant into an independent transmission grid company, a system operator and several generation companies (gencos), all directly owned by the government and minority shareholders. A single holding company will consolidate the stakes that UES holds in regional energy companies. UES will, in effect, end up controlling the national grid. Initial, legislative and administrative, steps to implement this scheme have already been taken.

Yet, Chubais' checkered past and even more checkered friends render him automatically suspect. Everything he says makes incontrovertible economic sense. Power generation, the national and regional grids, the pricing structure, the cost of fossil fuels - all require nothing short of an agonizing transformation.

But Chubais' history of ulterior motives invariably invokes the question: what's in it for him? Why is he so bent on disposing of UES assets at bargain basement valuations, since electricity prices have not yet been adjusted to reflect costs? According to The Economist, the very foreign investors that Chubais so clamors for may be shunning a UES dominated by him. Many of them remember the attempt they thwarted a few years back to sell generators on the cheap to local tycoons in favor or his dubious ties to the aluminum industry, a heavy consumer of electricity.

Others were shocked by a contract signed with Renaissance Capital, owner of 25% of a UES subsidiary, Kuzbassenergo, granting Renaissance cheap generation capacity in future tenders. Such qualms aside, foreign utilities and Russian oil companies, though, would find a UES divestiture irresistible.

In the best of Russian traditions, Chubais is busy expanding his fief and preparing for yet another round of self-serving "restructuring". This is not without precedent. Viktor Chernomyrdin, an erstwhile Russian prime minister, similarly leveraged his management of Gazprom, Russia's energy colossus, between 1989 and 1992.

A - just - complaint Chubais penned regarding inflated pricing and predatory business practices of Mezhregiongaz, Russia's natural gas monopoly, led to an audit order by Kremlin-appointed Alexei Miller. This could weaken Putin's St. Petersburg pals and strengthen guess who.

UES is merely a Chubais vehicle. An impossible supermajority of three quarters of all shareholders was required to oust him until foreign investors reduced it to 51 percent. Chubais leverages UES to amass personal clout in the energy-hungry provinces.

Consider destitute Bashkortostan. In December 2002 its power grid, BSK, resolved to establish a joint stock company and to spin off the management, sales and maintenance functions to separate entities. The outcome of the upheaval? UES would become the second largest shareholder of BSK.

A similar deal regarding Mosenergo was struck in November 2002 with a reluctant Yuri Luzhkov, Moscow's mayor, after much acrimony. The municipality will enhance its share of the lucrative power generation business by investing in it "assets" valued at "market prices".

Takeovers of fossil fuel companies led Chubais to confrontations with politicians and oligarchs throughout the vast land. In 1999 he clashed with the late Alexander Lebed, governor of Krasnoyarsk Krai, over the control of the Krasugol, the regional coal extractor. Lebed ultimately won.

Chubais is a man for all audiences. On the one hand, in the penumbral corridors of power, he presses for a vertiginous hike of electricity prices to enable him to attract investors for his plan to invest $50 billion over the next decade in modernizing the network.

On the other hand, in interviews to the media, he denies any such intentions. "I am sure no boost in prices either before the reform or after it can threaten us ... (my reform proposals) will undoubtedly lead to a decline in the prices" - he reassured the public in an interview to RTR Television, quoted by Interfax on October 19, 2002.

What lurks behind Chubais' undisputed sway? When UES raised tariffs in flood-stricken areas to recoup the costs of restoration work - Russia's President, Vladimir Putin delivered a vitriolic diatribe against the behemoth. Yet, not daring to confront Chubais directly, he instead castigated his hapless deputy, Andrey Rapaport. The pro-Kremlin factions in the Duma passed, in September 2001, a resolution calling for an investigation of UES' upper echelons. Again, Chubais went unnamed.

UES contributes to the federal budget c. $1.5 billion annually - the equivalent of the entire defense outlay. But such compulsory corporate largesse does not depend on the identity of the utility's management. Business Week described, in January 2002, a meeting between the Swedish-born director of Prosperity Capital Management, Mattias Westman, and Putin. The Russian President boasted that he has blocked Chubais' ability to asset-strip UES and distribute the goodies to his regional cronies.

"When a Westman aide asked what Chubais' managers had received in return for accepting this change, Putin answered in a deadpan tone: 'I have agreed that they can keep their jobs.' With that, Westman recalled, Russia's President nearly fell off his chair laughing."

In an article published in late 2002 in the Financial Times, Anders Aslund of the Carnegie Endowment for International Peace, who was involved in early Russian privatization, is unrepentant:

"Compared with pre-crisis January 1998, Russia has seen a productivity boom that makes US productivity growth appear lethargic ... Russia's industrial transformation runs counter to prevailing ideas about enterprises after communism. Many thought big Soviet industrial enterprises so hopeless that they were best abandoned, as widely occurred in central Europe. Russia's mass privatisation was condemned as an economic disaster ... But Russia has put all this conventional wisdom into question.

Privatisation is the root cause of Russia's enterprise restructuring. Whereas only 10 years ago Russia's industry was fully state-owned, today 90 per cent of it is privatised and 61 per cent of the companies have one controlling shareholder group. All of the success stories are private enterprises. State-owned companies remain a remarkable failure."

But this is a counterfactual self-interested minority view not held even by foreign investors. The legacy of the botched privatization process in the early 1990s is an anti-competitive marketplace, governed by monopolies and duopolies, closely owned by an elite of insiders who regularly abuse minority shareholders, the state and the rule of law.

In 2002, the World Economic Forum rates Russia 64th out of 80 countries in growth competitiveness. Russia made it to the abysmal 135th place out of 156 nations on the 2003 Index of World Economic Freedom, compiled by the Washington-based Heritage Foundation and The Wall Street Journal. Nor is GDP growth a proxy for productivity growth, as Aslund erroneously states.

The Russian market is far from free. In the October 10, 2002 issue of the RFE/RL Russian Political Weekly, David E. Hoffman, The Washington Post foreign editor and author of "The Oligarchs: Wealth and Power in the New Russia" (Public Affairs, 2001), stated:

"(The) structure of the economy ... remains dominated by large industrial groups. Peter Boone and Denis Rodionov, in their recent paper, provide good evidence of this. They found that Russia's economy is still structured around the kind of large oligarchic groups which took root in the 1990s. Of Russia's top 64 companies, where the government no longer has a controlling stake, 85 percent of the value is controlled by just eight shareholder groups, which generally hold 40 percent-100 percent stakes in the companies they control."

Business in Russia is still largely into rent seeking and profitable collusion with the elites: politicians, the security services, the army, regional governors. These mildly functioning enterprises - not as remotely thriving as Aslund makes them out to be - arose despite the looting, overseen by Chubais, of state assets by insiders and organized crime - not because of it.

Most of the successful privately owned conglomerates and firms in Russia have been shaped by favorable terms of trade, rising oil prices and a process of streamlining induced by the implosion of the economy in 1998. The discipline imposed by vocal minority shareholders - both foreign and domestic - and punitive capital markets has also helped.

In September 2002, Chubais announced a freeze on all asset disposals. Andrei Illarionov, Putin's economic advisor at the time, who maintains an unblemished liberal reputation, has repeatedly attacked Chubais publicly, recently at the Harvard-sponsored Sixth Annual Russian Investment Symposium in Boston. Chubais cancelled his appearance and other representatives of UES refused to divulge the identity of buyers of UES assets, citing "confidentiality" as a reason. Quoted by Radio Free Europe/Radio Liberty, Illarionov said:

"It looks like those people just forgot that they are management, not a group of bandits (who) captured the company. And this management is hired and can be fired, and completely forgot about it. And such is (an) absolutely inappropriate, vulgar, and boorish attitude ... (Chubais intends to create a power monopoly) in the sense of might, in the sense of control, (an) economic and political one."

Minority shareholders, such as Hermitage Capital, seek to convene an extraordinary shareholders meeting to get rid of Chubais. Presumably, they enjoy tacit government support. In the wake of the Yukos affair, Russia may have finally decided to confront Chubais and his lot, relics of the rot that gripped Russia in the buccaneering phase of its hitherto botched transition.

Oligopolies

The Wall Street Journal has recently published an elegiac list:

"Twenty years ago, cable television was dominated by a patchwork of thousands of tiny, family-operated companies. Today, a pending deal would leave three companies in control of nearly two-thirds of the market. In 1990, three big publishers of college textbooks accounted for 35% of industry sales. Today they have 62% ... Five titans dominate the (defense) industry, and one of them, Northrop Grumman ... made a surprise (successful) $5.9 billion bid for (another) TRW ... In 1996, when Congress deregulated telecommunications, there were eight Baby Bells. Today there are four, and dozens of small rivals are dead. In 1999, more than 10 significant firms offered help-wanted Web sites. Today, three firms dominate."

Mergers, business failures, deregulation, globalization, technology, dwindling and more cautious venture capital, avaricious managers and investors out to increase share prices through a spree of often ill-thought acquisitions - all lead inexorably to the congealing of industries into a few suppliers. Such market formations are known as oligopolies. Oligopolies encourage customers to collaborate in oligopsonies and these, in turn, foster further consolidation among suppliers, service providers, and manufacturers.

Market purists consider oligopolies - not to mention cartels - to be as villainous as monopolies. Oligopolies, they intone, restrict competition unfairly, retard innovation, charge rent and price their products higher than they could have in a perfect competition free market with multiple participants. Worse still, oligopolies are going global.

But how does one determine market concentration to start with?

The Herfindahl-Hirschmann index squares the market shares of firms in the industry and adds up the total. But the number of firms in a market does not necessarily impart how low - or high - are barriers to entry. These are determined by the structure of the market, legal and bureaucratic hurdles, the existence, or lack thereof of functioning institutions, and by the possibility to turn an excess profit.

The index suffers from other shortcomings. Often the market is difficult to define. Mergers do not always drive prices higher. University of Chicago economists studying Industrial Organization - the branch of economics that deals with competition - have long advocated a shift of emphasis from market share to - usually temporary - market power. Influential antitrust thinkers, such as Robert Bork, recommended to revise the law to focus solely on consumer welfare.

These - and other insights - were incorporated in a theory of market contestability. Contrary to classical economic thinking, monopolies and oligopolies rarely raise prices for fear of attracting new competitors, went the new school. This is especially true in a "contestable" market - where entry is easy and cheap.

An Oligopolistic firm also fears the price-cutting reaction of its rivals if it reduces prices, goes the Hall, Hitch, and Sweezy theory of the Kinked Demand Curve. If it were to raise prices, its rivals may not follow suit, thus undermining its market share. Stackleberg's amendments to Cournot's Competition model, on the other hand, demonstrate the advantages to a price setter of being a first mover.

In "Economic assessment of oligopolies under the Community Merger Control Regulation, in European Competition law Review (Vol 4, Issue 3), Juan Briones Alonso writes:

"At first sight, it seems that ... oligopolists will sooner or later find a way of avoiding competition among themselves, since they are aware that their overall profits are maximized with this strategy. However, the question is much more complex. First of all, collusion without explicit agreements is not easy to achieve. Each supplier might have different views on the level of prices which the demand would sustain, or might have different price preferences according to its cost conditions and market share. A company might think it has certain advantages which its competitors do not have, and would perhaps perceive a conflict between maximising its own profits and maximizing industry profits.

Moreover, if collusive strategies are implemented, and oligopolists manage to raise prices significantly above their competitive level, each oligopolist will be confronted with a conflict between sticking to the tacitly agreed behaviour and increasing its individual profits by 'cheating' on its competitors. Therefore, the question of mutual monitoring and control is a key issue in collusive oligopolies."

Monopolies and oligopolies, went the contestability theory, also refrain from restricting output, lest their market share be snatched by new entrants. In other words, even monopolists behave as though their market was fully competitive, their production and pricing decisions and actions constrained by the "ghosts" of potential and threatening newcomers.

In a CRIEFF Discussion Paper titled "From Walrasian Oligopolies to Natural Monopoly - An Evolutionary Model of Market Structure", the authors argue that: "Under decreasing returns and some fixed cost, the market grows to 'full capacity' at Walrasian equilibrium (oligopolies); on the other hand, if returns are increasing, the unique long run outcome involves a profit-maximising monopolist."

While intellectually tempting, contestability theory has little to do with the rough and tumble world of business. Contestable markets simply do not exist. Entering a market is never cheap, nor easy. Huge sunk costs are required to counter the network effects of more veteran products as well as the competitors' brand recognition and ability and inclination to collude to set prices.

Victory is not guaranteed, losses loom constantly, investors are forever edgy, customers are fickle, bankers itchy, capital markets gloomy, suppliers beholden to the competition. Barriers to entry are almost always formidable and often insurmountable.

In the real world, tacit and implicit understandings regarding prices and competitive behavior prevail among competitors within oligopolies. Establishing a reputation for collusive predatory pricing deters potential entrants. And a dominant position in one market can be leveraged into another, connected or derivative, market.

But not everyone agrees. Ellis Hawley believed that industries should be encouraged to grow because only size guarantees survival, lower prices, and innovation. Louis Galambos, a business historian at Johns Hopkins University, published a 1994 paper titled "The Triumph of Oligopoly". In it, he strove to explain why firms and managers - and even consumers - prefer oligopolies to both monopolies and completely free markets with numerous entrants.

Oligopolies, as opposed to monopolies, attract less attention from trustbusters. Quoted in the Wall Street Journal on March 8, 1999, Galambos wrote: "Oligopolistic competition proved to be beneficial ... because it prevented ossification, ensuring that managements would keep their organizations innovative and efficient over the long run."

In his recently published tome "The Free-Market Innovation Machine - Analysing the Growth Miracle of Capitalism", William Baumol of Princeton University, concurs. He daringly argues that productive innovation is at its most prolific and qualitative in oligopolistic markets. Because firms in an oligopoly characteristically charge above-equilibrium (i.e., high) prices - the only way to compete is through product differentiation. This is achieved by constant innovation - and by incessant advertising.

Baumol maintains that oligopolies are the real engines of growth and higher living standards and urges antitrust authorities to leave them be. Lower regulatory costs, economies of scale and of scope, excess profits due to the ability to set prices in a less competitive market - allow firms in an oligopoly to invest heavily in research and development. A new drug costs c. $800 million to develop and get approved, according to Joseph DiMasi of Tufts University's Center for the Study of Drug Development, quoted in The wall Street Journal.

In a paper titled "If Cartels Were Legal, Would Firms Fix Prices", implausibly published by the Antitrust Division of the US Department of Justice in 1997, Andrew Dick demonstrated, counterintuitively, that cartels are more likely to form in industries and sectors with many producers. The more concentrated the industry - i.e., the more oligopolistic it is - the less likely were cartels to emerge.

Cartels are conceived in order to cut members' costs of sales. Small firms are motivated to pool their purchasing and thus secure discounts. Dick draws attention to a paradox: mergers provoke the competitors of the merging firms to complain. Why do they act this way?

Mergers and acquisitions enhance market concentration. According to conventional wisdom, the more concentrated the industry, the higher the prices every producer or supplier can charge. Why would anyone complain about being able to raise prices in a post-merger market?

Apparently, conventional wisdom is wrong. Market concentration leads to price wars, to the great benefit of the consumer. This is why firms find the mergers and acquisitions of their competitors worrisome. America's soft drink market is ruled by two firms - Pepsi and Coca-Cola. Yet, it has been the scene of ferocious price competition for decades.

"The Economist", in its review of the paper, summed it up neatly:

"The story of America's export cartels suggests that when firms decide to co-operate, rather than compete, they do not always have price increases in mind. Sometimes, they get together simply in order to cut costs, which can be of benefit to consumers."

The very atom of antitrust thinking - the firm - has changed in the last two decades. No longer hierarchical and rigid, business resembles self-assembling, nimble, ad-hoc networks of entrepreneurship superimposed on ever-shifting product groups and profit and loss centers.

Competition used to be extraneous to the firm - now it is commonly an internal affair among autonomous units within a loose overall structure. This is how Jack "neutron" Welsh deliberately structured General Electric. AOL-Time Warner hosts many competing units, yet no one ever instructs them either to curb this internecine competition, to stop cannibalizing each other, or to start collaborating synergistically. The few mammoth agencies that rule the world of advertising now host a clutch of creative boutiques comfortably ensconced behind Chinese walls. Such outfits often manage the accounts of competitors under the same corporate umbrella.

Most firms act as intermediaries. They consume inputs, process them, and sell them as inputs to other firms. Thus, many firms are concomitantly consumers, producers, and suppliers. In a paper published last year and titled "Productive Differentiation in Successive Vertical Oligopolies", that authors studied:

"An oligopoly model with two brands. Each downstream firm chooses one brand to sell on a final market. The upstream firms specialize in the production of one input specifically designed for the production of one brand, but they also produce he input for the other brand at an extra cost. (They concluded that) when more downstream brands choose one brand, more upstream firms will specialize in the input specific to that brand, and vice versa. Hence, multiple equilibria are possible and the softening effect of brand differentiation on competition might not be strong enough to induce maximal differentiation" (and, thus, minimal competition).

Both scholars and laymen often mix their terms. Competition does not necessarily translate either to variety or to lower prices. Many consumers are turned off by too much choice. Lower prices sometimes deter competition and new entrants. A multiplicity of vendors, retail outlets, producers, or suppliers does not always foster competition. And many products have umpteen substitutes. Consider films - cable TV, satellite, the Internet, cinemas, video rental shops, all offer the same service: visual content delivery.

And then there is the issue of technological standards. It is incalculably easier to adopt a single worldwide or industry-wide standard in an oligopolistic environment. Standards are known to decrease prices by cutting down R&D expenditures and systematizing components.

Or, take innovation. It is used not only to differentiate one's products from the competitors' - but to introduce new generations and classes of products. Only firms with a dominant market share have both the incentive and the wherewithal to invest in R&D and in subsequent branding and marketing.

But oligopolies in deregulated markets have sometimes substituted price fixing, extended intellectual property rights, and competitive restraint for market regulation. Still, Schumpeter believed in the faculty of "disruptive technologies" and "destructive creation" to check the power of oligopolies to set extortionate prices, lower customer care standards, or inhibit competition.

Linux threatens Windows. Opera nibbles at Microsoft's Internet Explorer. Amazon drubbed traditional booksellers. eBay thrashes Amazon. Bell was forced by Covad Communications to implement its own technology, the DSL broadband phone line.

Barring criminal behavior, there is little that oligopolies can do to defend themselves against these forces. They can acquire innovative firms, intellectual property, and talent. They can form strategic partnerships. But the supply of innovators and new technologies is infinite - and the resources of oligopolies, however mighty, are finite. The market is stronger than any of its participants, regardless of the hubris of some, or the paranoia of others.

OPEC (Organization of Petroleum Exporting Countries)

As oil prices shot past the $57 mark in the crude futures markets on both sides of the Atlantic, OPEC, in a meeting in March 2005, raised its combined output by 500,000 barrels per day (bpd), reversing a December 2004 decision to cut production by 1 million bpd.

How times change! It is instructive to re-visit the incredibly very recent past.

Just two years ago, OPEC was preoccupied with production cuts. Indonesia's then Energy Minister, Purnomo Yusgiantoro, was unhappy with the modest production cut of 2 million barrels per day, adopted by the Organization of Petroleum Exporting Countries in April 2003, to be implemented from June 1, 2003. At the June 11, 2003 get-together in Qatar, he demanded further reductions.

The deal ultimately struck was so convoluted and loopholed that actual output declined by no more than 600,000 bpd, even with miraculously full compliance. Quotas were first raised before the Iraq war to 27.4 million bpd - a theoretical level, not met by actual supply. Crude prices, entering a period of seasonal weakening, dropped further on the June 2003 OPEC news.

Despite Nigerian and Venezuelan crude recovering from months of strife, this downtrend proved to be temporary. Demand soared in both West and East (China). Global excess capacity is at mere 1 million bpd - one fifth its prewar level and one fifth the amount needed to effectively regulate prices, according to the International Monetary Fund’s next "World Economic Outlook" (published in April 2005).

So, is OPEC dead in the water?

Far from it. As North American and North Sea production decline, the importance of Gulf producers soars. OPEC's eleven countries - Algeria, Indonesia, Iran, Iraq (suspended in 1990, following its invasion of Kuwait), Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates and Venezuela - control one third to two fifths of global oil output and three quarters of the far more important residual demand - traded between net consumers and net exporters. Residual demand is set to double by 2010.

And OPEC counts among its ranks some of its most astute players in the oil markets. Example: Ali al-Naimi, the Saudi oil minister. Al-Naimi is widely credited with engineering the tripling of oil prices to more than $30 a barrel between 1998 and 1999. As the informal boss of the state-owned Saudi oil behemoth, Aramco, he had introduced postwar output cuts. The oil market is so volatile that even marginal production shifts affect prices disproportionately. Al-Naimi is a master of such fine tuning.

Yet, OPEC - led by Saudi Arabia, now off the US buddy list - faces fundamental problems that no tweaking can resolve. Iraq, in the throes of reconstruction and under America's thumb, may opt to exit the club it has founded in 1960 and, thus unfettered, flood the market with its 2.3 to 2.8 million bpd of oil. Insurgency permitting, Iraqi production can reach 7-8 million bpd in six years, completely upsetting the carefully balanced market sharing agreements among OPEC members.

This nightmare may be years away, what with Iraq's dilapidated and much-looted infrastructure and vehement international wrangling over past and future contracts. All the same, it looms menacing over the organization's future.

Far more ominous perils lurk in Russia, the second largest oil producer and growing. Though the cheapest and most abundant reserves are still to be found in the Persian Gulf, Central Asia and Russia are catching up fast.

Saudi Arabia regards itself as the market regulator. It keeps expensive, fully-developed wells idle as a 1.9 million bpd buffer against supply disruptions. It is this "self-sacrificial" policy that endows it with tremendous clout in the energy markets. Only the United States can afford to emulate it - and even then, the Saudi Kingdom still possesses the largest known reserves and sports the lowest extraction costs worldwide.

OPEC is, therefore, not without muscle. Saudi Arabia had punished uppity producers, such as Nigeria, by flooding the markets and pulverizing prices. Yet, the organization is riven by internecine squabbles about market shares and production ceilings. Giants and dwarves cohabit uneasily and collude to choreograph prices in what has long been a buyers' market. These inherent contradictions are detrimental. If OPEC fails to recruit another massive producer (namely: Russia) soon - it is doomed.

Paradoxically, the Iraq war is exactly what the doctor ordered. OPEC's only long-term hope lies in a geopolitical shift, the harbingers of which are already visible. Russia may join the cartel, disenchanted by an imperious and haughty USA - or the Europeans may "adopt" OPEC as a counterweight to the sole "hyperpower" newfound energy preeminence.

America announced its intention to pull out its troops stationed in Saudi Arabia. As this major producer is thrust into the role of the "bad guy", it acquires incentives to team up with other "pariahs" such as France and, potentially, Russia. Controlling the oil taps is a sure way to render the USA less unilateral and more accommodating.

US interests are diametrically opposed to those of oil producers, whether in OPEC's ranks or without. The United States seeks to secure an uninterrupted supply of cheap oil. Yet, a consistently low price level would go a long way towards reducing Russia back to erstwhile penury. It would also destabilize authoritarian and venal regimes throughout the Middle East.

This unsettling realization is dawning now on minds from Paris to Riyadh and from St. Petersburg to Tehran. As the United States looms large over both producers and consumers, the ironic outcome of the Iraqi war may well be a prolonged oil crunch rather than an oil glut.

Organ Trafficking

A kidney fetches $2700 in Turkey. According to the October 2002 issue of the Journal of the American Medical Association, this is a high price. An Indian or Iraqi kidney enriches its former owner by a mere $1000. Wealthy clients later pay for the rare organ up to $150,000.

CBS News aired, five years ago, a documentary, filmed by Antenna 3 of Spain, in which undercover reporters in Mexico were asked, by a priest acting as a middleman for a doctor, to pay close to 1 million dollars for a single kidney. An auction of a human kidney on eBay in February 2000 drew a bid of $100,000 before the company put a stop to it. Another auction in September 1999 drew $5.7 million - though, probably, merely as a prank.

Organ harvesting operations flourish in Turkey, in central Europe, mainly in the Czech Republic, and in the Caucasus, mainly in Georgia. They operate on Turkish, Moldovan, Russian, Ukrainian, Belarusian, Romanian, Bosnian, Kosovar, Macedonian, Albanian and assorted east European donors.

They remove kidneys, lungs, pieces of liver, even corneas, bones, tendons, heart valves, skin and other sellable human bits. The organs are kept in cold storage and air lifted to illegal distribution centers in the United States, Germany, Scandinavia, the United Kingdom, Israel, South Africa, and other rich, industrialized locales. It gives "brain drain" a new, spine chilling, meaning.

Organ trafficking has become an international trade. It involves Indian, Thai, Philippine, Brazilian, Turkish and Israeli doctors who scour the Balkan and other destitute regions for tissues. The Washington Post reported, in November 2002, that in a single village in Moldova, 14 out of 40 men were reduced by penury to selling body parts.

Four years ago, Moldova cut off the thriving baby adoption trade due to an - an unfounded - fear the toddlers were being dissected for spare organs. According to the

Israeli daily, Ha'aretz, the Romanians are investigating similar allegations in Israel and have withheld permission to adopt Romanian babies from dozens of eager and out of pocket couples. American authorities are scrutinizing a two year old Moldovan harvesting operation based in the United States.

Organ theft and trading in Ukraine is a smooth operation. According to news agencies, in August 2002, three Ukrainian doctors were charged in Lvov with trafficking in the organs of victims of road accidents. The doctors used helicopters to ferry kidneys and livers to colluding hospitals. They charged up to $19,000 per organ.

The West Australian daily surveyed in January 2002 the thriving organs business in Bosnia-Herzegovina. Sellers are offering their wares openly, through newspaper ads. Prices reach up to $68,000. Compared to an average monthly wage of less than $200, this is an unimaginable fortune.

National health insurance schemes turn a blind eye. Israel's participates in the costs of purchasing organs abroad, though only subject to rigorous vetting of the sources of the donation. Still, a May 2001 article in a the New York Times Magazine, quotes "the coordinator of kidney transplantation at Hadassah University Hospital in Jerusalem (as saying that) 60 of the 244 patients currently receiving post-transplant care purchased their new kidney from a stranger - just short of 25 percent of the patients at one of Israel's largest medical centers participating in the organ business".

Many Israelis - attempting to avoid scrutiny - travel to east Europe, accompanied by Israeli doctors, to perform the transplantation surgery. These junkets are euphemistically known as "transplant tourism". Clinics have sprouted all over the benighted region. Israeli doctors have recently visited impoverished Macedonia, Bulgaria, Kosovo and Yugoslavia to discuss with local businessmen and doctors the setting up of kidney transplant clinics.

Such open involvement in what can be charitably described as a latter day slave trade gives rise to a new wave of thinly disguised anti-Semitism. The Ukrainian Echo, quoting the Ukrinform news agency, reported, on January 7, 2002, that, implausibly, a Ukrainian guest worker died in Tel-Aviv in mysterious circumstances and his heart was removed. The Interpol, according to the paper, is investigating this lurid affair.

According to scholars, reports of organ thefts and related abductions, mainly of children, have been rife in Poland and Russia at least since 1991. The buyers are supposed to be rich Arabs.

Nancy Scheper-Hughes, an anthropologist at the University of California at Berkeley and co-founder of Organs Watch, a research and documentation center, is also a member and co-author of the Bellagio Task Force Report on Transplantation, Bodily Integrity and the International Traffic in Organs. In a report presented in June 2001 to the House Subcommittee on International Operations and Human Rights, she substantiated at least the nationality of the alleged buyers, though not the urban legends regarding organ theft:

"In the Middle East residents of the Gulf States (Kuwait, Saudi Arabia, and Oman) have for many years traveled to

India, the Philippines, and to Eastern Europe to purchase kidneys made scarce locally due to local fundamentalist Islamic teachings that allow organ transplantation (to save a life), but prohibit organ harvesting from brain-dead bodies.

Meanwhile, hundreds of kidney patients from Israel, which has its own well -developed, but under-used transplantation centers (due to ultra-orthodox Jewish reservations about brain death) travel in 'transplant tourist' junkets to Turkey, Moldova, Romania where desperate kidney sellers can be found, and to Russia where an excess of lucrative cadaveric organs are produced due to lax standards for designating brain death, and to South Africa where the amenities in transplantation clinics in private hospitals can resemble four star hotels.

We found in many countries - from Brazil and Argentina to India, Russia, Romania, Turkey to South Africa and parts of the United States - a kind of 'apartheid medicine' that divides the world into two distinctly different populations of 'organs supplies' and 'organs receivers'."

Russia, together with Estonia, China and Iraq, is, indeed, a major harvesting and trading centre. International news agencies described, five years ago, how a grandmother in Ryazan tried to sell her grandchild to a mediator. The boy was to be smuggled to the West and there dismembered for his organs. The uncle, who assisted in the matter, was supposed to collect $70,000 - a fortune in Russian terms.

When confronted by the European Union on this issue, Russia responded that it lacks the resources required to monitor organ donations. The Italian magazine, Happy Web, reports that organ trading has taken to the Internet.

A simple query on the Google search engine yields thousands of Web sites purporting to sell various body parts - mostly kidneys - for up to $125,000. The sellers are Russian, Moldovan, Ukrainian and Romanian.

Scheper-Hughes, an avid opponent of legalizing any form of trade in organs, says that "in general, the movement and flow of living donor organs - mostly kidneys - is from South to North, from poor to rich, from black and brown to white, and from female to male bodies".

Yet, in the summer of 2002, bowing to reality, the American Medical Association commissioned a study to examine the effects of paying for cadaveric organs would have on the current shortage. The 1984 National Organ Transplant Act that forbids such payments is also under attack. Bills to amend it were submitted recently by several Congressmen. These are steps in the right direction.

Organ trafficking is the outcome of the international ban on organ sales and live donor organs. But wherever there is demand there is a market. Excruciating poverty of potential donors, lengthening patient waiting lists and the better quality of organs harvested from live people make organ sales an irresistible proposition. The medical professions and authorities everywhere would do better to legalize and regulate the trade rather than transform it into a form of organized crime. The denizens of Moldova would surely appreciate it.

P-Q

Pakistan, Economy of

Causing trouble is sometimes a profitable business. The Taliban is, to a large extent, the creation of Pakistan. Yet, it stands to benefit greatly, economically as well as politically, from the destruction of the Taliban at the hands of the anti-terror coalition. In the process, its autonomous and contumacious intelligence services keep supplying the Taliban with food and weapons. The government denies either knowledge or responsibility but the border remains porous, to the economic benefit of many.

The self-appointed President of Pakistan, General Pervez Musharraf, said a few months ago that Pakistan was "on the road to economic recovery". This was incompatible with a simultaneous official reduction in the economic growth target of country (from 4.5% to 3.8%). But, in May, Pakistan's debt was being rescheduled with the blessings of the IMF (which contributed 200 million US dollars to the effort) and the World Bank (in the process of approving $700 million in soft loans). Yet another Paris Club rescheduling seemed imminent.

Two months later, talk was in the air about a multinationally-managed natural (non-liquefied) gas pipeline from Iran to India, through Pakistani territory. "The Economist" (July 14, 2001) estimated that "... the pipeline might yield Pakistan anything from $250m to $600m a year in transit fees".

There was cause for this optimism.

To their credit, Musharraf's skilled economic team of technocrats went where their predecessors feared to tread. They imposed a highly unpopular and much protested against sales tax on all retail trade. Musharraf threatened to imprison tax evaders and debt defaulters and backed his threat with (constitutionally dubious) arrests. The immediate result was that tax collection (by the outlandishly corrupt tax authorities) increased by c. $800 million in the 12 months to June 30, 2001 (the end of the Pakistani fiscal year) - though mostly from import inhibiting exorbitant customs and indirect taxes.

Funds, doled out by corrupt bank managers to defunct enterprises and used to roll over bad loans - were suddenly recalled. The hitherto symbolic prices of oft-wasted and oft-stolen oil, gas, and electricity were gradually increased and subsidies to state-owned utilities (such as cotton mills) decreased. This brought about a belated wave of painful restructuring and Pakistan's shambolic and patronage-based industries almost evaporated. Serious privatization is on the cards. The phone company is up for grabs and all privatization proceeds (optimists put them at $3 billion, realists at a billion dollars less) are earmarked to pay off foreign debt. The budget deficit stabilized around 5% of GDP (compared to 6.5% the year before), aided by a cut in defence spending (which reached 6% in 1997 but deteriorated ever since compared to India, whose defence spending increased by 40% in the same period). Despite growing energy costs, inflation was tamed, down to 4% (2000) from 8% (1999).

Yet, tax revenues are still less than 17% of GDP and less than 1.5% of all taxpayers bother to file tax returns of any kind. In other words, these largely cosmetic measures failed to tackle the systemic failure that passes for Pakistan's economy. Reform - both economic and political - was still sluggish and half-hearted, Pakistan's current account deficits ballooned (to $3 billion in 1999), the geopolitical neighbourhood roughened, and the world economy dived. Pakistan's imminent economic collapse looked inevitable.

Then came September 11. Weeks later, US sanctions imposed on Pakistan since 1990 and 1998 (following its nuclear tests) were waived by President Bush and he rescheduled $400 million in Pakistani debt to various agencies of the US administration. The predicted wave - which has yet to materialize - of 1.5 million Afghan refugees - was worth to Pakistan $600 million in US aid alone ($150 million of which were already disbursed).

The IMF - ostensibly an independent organization bent on economic reform and impervious to geopolitical concerns - swiftly switched from tentative approval (the second tranche of the almost twentieth IMF loan was approved in August, before the attacks) to unmitigated praise regarding Pakistan's economic (mis)management. The $200 million it so reluctantly promised in May and the $1 billion a year (for a period of 2-3 years) Pakistan was hoping to secure in August gleefully mushroomed to $2.5-3.5 billion in October. The rupee shot up in response. Debt forgiveness is discussed with Pakistan accorded a status of HIPC - Highly Indebted Poor Country - which it, otherwise, doesn't deserve, on pure macroeconomic grounds.

Consider this:

On September 10, each citizen of Pakistan, man, woman, and infant, owed only $300 in external government debt. This represented a mere 60% of GDP per capita (or 53% of GDP) in 1997. On that same year, Pakistan's GDP per capita was 25% higher than India's, average GDP growth in the two decades to 1997 was 5.7% p.a. (India - 5.8%), and it was rated 3.4 (India - 3.7) on the economic freedom index. After a dip in 1999 (3.1%) - growth picked up again to 4.5% , fuelled by bumper cotton and wheat crops in 2000. Pakistani citizens had as many durables as Indians. Definitely not an HIPC, Pakistan is an emerging middle-class east Asian country.

Admittedly, though, the picture is not entirely rosy.

Pakistan's external debt - mainly used to finance consumption and to plug holes in its uninterrupted string of unsustainable government budgets - was double India's (as proportion of GDP) and it had only 4% of India's foreign exchange reserves (c. $1 billion, enough for three weeks of imports). Per capita, it had 30% as much as India's foreign exchange reserves. As default loomed, growth collapse to 2.6% in 1995-2000, barely enough to sustain the increase in population. The usual IMF prescription (austerity) served only to depress consumption and deter FDI. Foreign direct investment was identical in both 2000 and 1988 - a meager $180 million (less than FDI in Kosovo's neighbour, Macedonia, with its 2 million citizens to Pakistan's 140 million).

Luckily for it, Pakistan has a (largely underground) vibrant though impromptu private sector which fills the vacuum left by the nefarious public sector. Many ostensibly public goods - from bus services to schools, from clinics to policing, from public toilettes to farming -

are affordably provided by domestic, small time, entrepreneurs often aided by NGO's.

Yet, an economy is more than the sum of its statistics. A failed, feeble, passive-aggressive central government is largely supplanted in Pakistan by criminally-tainted regional political networks of patronage, venality, nepotism, and cronyism. More than 50% of all food aid may be squandered, "taxed" by local functionaries. Teachers pay schoolmasters a portion of salaries not to teach. Maintenance workers, sanitary squads, telephone installers, medical doctors, surgeons, professors in universities, policemen - all demand, and receive, bribes to fulfill their duties, or, more often, to turn a blind eye. Pakistan habitually trails the The UNDP's Human Development Index (which takes into account the quality of life - things like life expectancy, literacy, and gender and income inequalities). This dismal showing is after Pakistan made strides in literacy, life expectancy and decreasing infant mortality.

Since independence in 1947, Pakistan's GNP has quadrupled and income per capita has doubled. But it still spends more on defence than on health and education combined and less than most developing countries. The botched experiments with "Islamic economy" did not help. Pakistan, like certain belles, still survives on the kindness of others - remittances by expatriates and other external capital flows account for 10% of GDP and 50% of domestic investment. And the main export of this country is its skilled manpower - despite its surprisingly diverse economy. Less than one third of Pakistanis bother to vote - a clear and sad statement by abstention.

Patent Law

Forgent Networks from Texas wants to collect a royalty every time someone compresses an image using the JPEG algorithm. It urges third parties to negotiate with it separate licensing agreements. It bases its claim on a 17 year old patent it acquired in 1997 when VTel, from which Forgent was spun-off, purchased the San-Jose based Compression Labs.

The patent pertains to a crucial element in the popular compression method. The JPEG committee of ISO - the International Standards Organization - threatens to withdraw the standard altogether. This would impact thousands of software and hardware products.

This is only the latest in a serious of spats. Unisys has spent the better part of the last 15 years trying to enforce a patent it owns for a compression technique used in two other popular imaging standards, GIF and TIFF. BT Group sued Prodigy, a unit of SBC Communications, in a US federal court, for infringement of its patent of the hypertext link, or hyperlink - a ubiquitous and critical element of the Web. Dell Computer has agreed with the FTC to refrain from enforcing a graphics patent having failed to disclose it to the standards committee in its deliberations of the VL-bus graphics standard.

"Wired" reported yesterday that the Munich Upper Court declared "deep linking" - posting links to specific pages within a Web site - in violation the European Union "Database Directive". The directive copyrights the "selection and arrangement" of a database - even if the content itself is not owned by the database creator. It explicitly prohibits hyperlinking to the database contents as "unfair extraction". If upheld, this would cripple most search engines. Similar rulings - based on national laws - were handed down in other countries, the latest being Denmark.

Amazon sued Barnes and Noble - and has since settled out of court in March - for emulating its patented "one click purchasing" business process. A Web browser command to purchase an item generates a "cookie" - a text file replete with the buyer's essential details which is then lodged in Amazon's server. This allows the transaction to be completed without a further confirmation step.

A clever trick, no doubt. But even Jeff Bezos, Amazon's legendary founder, expressed doubts regarding the wisdom of the US Patent Office in granting his company the patent. In an open letter to Amazon's customers, he called for a rethinking of the whole system of protection of intellectual property in the Internet age.

In a recently published discourse of innovation and property rights, titled "The Free-Market Innovation Machine", William Baumol of Princeton University claims that only capitalism guarantees growth through a steady flow of innovation. According to popular lore, capitalism makes sure that innovators are rewarded for their time and skills since property rights are enshrined in enforceable contracts.

Reality is different, as Baumol himself notes. Innovators tend to maximize their returns by sharing their technology and licensing it to more efficient and profitable manufacturers. This rational division of labor is hampered by the increasingly more stringent and expansive intellectual property laws that afflict many rich countries nowadays. These statutes tend to protect the interests of middlemen - manufacturers, distributors, marketers - rather than the claims of inventors and innovators.

Moreover, the very nature of "intellectual property" is in flux. Business processes and methods, plants, genetic material, strains of animals, minor changes to existing technologies - are all patentable. Trademarks and copyright now cover contents, brand names, and modes of expression and presentation. Nothing is safe from these encroaching juridical initiatives. Intellectual property rights have been transformed into a myriad pernicious monopolies which threaten to stifle innovation and competition.

Intellectual property - patents, content libraries, copyrighted material, trademarks, rights of all kinds - are sometimes the sole assets - and the only hope for survival - of cash-strapped and otherwise dysfunctional or bankrupt firms. Both managers and court-appointed receivers strive to monetize these properties and patent-portfolios by either selling them or enforcing the rights against infringing third parties.

Fighting a patent battle in court is prohibitively expensive and the outcome uncertain. Potential defendants succumb to extortionate demands rather than endure the Kafkaesque process. The costs are passed on to the consumer. Sony, for instance already paid Forgent an undisclosed amount in May. According to Forgent's 10-Q form, filed on June 17, 2002, yet another, unidentified "prestigious international" company, parted with $15 million in April.

In commentaries written in 1999-2000 by Harvard law professor, Lawrence Lessig, for "The Industry Standard", he observed:

"There is growing skepticism among academics about whether such state-imposed monopolies help a rapidly evolving market such as the Internet. What is 'novel', 'nonobvious' or 'useful' is hard enough to know in a relatively stable field. In a transforming market, it's nearly impossible..."

The very concept of intellectual property is being radically transformed by the onslaught of new technologies.

The myth of intellectual property postulates that entrepreneurs assume the risks associated with publishing books, recording records, and inventing only because - and where - the rights to intellectual property are well defined and enforced. In the absence of such rights, creative people are unlikely to make their works accessible to the public. Ultimately, it is the public which pays the price of piracy and other violations of intellectual property rights, goes the refrain.

This is untrue. In the USA only few authors actually live by their pen. Even fewer musicians, not to mention actors, eke out subsistence level income from their craft. Those who do can no longer be considered merely creative people. Madonna, Michael Jackson, Schwarzenegger and Grisham are businessmen at least as much as they are artists.

Intellectual property is a relatively new notion. In the near past, no one considered knowledge or the fruits of creativity (artwork, designs) as 'patentable', or as someone's 'property'. The artist was but a mere channel through which divine grace flowed. Texts, discoveries, inventions, works of art and music, designs - all belonged to the community and could be replicated freely. True, the chosen ones, the conduits, were revered. But they were rarely financially rewarded.

Well into the 19th century, artists and innovators were commissioned - and salaried - to produce their works of art and contrivances. The advent of the Industrial Revolution - and the imagery of the romantic lone inventor toiling on his brainchild in a basement or, later, a garage - gave rise to the patent. The more massive the markets became, the more sophisticated the sales and marketing techniques, the bigger the financial stakes - the larger loomed the issue of intellectual property.

Intellectual property rights are less about the intellect and more about property. In every single year of the last decade, the global turnover in intellectual property has outweighed the total industrial production of the world. These markets being global, the monopolists of intellectual products fight unfair competition globally. A pirate in Skopje is in direct rivalry with Bill Gates, depriving Microsoft of present and future revenue, challenging its monopolistic status as well as jeopardizing its competition-deterring image.

The Open Source Movement weakens the classic model of property rights by presenting an alternative, viable, vibrant, model which does not involve over-pricing and anti-competitive predatory practices. The current model of property rights encourages monopolistic behavior, non-collaborative, exclusionary innovation (as opposed, for instance, to Linux), and litigiousness. The Open Source movement exposes the myths underlying current property rights philosophy and is thus subversive.

But the inane expansion of intellectual property rights may merely be a final spasm, threatened by the ubiquity of the Internet as they are. Free scholarly online publications nibble at the heels of their pricey and anticompetitive offline counterparts. Electronic publishing poses a threat - however distant - to print publishing. Napster-like peer to peer networks undermine the foundations of the music and film industries. Open source software is encroaching on the turf of proprietary applications. It is very easy and cheap to publish and distribute content on the Internet, the barriers to entry are virtually nil.

As processors grow speedier, storage larger, applications multi-featured, broadband access all-pervasive, and the Internet goes wireless - individuals are increasingly able to emulate much larger scale organizations successfully. A single person, working from home, with less than $2000 worth of equipment - can publish a Webzine, author software, write music, shoot digital films, design products, or communicate with millions and his work will be indistinguishable from the offerings of the most endowed corporations and institutions.

Obviously, no individual can yet match the capital assets, the marketing clout, the market positioning, the global branding, the sales organization, and the distribution network of the likes of Sony, or Microsoft. In an age of information glut, it is still the marketing, the media campaign, the distribution, and the sales that determine the economic outcome.

This advantage, however, is also being eroded, albeit glacially.

The Internet is essentially a free marketing and - in the case of digital goods - distribution channel. It directly reaches 200 million people all over the world. Even with a minimum investment, the likelihood of being seen by surprisingly large numbers of consumers is high. Various business models are emerging or reasserting themselves - from ad sponsored content to packaged open source software.

Many creative people - artists, authors, innovators - are repelled by the commercialization of their intellect and muse. They seek - and find - alternatives to the behemoths of manufacturing, marketing and distribution that today control the bulk of intellectual property. Many of them go freelance. Indie music labels, independent cinema, print on demand publishing - are omens of things to come.

This inexorably leads to disintermediation - the removal of middlemen between producer or creator and consumer. The Internet enables niche marketing and restores the balance between the creative genius and the commercial exploiters of his product. This is a return to pre-industrial times when artisans ruled the economic scene.

Work mobility increases in this landscape of shifting allegiances, head hunting, remote collaboration, contract and agency work, and similar labour market trends. Intellectual property is likely to become as atomized as labor and to revert to its true owners - the inspired folks. They, in turn, will negotiate licensing deals directly with their end users and customers.

Capital, design, engineering, and labor intensive goods - computer chips, cruise missiles, and passenger cars - will still necessitate the coordination of a massive workforce in multiple locations. But even here, in the old industrial landscape, the intellectual contribution to the collective effort will likely be outsourced to roving freelancers who will maintain an ownership stake in their designs or inventions.

This intimate relationship between creative person and consumer is the way it has always been. We may yet look back on the 20th century and note with amazement the transient and aberrant phase of intermediation - the Sony's, Microsoft's, and Forgent's of this world.

Pharmaceuticals (in Central and East Europe)

In early October 2006, New Jersey-based Barr Pharmaceuticals Inc. has acquired 73% of Pliva Pharmaceuticals, Croatia's and, arguably, the Balkans' largest pharmaceutical company. Pliva, established in the 1920s, specializes in generic drugs. Barr paid almost 3 billion US dollars for its acquisition.

But Pliva is way beyond its prime. In the 1980s it was a major player in the research and development of new drugs in the Eastern Bloc. It maintained facilities in Poland, the Czech Republic, and Hungary. Pliva's antibiotic Sumamed is still a bestseller throughout Europe. But a few years ago it shut down all its non-manufacturing operations and concentrate on marketing its stable of brand and generic drugs through 30 affiliates the world over.

Novartis, the Swiss drug giant announced In mid-January 2003 that it will unite its 14 brands of generic drugs under the Sandoz name, harking back to its origins as a manufacturer of affordable, off-patent, medication and raw materials ("active ingredients"). The rebranding will engulf the company's central and east European units, including Biochemie in Austria and Azupharma in Germany - but not Lek in Slovenia.

This exclusion signifies the strength of the pharmaceuticals sector in the formerly communist countries in transition. Even in economically abysmal Macedonia, Alkaloid, a local drug manufacturer, is thriving. It employs almost 1400 workers and dabbles in chemicals, coatings and cosmetics. It is locally renowned for its research and development, heavy investment in quality control and high wages.

Alkaloid is a veritable multinational with operations in Switzerland, Russia, Slovenia, Croatia, Bosnia & Herzegovina, Yugoslavia, Bulgaria and Albania. It is partly owned by the European Bank for Reconstruction and Development (EBRD) and the World Bank's International Finance Corporation (IFC).

Still, with annual sales of c. $50 million, it is a minion compared to the likes of Lek Slovenia and the Croatian Pliva.

Lek Slovenia has subsidiaries in twenty countries, including Nigeria, Pakistan and virtually all of central and east Europe. Besides drugs, the group manufactures - usually through autonomous companies - animal care products as well as medical devices.

The group employs 4000 people worldwide. Production is distributed. In July 2002, Lek laid the foundation stone for a factory in Romania, for instance. This was followed in September 2002 by a cornerstone for a new logistics and production center in Poland. It maintains representative offices from Bulgaria to China.

Lek is an aggressive mid-sized player. It just started marketing, in the lucrative US market, Augmentin, the generic form of GalxoSmithKline's (GSK) off-patent blockbuster. GSK promptly sued Lek and three other firms in Switzerland, India and Israel. But Lek is undeterred. It expected to sell $100 million of Amoxiclav, its version of the drug annually - but booked $27 million of orders on the first day.

Lek's sales exceeded $420 million in 2002 and grew by a whopping 42 percent the year after, according to its management. Most of this phenomenal growth is attributable to Amoxiclav.

Pliva is by far the region's pharmaceutical behemoth. With its $750 million in consolidated revenues and 30 percent income growth rate it combines a mid-tech business with hi-tech growth. Pliva's net income in 2002 exceeded $140 million and earnings before interest and taxes - excluding extraordinary items - is at a respectable, though uninspiring, 8 percent.

The expiry in 2005, of the US patent of Azithromycin, the company's flagship product, made a serious dent in its portfolio. It is feverishly developing in-house generic and specialty products to weather the anticipated blow to revenues and operating profits. Pliva has R&D

collaboration agreements with leading global pharmaceutical firms, such as GlaxoSmithKline.

Pliva's total assets are close to $1.5 billion with $750 million in shareholders' equity. Its current cash flow is much sounder than in the early 2000s though the picture is marred by a precipitously declining net working capital and hefty increases in liabilities. Pliva's leverage surged by almost half to 57 percent by end-September 2002.

The company is expanding aggressively throughout the world, even in in rich markets such as the United States, where it purchased Sidmak Laboratories last year and Denmark, where it took over 2K Pharmaceuticals (renamed Pliva Pharma Nordic). Other target countries included Germany, France, the United Kingdom and the Czech Republic. In 2002, the first drug developed in-house by Pliva was registered in the European Union.

Pliva's cosmetics, food and agrochemicals production units were divested and spun off as stand alone companies. Some of these, in turn, were sold to erstwhile competitors. Like many European drug companies, Pliva subcontracts the manufacture of many of its formulas to cheaper developing countries, such as India, where, earlier this month, it inked an agreement with a production and marketing outfit called Kopran.

Pliva also doubles as a distributor. In October 2002, for instance, it became the exclusive distributor in central and east Europe, NIS and Turkey of the British firm, Allergy Therapeutics. These regional markets - even the most advanced ones in the EU candidates - are considered so idiosyncratic and risky that western manufacturers opt to work through indigenous venues rather than establish their own presence.

Consider one of the most promising - and hitherto, disappointing - markets: the Czech Republic and Slovakia. It is teeming with activity. In January 2003, for instance, Warburg Pincus, an American investment fund, acquired Slovakofarma by merging it with Leciva, another Slovak manufacturer double its size. This yielded the largest pharmaceutical firm in central Europe with intentions to expand in Poland, Russia and the countries of the former USSR.

Yet, underneath the veneer of civility and financial froth lurk serious faults.

Producers are forced by Czech healthcare providers, health authorities and domestic insurance companies to trim their prices. Even so, the entire health care system in the Czech republic - especially public hospitals - is close to insolvency. The Prague Tribune reported how AVEL - the Association of Drug Distributors - decided to sue debtor hospitals. Among the litigants, pharmaceutical distributors Aliance Unichem, Phoenix, Purus, and Gehe, which account for 70% of the market, and are owed c. $25 million. This illiquidity and coercive differential pricing encourage the use of cheap generics.

The Prague Tribune quotes Pavol Mazan, the executive director of the International Association of Pharmaceutical Companies (MAFS):

"The Ministry of Health boasts that in this country there is a fully paid drug for every disease. But the problem is that a drug paid for (by the insurer) is the least

expensive, and in many cases it is less effective. The result is that of the six most important therapeutic groups, there are no new, imported drugs in five of them."

The paper notes that, in the Czech Republic, generic drugs account for 45 percent of all medications sold, compared to 15 percent in the EU. Next year's accession is supposed to improve market conditions considerably, though.

The stories of drug companies in central and east Europe revolve around the same axes: international diversification, poaching the off-patent portfolios of other pharmaceuticals, mixing generic and specialty drugs, in-house research and development heavily titled towards generics, expanding through mergers and acquisitions, subcontracting production to cheaper locales, divesting non-core activities and catering to the marketing and distribution needs in central and east Europe of American and west European drug multinationals.

Consolidation is inevitable. Global giants, such as Novartis (Europe's third largest) are already gobbling up mid-sized manufacturers in the countries in transition. These, in turn, look to purchase and assimilate small to puny producers, such as Alkaloid in Macedonia. Those who survive the onslaught will be either huge (by regional standards) or specialty niche players (boutiques). Such polarity will make for a much healthier industry, able to invest in the spiraling R&D costs of new product development.

Ponzi and Pyramid Schemes – See: Scandals, Financial

(Over)Population

The latest census in Ukraine revealed an apocalyptic drop of 10% in its population - from 52.5 million a decade ago to a mere 47.5 million last year. Demographers predict a precipitous decline of one third in Russia's impoverished, inebriated, disillusioned, and ageing citizenry. Births in many countries in the rich, industrialized, West are below the replacement rate. These bastions of conspicuous affluence are shriveling.

Scholars and decision-makers - once terrified by the Malthusian dystopia of a "population bomb" - are more sanguine now. Advances in agricultural technology eradicated hunger even in teeming places like India and China. And then there is the old idea of progress: birth rates tend to decline with higher education levels and growing incomes. Family planning has had resounding successes in places as diverse as Thailand, China, and western Africa.

In the near past, fecundity used to compensate for infant mortality. As the latter declined - so did the former. Children are means of production in many destitute countries. Hence the inordinately large families of the past - a form of insurance against the economic outcomes of the inevitable demise of some of one's off-spring.

Yet, despite these trends, the world's populace is augmented by 80 million people annually. All of them are born to the younger inhabitants of the more penurious corners of the Earth. There were only 1 billion people alive in 1804. The number doubled a century later.

But our last billion - the sixth - required only 12 fertile years. The entire population of Germany is added every half a decade to both India and China. Clearly, Mankind's growth is out of control, as affirmed in the 1994 Cairo International Conference on Population and Development.

Dozens of millions of people regularly starve - many of them to death. In only one corner of the Earth - southern Africa - food aid is the sole subsistence of entire countries. More than 18 million people in Zambia, Malawi, and Angola survived on charitable donations in 1992. More than 10 million expect the same this year, among them the emaciated denizens of erstwhile food exporter, Zimbabwe.

According to Medecins Sans Frontiere, AIDS kills 3 million people a year, Tuberculosis another 2 million. Malaria decimates 2 people every minute. More than 14 million people fall prey to parasitic and infectious diseases every year - 90% of them in the developing countries.

Millions emigrate every year in search of a better life. These massive shifts are facilitated by modern modes of transportation. But, despite these tectonic relocations - and despite famine, disease, and war, the classic Malthusian regulatory mechanisms - the depletion of natural resources - from arable land to water - is undeniable and gargantuan.

Our pressing environmental issues - global warming, water stress, salinization, desertification, deforestation, pollution, loss of biological diversity - and our ominous social ills - crime at the forefront - are traceable to one, politically incorrect, truth:

There are too many of us. We are way too numerous. The population load is unsustainable. We, the survivors, would be better off if others were to perish. Should population growth continue unabated - we are all doomed.

Doomed to what?

Numerous Cassandras and countless Jeremiads have been falsified by history. With proper governance, scientific research, education, affordable medicines, effective family planning, and economic growth - this planet can support even 10-12 billion people. We are not at risk of physical extinction and never have been.

What is hazarded is not our life - but our quality of life. As any insurance actuary will attest, we are governed by statistical datasets.

Consider this single fact:

About 1% of the population suffer from the perniciously debilitating and all-pervasive mental health disorder, schizophrenia. At the beginning of the 20th century, there were 16.5 million schizophrenics - nowadays there are 64 million. Their impact on friends, family, and colleagues is exponential - and incalculable. This is not a merely quantitative leap. It is a qualitative phase transition.

Or this:

Large populations lead to the emergence of high density urban centers. It is inefficient to cultivate ever smaller plots of land. Surplus manpower moves to centers of industrial production. A second wave of internal migrants caters to their needs, thus spawning a service sector.

Network effects generate excess capital and a virtuous cycle of investment, employment, and consumption ensues.

But over-crowding breeds violence (as has been demonstrated in experiments with mice). The sheer numbers involved serve to magnify and amplify social anomies, deviate behaviour, and antisocial traits. In the city, there are more criminals, more perverts, more victims, more immigrants, and more racists per square mile.

Moreover, only a planned and orderly urbanization is desirable. The blights that pass for cities in most third world countries are the outgrowth of neither premeditation nor method. These mega-cities are infested with non-disposed of waste and prone to natural catastrophes and epidemics.

No one can vouchsafe for a "critical mass" of humans, a threshold beyond which the species will implode and vanish.

Luckily, the ebb and flow of human numbers is subject to three regulatory demographic mechanisms, the combined action of which gives hope.

The Malthusian Mechanism

Limited resources lead to wars, famine, and diseases and, thus, to a decrease in human numbers. Mankind has done well to check famine, fend off disease, and staunch war. But to have done so without a commensurate policy of population control was irresponsible.

The Assimilative Mechanism

Mankind is not divorced from nature. Humanity is destined to be impacted by its choices and by the reverberations of its actions. Damage caused to the environment haunts - in a complex feedback loop - the perpetrators.

Examples:

Immoderate use of antibiotics leads to the eruption of drug-resistant strains of pathogens. A myriad types of cancer are caused by human pollution. Man is the victim of its own destructive excesses.

The Cognitive Mechanism

Humans intentionally limit the propagation of their race through family planning, abortion, and contraceptives. Genetic engineering will likely intermesh with these to produce "enhanced" or "designed" progeny to specifications.

We must stop procreating. Or, else, pray for a reduction in our numbers.

This could be achieved benignly, for instance by colonizing space, or the ocean depths - both remote and technologically unfeasible possibilities.

Yet, the alternative is cataclysmic. Unintended wars, rampant disease, and lethal famines will ultimately trim our numbers - no matter how noble our intentions and how diligent our efforts to curb them.

Is this a bad thing?

Not necessarily. To my mind, even a Malthusian resolution is preferable to the alternative of slow decay, uniform impecuniosity, and perdition in instalments - an alternative made inexorable by our collective irresponsibility and denial.

From an interview granted to Transitions Online, August 2008

The Macedonian government has initiated a campaign to provide economic support and benefits to families with children.

Q: Do you think that the economy maybe influences the society in some other way - maybe with the young people going out of the country to work, or the fact that the majority of the workers don't have free time for the family or...?

A: The fact is that the poor people have more children. The highest birth rates in the world are registered in Africa and parts of Asia with less than 1 US dollar a day in income. Birth rates decline as people become more educated and wealthier. The lowest birth rates in the world are in Germany, Scandinavia, and California. Even within Macedonia, poor minorities have the most children per household.

People tend to rationalize their decision not to procreate by using economic excuses. The truth is that many of them simply put career, money-making, enjoying life, and seeing the world ahead of having children. It is a shift in social values and priorities, not a decision driven by harsh economic realities (and, admittedly, in Macedonia they are harsh).

Q: What is according to you the best idea to stimulate the people to have children? What is your opinion about this whole campaign? How it may effect
the economy on short, medium and on long term???

A: Not every problem can be solved by throwing money at it. Modern civilization is self-centered, individualistic, hedonistic, and narcissistic. People put themselves and their interests first. Experience from countries such as Israel, France, Germany, and Scandinavia where childbirth and childrearing are heavily subsidized shows that government intervention is futile and a colossal waste of resources. In the medium to long-term, it has zero (insignificant) statistical effect. In all these countries - despite the fact that these policies are still being implemented - population growth is flat to negative (except in Israel and France which have a lot of immigrants).

Instead of encouraging women to have more children, the government should make sure that current families and households are well catered to: workplace discrimination against pregnant women and women in childbirth ages should be outlawed and persecuted; day care centers should be opened and made available to young mothers; parenting classes and free medical care should be rendered accessible and affordable; a whole gamut of goods and services - from public transport to formula milk to textbooks should be made free to families with more than 4 children; maternity wards should be improved and modernized; new mothers should have preference in professional re-skilling and re-training.

Poverty (in Central and Eastern Europe)

Many of the nations of central and east Europe have spent most of their history as components of one empire or another. People in this region are used to be at the receiving end of directives and planning from the center. Though ostensibly fervid nationalists, they are ill at ease with their re-founded and re-found nation-states.

The identity of the denizens of these parts is more regional than national and evolving towards the supra-national. People are from this or that city, or district, or village. And they aspire to become citizens of Europe and the great experiment of the European Union. They are only hesitantly and tentatively Macedonians, or Moldovans, or Belarusians, or Kazakhs, or Yugoslavs.

The likes of the Czechs, the Estonians and the Slovenes are well-suited to become constituents of a larger whole. They make better Europeans than the British, or the Norwegians. They have survived far mightier and more bloated bureaucracies than Brussels'. They are unsurpassed manipulators of officialdom. In the long run, the new members stand to benefit the most from the EU's enlargement and to form its unwaveringly loyal core.

Not yet the full-fledged individualists of the Anglo-Saxon model of capitalism - these nations are consensus-seeking team-players. Tutored by centuries of occupation and hardship, they are instinctual multilateralists. They are avid Westerners by persuasion, if not yet in practice, or geography.

Moreover, their belated conversion to the ways of the market is an undisguised blessing.

Though still a promise largely unfulfilled, the countries in transition could now leapfrog whole stages of development by adopting novel technologies and through them the expensive Western research they embody. The East can learn from the West's mistakes and, by avoiding them, achieve a competitive edge.

Technology is a social phenomenon with social implications. It fosters entrepreneurship and social mobility. By allowing the countries in transition to skip massive investments in outdated technologies - the cellular phone, the Internet, cable TV, and the satellite become shortcuts to prosperity.

Poverty is another invaluable advantage.

With the exception of Slovenia, Estonia, Croatia and the Czech Republic - the population of the countries in transition is poor, sometimes inordinately so. Looming and actual penury is a major driver of entrepreneurship, initiative and innovation. Wealth formation and profit seeking are motivated by indigence, both absolute and relative. The poor seek to better their position in the world by becoming middle-class. They invest in education, in small businesses, in consumer products, in future generations.

The Germans - sated and affluent - are unlikely to experience a second economic miracle. The Serbs, Albanians, Ukrainians, Poles, or Romanians won't survive without one. The West is just discovering this truth and is opening its gates - albeit xenophobically and intermittently - to poorer foreigners. For what is immigration if not the importation of ambitious indigents, certain to revitalize the EU's rich and somnolent economies?

The countries of central and eastern Europe, thus, stand to benefit twice.

Their own economic Renaissance is spurred on by a striving home-grown proletariat. And they are uniquely positioned - geographically and culturally - to export destitute go-getters to the wealthy West and to reap the rewards of the inevitable spurt in entrepreneurship and innovation that follows. Remittances, returning expatriates, thriving and networked Diasporas would do more to uplift the countries of origin than any amount of oft-misallocated multilateral aid.

This cornucopian vision is threatened from numerous sides.

Geopolitical instability, resurgent trade protectionism, dysfunctional global capital markets and banks - can all reverse the course of a successful transition to market economies. Still, the more pernicious threats are from the inside: venal, delegitimized politicians, brain drain, crumbling infrastructure, cheap foreign competition, or inter-ethnic tensions.

Perhaps the most serious hindrance to progress would be a fanatic emulation by the countries in transition of the European Union. An overly generous social safety net, a sprawling bureaucracy, inane laws and regulations about everything from the environment to the welfare of pigs, paralyzed decision-making processes and deleterious subventions - can all scupper progress and depress entrepreneurship and innovation.

The cautionary tale of eastern Germany - smothered by western red tape and lethargy - should forewarn every new member and aspiring candidate. They need to join the European Union in the hope of helping to reform it from the inside. They should not succumb to the allure of German largesse, nor acquire the French, Spanish, Greek and Portuguese addiction to it. They cannot afford to.

Price Discovery

Three of the most important functions of free markets are: price discovery, the provision of liquidity, and capital allocation. Honest and transparent dealings between willing buyers and sellers are thought to result in liquid and efficient marketplaces. Prices are determined, second by second, in a process of public negotiation, taking old and emergent information about risks and returns into account. Capital is allocated to the highest bidder, who, presumably, can make the most profit on it. And every seller finds a buyer and vice versa.

The current global crisis is not only about the failure of a few investment banks (in the USA) and retail banks (in Europe). The very concept of free markets seems to have gone bankrupt. This was implicitly acknowledged by governments as they rushed to nationalize banks and entire financial systems.

In the last 14 months (August 2007 to October 2008), markets repeatedly failed to price assets correctly. From commodities to stocks, from derivatives to houses, and from currencies to art prices gyrate erratically and irrationally all over the charts. The markets are helpless and profoundly dysfunctional: no one seems to know what is the "correct" price for oil, shares, housing, gold, or anything else for that matter. Disagreements between buyers and sellers regarding the "right" prices are so unbridgeable and so frequent that price volatility (as measured, for instance, by the VIX index) has increased to an all time high. Speculators have benefited from unprecedented opportunities for arbitrage. Mathematical-economic models of risk, diversification, portfolio management and insurance have proven to be useless.

Inevitably, liquidity has dried up. Entire markets vanished literally overnight: collateralized debt obligations and swaps (CDOs and CDSs), munis (municipal bonds), commercial paper, mortgage derivatives, interbank lending. Attempts by central banks to inject liquidity into a moribund system have largely floundered and proved futile.

Finally, markets have consistently failed to allocate capital efficiently and to put it to the most-profitable use. In the last decade or so, business firms (mainly in the USA) have destroyed more economic value than they have created. This net destruction of assets, both tangible and intangible, retarded wealth formation. In some respects, the West - and especially the United States - are poorer now than they were in 1988. This monumental waste of capital was a result of the policies of free and easy money adopted by the world's central banks since 2001. Easy come, easy go, I guess.

Pricing, Differential

Last April, the World Health Organization (WHO), the World Trade Organization (WTO), the Norwegian Foreign Ministry, and the US-based Global Health Council held a 3-days workshop about "Pricing and

Financing of Essential Drugs" in poor countries. Not surprisingly, the conclusion was:

"... There was broad recognition that differential pricing could play an important role in ensuring access to existing drugs at affordable prices, particularly in the poorest countries, while the patent system would be allowed to continue to play its role in providing incentives for research and development into new drugs."

The 80 experts, who attended the workshop, proposed to reconcile these two, apparently contradictory, aspirations by introducing different prices for drugs in low-income and rich countries. This could be achieved bilaterally, between companies and purchasers, patent holders and manufacturers, global suppliers and countries - or through a market mechanism.

According to IMS Health, poor countries are projected to account for less than one quarter of pharmaceutical sales this year. Of every $100 spent on medicines worldwide - 42 are in the USA, 25 in Europe, 11 in Japan, 7.5 in Latin America and the Caribbean, 5 in China and South East Asia, less than 2 in East Europe and India each, about 1 in Africa and the Commonwealth of Independent States (CIS) each.

Vaccines, contraceptives, and condoms are already subject to cross-border differential pricing. Lately, drug companies, were forced to introduce multi-tiered pricing following court decisions, or agreements with the authorities. Brazilians and South Africans, for instance, pay a fraction of the price paid in the West for their anti-retroviral AIDS medication.

Even so, the price of a typical treatment is not affordable. Foreign donors, private foundations - such as the Bill and Melissa Gates Foundation - and international organizations had to step in to cover the shortfall.

The experts acknowledged the risk that branded drugs sold cheaply in a poor country might end up being smuggled into and consumed in a much richer ones. Less likely, industrialized countries may also impose price controls, using poor country prices as benchmarks. Other participants, including dominant NGO's, such as Oxfam and Medecins Sans Frontieres, rooted for a reform of the TRIPS agreement - or the manufacturing of generic alternatives to branded drugs.

The "health safeguards" built into the Trade-related Aspects of Intellectual Property Rights (TRIPS) convention allow for compulsory licensing - manufacturing a drug without the patent holder's permission - and for parallel imports - importing a drug from another country where it is sold at a lower price - in case of an health emergency.

Aware of the existence of this Damocles sword, the European Union and the trans-national pharmaceutical lobby have come out last May in favor of "global tiered pricing".

In its 2001 Human Development Report (HDR), the United Nations Development Program (UNDP) called to introduce differential rich versus poor country pricing for "essential high-tech products" as well. The Health GAP Coalition commented on the report:

"On the issue of differential pricing, the Report notes that, while an effective global market would encourage different prices in different countries for products such as pharmaceuticals, the current system does not. With high-tech products, where the main cost to the seller is usually research rather than production, such tiered pricing could lead to an identical product being sold in poor countries for just one-tenth-or one-hundredth- the price in Europe or the United States.

But drug companies and other technology producers fear that knowledge about such discounting could lead to a demand for lower prices in rich countries as well. They have tended to set global prices that are unaffordable for the citizens of poor countries (as with many AIDS drugs).

'Part of the battle to establish differential pricing must be won through consumer education. The citizens of rich countries must understand that it is only fair for people in developing countries to pay less for medicines and other critical technology products.' - stated Ms. Sukaki Fukuda-Parr" the lead author of the Report.

Public declarations issued in Havana, Cuba, in San Jose, Costa Rica in the late 1990's touted the benefits of free online scholarship for developing countries. The WHO and the Open Society Institute initiated HINARI - Health InterNetwork Access to Research Initiative. Peter Suber, the publisher of the "Free Online Scholarship" newsletter, summarizes the initiative thus:

"Under the program, the world's six largest publishers of biomedical journals have agreed to three-tiered pricing. For countries in the lowest tier (GNP per capita below $1k), online subscriptions are free of charge. For countries in the middle tier (GNP per capita between $1k and $3k), online subscriptions will be discounted by an amount to be decided this June. Countries in the top tier pay full price.

The six participating publishers are Blackwell Synergy, Elsevier Science Direct, Harcourt IDEAL, Springer Link, Wiley Interscience, and Wolters Kluwer. The subscriptions are given to universities and research institutions, not to individuals. But they are identical in scope to the subscriptions received by institutions paying the full price."

Of 500 bottom-tier eligible institutions, more than 200 have already signed up. Additional publishers have joined this 3-5 years program and most biomedical journals are already on offer. Mid-tier pricing will be declared by January next year. HINARI will probably be expanded to cover other scientific disciplines.

Authors from developing countries also benefit from the spread of free online scholarship coupled with differential pricing. "Best of Science", for example, a free, peer-reviewed, online science journal subsists on fees paid by the authors. It charges authors from developing countries less.

But differential pricing is unlikely to be confined to scholarly journals. Already, voices in developing countries demand tiered pricing for Western textbooks sold in emerging economies. Quoted in the Free Online Scholarship newsletter, Lai Ting-ming of the Taipei Times criticized, on March 26, "western publishers for selling textbooks to third world students at first world prices. There is a 'textbook pricing crisis' in developing countries, which is most commonly solved by illicit photocopying."

Touchingly, the issue of the dispossessed within rich country societies was raised by two African Special Rapporteurs in a report submitted last year to the UN sub-Commission on Human Rights and titled "Globalization and its Impact on the Full Enjoyment of Human Rights". It said:

" ... The emphasis on R & D investment conveniently omits mention of the fact that some of the financing for this research comes from public sources; how then can it be justifiably argued that the benefits that derive from such investment should accrue primarily to private interests? Lastly, the focus on differential pricing between (rich and poor) countries omits consideration of the fact that there are many people within developed countries who are also unable to afford the same drugs. This may be on account of an inaccessible or inhospitable health care system (in terms of cost or an absence of adequate social welfare mechanisms), or because of racial, gender, sexual orientation or other forms of discrimination."

Differential pricing is often confused with dynamic pricing.

Bob Gressens of Moai Technologies and Christopher Brousseau of Accenture define dynamic pricing, in their paper "The Value Propositions of Dynamic Pricing in Business-to-Business E-Commerce" as: "... The buying and selling of goods and services in markets where prices are free to move in response to supply and demand conditions."

This is usually done through auctions or requests for quotes or tenders. Dynamic pricing is most often used in the liquidation of surplus inventories and for e-sourcing.

Nor is differential pricing entirely identical with non-linear pricing. In the real world, prices are rarely fixed. Some prices vary with usage - "pay per view" in the cable TV industry, or "pay per print" in scholarly online reference. Other prices combine a fixed element (e.g., a subscription fee) with a variable element (e.g., payment per broadband usage). Volume discounts, sales, cross-selling, three for the price of two - are all examples of non-linear pricing. Non-linear pricing is about charging different prices to different consumers - but within the same market.

Hal Varian of the School of Information Management and Systems at the University of California in Berkeley summarizes the treatment of "Price Discrimination" in A. C. Pigou's seminal 1920 tome, "The Economics of Welfare":

"First-degree price discrimination means that the producer sells different units of output for different prices and these prices may differ from person to person. This is sometimes known as the case of perfect price discrimination.

Second-degree price discrimination means that the producer sells different units of output for different prices, but every individual who buys the same amount of the good pays the same price. Thus prices depend on the amount of the good purchased, but not on who does the purchasing. A common example of this sort of pricing is volume discounts.

Third-degree price discrimination occurs when the producer sells output to different people for different prices, but every unit of output sold to a given person sells for the same price. This is the most common form of price discrimination, and examples include senior citizens' discounts, student discounts, and so on."

Varian evaluates the contribution of each of these practices to economic efficiency in a 1996 article published in "First Monday":

"First-degree price discrimination yields a fully efficient outcome, in the sense of maximizing consumer plus producer surplus.

Second-degree price discrimination generally provides an efficient amount of the good to the largest consumers, but smaller consumers may receive inefficiently low amounts. Nevertheless, they will be better off than if they did not participate in the market. If differential pricing is not allowed, groups with small willingness to pay may not be served at all.

Third-degree price discrimination increases welfare when it encourages a sufficiently large increase in output. If output doesn't increase, total welfare will fall. As in the case of second-degree price discrimination, third-degree price discrimination is a good thing for niche markets that would not otherwise be served under a uniform pricing policy.

The key issue is whether the output of goods and services is increased or decreased by differential pricing."

Strictly speaking, global differential pricing is none of the above. It involves charging different prices in different markets, in accordance with the purchasing power of the local clientele (i.e., their willingness and ability to pay) - or in deference to their political and legal clout.

Differential prices are not set by supply and demand and, therefore, do not fluctuate. All the consumers within each market are charged the same - prices vary only across markets. They are determined by the manufacturer in each and every market separately in accordance with local conditions.

A March 2001 WHO/WTO background paper titled "More Equitable Pricing for Essential Drugs" discovered immense variations in the prices of medicines among different national markets. But, surprisingly, these price differences were unrelated to national income.

Even allowing for price differentials, the one-month cost of treatment of Tuberculosis in Tanzania was the equivalent of 500 working hours - compared to 1.4 working hours in Switzerland. The price of medicines in poor countries - from Zimbabwe to India - was clearly higher than one would have expected from income measures such as GDP per capita or average wages. Why didn't drug prices adjust to reflect indigenous purchasing power?

According to the Paris-based International Chamber of Commerce (ICC), differential pricing is also - perhaps mostly - influenced by other considerations such as: transportation costs, disparate tax and customs regimes, cost of employment, differences in property rights and royalties, local safety and health standards, price controls, quality of internal distribution systems, the size of the order, the size of the market, and so on.

Differential pricing was made possible by the application of mass manufacturing to the knowledge society. Many industries, both emerging ones, like telecommunications, or information technology - and mature ones, like airlines, or pharmaceuticals - defy conventional pricing theory. They involve huge sunk and fixed costs - mainly in research and development and plant.

But the marginal cost of each and every manufactured unit is identical - and vanishingly low. Beyond a certain quantitative threshold returns skyrocket and revenues contribute directly to the bottom line.

Consider software applications. The first units sold cover the enormous fixed and sunk costs of authoring the software and the machine tools used in the manufacturing process. The actual production ("variable" or "marginal") cost of each unit is a mere few cents - the wholesale price of the diskettes or CD-ROM's consumed. Thus, after having achieved breakeven, sales revenues translate immediately to gross profits.

This bifurcation - the huge fixed costs versus the negligible marginal costs - vitiates the rule: "set price at marginal cost". At which marginal cost? To compensate for the sunk and fixed costs, the first "marginal units" must carry a much higher price tag than the last ones.

Hal Varian studied this problem. His conclusions:

"(i) Efficient pricing in such environments will typically involve prices that differ across consumers and type of service; (ii) producers will want to engage in product and service differentiation in order for this differential pricing to be feasible; and, (iii) differential pricing will arise naturally as a result of profit seeking by firms. It follows that differential pricing can generally be expected to contribute to economic efficiency."

Differential pricing is also the outcome of globalization. As brands become ubiquitous and as the information superhighway renders prices comparable and transparent - different markets react differently to price signals. In impoverished countries, differential pricing was introduced illegally where manufacturers insisted on rigid, rich-world, price lists.

Piracy of intellectual property, for instance, is a form of coercive (and illegal) differential pricing. The existence of thriving rip-off markets proves that, at the right prices, demand is rife (demand elasticity). Both piracy and differential pricing may be spreading to scholarly publishing and other form of intellectual property such as software, films, music, and e-books.

Consumers are divided on the issue of multi-tiered pricing tailored to fit the customer's purchasing power. Not surprisingly, rich world buyers are apprehensive. They feel that differential pricing is a form of hidden subsidy, or a kind of "third world tax".

On September 2000, Amazon.com conducted a unique poll - this time among customers - regarding differential pricing (actually, non-linear pricing) - showing different prices to different users on the same book.

Forty two percent of all respondents though it was "discrimination" and "should stop" - but a surprising 31 percent regarded it as "a valid use of data mining". A quarter said it is "OK, if explained to users". The comments were telling:

"I work over 80 hours a week. As a small business owner, I may make good money, but does that mean I should be charged more than unmotivated individuals who are broke because they don't want to work more than 30 hours a week. I don't think so ... Should (preferred) customers disappear in (the) off-line world? Should Gold Cards or Platinum Cards disappear? ...

The interesting thing is that discrimination of pricing is very common in the insurance industry - the basis for actuarial work and in airlines - based on load factors. The key is the pricing available to groups of customers with similar profiles ... Simple supply and demand, competition from other suppliers should offset ... A dangerous policy to implement ... As a consumer I don't necessarily like it, (unless I get a lower price!). However, economically speaking, (think of a monopolist's MR curve) the ideal is to have each person pay the maximum amount that they are willing to pay."

Private Armies

In July 2002 Christopher Deliso recounted in antiwar.com that Dutch Radio, based on reports leaked by a Dutch military analysis firm, accused the US government of aiding and abetting terrorists in Macedonia. Not for the first time, the Americans were rumored to have hired the services of MPRI (Military Professional Resources, Inc.) to train and assist the rebels of the NLA, the Albanian

National Liberation Army, which skirmished for months with the Macedonian police and military throughout last year.

MPRI is a leading Private Military Company (PMC) whose presence was espied in other Balkan trouble spots, such as Croatia, Kosovo, and Bosnia. The absurd is that MPRI has been training the Macedonia army - to little avail it would seem - since 1998 under a "Stability and Deterrence Program".

Croatian former Foreign Minister Tonino Picula described MPRI's role thus:

"We started at the beginning of the 1990's lacking all kind of assistance. We faced a war of aggression. We needed all kinds of friends to enhance our capability to keep a schedule. I know that it (MPRI) did a significant job in Croatia as a part of US assistance to Croatia during the 1990s."

Other governments - notably Colombia's and Nigeria's - were less sanguine about the utility of MPRI's services. Colombian officials complained "the MPRI's contributions were of little practical use", while according to the Center for Democracy and Development, the vociferous objections of the Nigerian military led to the dismissal by the president of senior army officers, among them General Malu, the Nigerian chief of staff.

The end of the Cold War spelled the termination of many an illustrious career in the military and the secret services - as well as the destabilization and disintegration of many states. The Big Powers are either much reduced (Russia), militarily over-stretched (Europe), their armies ill-prepared for rapid deployment and low intensity warfare (everyone), or lost interest in many erstwhile "hot spots" (USA). Besieged by overwhelming civil strife, rebellions, and invasions - many countries, political parties, politicians, corporations, and businessmen seek refuge and protection.

More than 5 million soldiers were let go all over the world between 1987-1994, according to Henry Sanchez of Rutgers University. Professional soldiers, suddenly unemployed in a hostile civilian environment, resorted to mercenariness. A few became rogue freelancers. The role of the Frenchman Bob Denard in the takeover of the Comoros Islands is now mythical. So is the failed coup in Seychelles in 1981, perpetrated by Colonel "Mad" Mike Hoare, a British ex-paratrooper.

Private armies for hire proliferated. Executive Outcomes acted in Sierra Leone, Congo, and Angola, Sandline International in Sierra Leone and Papua New Guinea, DynCorp in Colombia, Haiti, Kosovo, and Bosnia and, of course, MPRI in Bosnia, Croatia, Kosovo, and, lately, Macedonia. Aviation Development Corporation flies surveillance planes for the CIA. Its involvement was revealed when, in Peru, it misidentified a civilian light plane as carrying narcotics. It was shot down by the Peruvian air force.

But these are only the tip of a growing iceberg. Vinnell Corporation was established in the US during the Great Depression and is currently owned by TRW. It has coached militaries, operated facilities, and provided logistical support in more than 50 countries, starting in Saudi Arabia in 1975, where it won a controversial $77 million contract to train oilfield guards.

BDM International, Betac, Logicon, and SAIC are competitors, but Kroll of New York and Saladin Security of London do mainly intelligence gathering. Brown and Root of Houston, Texas, provide logistical support to peacekeeping operations, for example in Kosovo.

Pacific Architects and Engineering (PAE) furnishes logistical support and private security to armies the world over, mainly to the ECOMOG West African multilateral force. Control Risks Group offers corporate security, research, and intelligence solutions. It specializes in hostage situations. It boasts having advised in more than 1200 kidnappings and extortion cases in 80 countries.

Armor Holdings was founded in 1969 as "American Body Armor and Equipment" and incorporated in 1996. It is a Private Security Company (PSC). Its London-based subsidiary, Defense Systems Limited, guards industrial and other sensitive sites, such as embassies and HQ's of international organizations, mainly the UN's.

Armor itself manufactures police and other "non-lethal" equipment. It is a leading maker of armored passenger vehicles and the prime contractor to the U.S. Military for the supply of armoring and blast protection for High Mobility Multi-purpose Wheeled Vehicles (HMMWVs).

Gray Security is another PSC with clients in both Africa and among Latin American immigrants in Florida. Some PMC's are ethnically pure. Succumbing to market realities, the legendary Gurkhas now offer their services through Gurkha International. The oil-rich region of Cabinda is air-patrolled by AirScan - Airborne Surveillance and Security Services.

Big money is involved. The Los Angeles Times quoted, in its April 14th issue, Equitable Services, a security industry analyst. In 1997, it predicted that the international security market will mushroom from $56 billion in 1990 to $220 in 2010. This was long before the boost given to the sector by September 11.

"The top five executives at Science Applications International Corp. of San Diego made between $825,000 and $1.8 million in salaries in 2001, and each held more than $1.5 million worth of stock options." - continued the LA Times.

Control Risks Group's turnover last year exceeded $50 million. Armor Holding's 1999 revenues exceeded $150 million. Prior to its controversial demise, Executive Outcomes of South Africa was said to have earned c. $55 million in its last 4 years - excluding the $1.8 million per month contract it has signed with Sierra Leone, most of which went unpaid. There were unsubstantiated allegations of securing a share of the diamond trade in the ravaged country as well.

Sandline's contract with Papua New Guinea amounted to $36 million for the first 3 months with just under $1 million for any consecutive month - or a total of c. $45 million per the first year. The country's new government at first refused to honor the commitments of its predecessor - hurling at it vague corruption charges - but then compromised with Sandline and agreed to dole out $13 million.

Nor are these small ensembles. MPRI - now in its 14th year - employs over 800 people, most of them former high level US military personnel. It draws on a database of

12,500 freelancers "former defense, law enforcement, and other professionals, from which the company can identify every skill produced in the armed forces and public safety sectors". Many of its clients work under the US government's Foreign Military Sales program and abide by the GSA (General Services Administration) tariffs.

Control Risks Group - founded in 1975 as a subsidiary of the Hogg Robinson insurance group - claims to have had "more than 5,300 clients (including 86 of the Fortune 100 companies) in over 130 countries". Eighty three percent Of the firms comprising the FTSE 100 use one or more of CRG's services. It has 400 employees in 16 offices around the world. It has recently acquired Network Holdings Limited, the UK's largest private forensic laboratory.

The Armor Holdings Products Division is made up of nine operating companies in eight geographic locations. It offers its branded security products through a network of more than 500 distributors and agents internationally. ArmorGroup employs 5,500 people in 38 countries.

Modern PMC's, such as Sandline, are veritable - though miniature - armies, replete with staff military ranks, uniforms, doctrine, training syllabi, cohesion, unit spirit, and discipline.

Smaller, ad hoc, outfits from Ukraine, Russia, Belarus, France, the United Kingdom, Israel, Croatia, South Africa, the United States and other nationalities scour the Earth for emerging conflicts. Such units are often infiltrated by criminals on the run, terrorists in disguise, sadistic psychopaths, and intelligence officers.

These "dogs of war" are known for their disloyalty and lack of discipline. Many have committed acts of banditry, rapes, and an array of atrocities in the mutilated host countries. Still, these are marginal groups and in the minority of PMC's - the last resort, often hired by undesirables and failed states.

On February 12, the British Foreign and Commonwealth Office released a long-awaited briefing ("green") paper in support of regulating the private military sector. Quoted in "Defense News", the paper stated:

"The demand for private military services is likely to increase ... A strong and reputable private military sector might have a role in enabling the (United Nations) to respond more rapidly and more effectively in crises. The cost of employing private military companies for certain functions in U.N. operations could be much lower than that of national armed forces."

Regulation, though, has a poor record. All PMC's in the USA are subject to the porous and ill-enforced Arms Export Control Act overseen by the State Department. The Los Angeles Times is not impressed with the record:

"Congress is notified only of contracts worth more than $50 million. Sometimes there are conflicting views of what is in the U. S. interest. And once a license is granted, there are no reporting requirements or oversight of work that typically lasts years and takes the firms' employees to remote, lawless areas." Decisions often appear to be arbitrary and are mysteriously reversed. All major PMC's maintain lobbyists in Washington and function, partly, as rent seekers.

Still, PMC's are the most cost-effective alternative. According to the UN Special Representative to Sierra Leone, The UN peacekeeping mission there costs more than $500 million per year - compared to Executive Outcomes' $33 million spread over 21 months.

Regulation may amount to a belated acceptance of reality. MPRI boasts that it already operates in foreign countries with the full knowledge and "licence" of the American administration. It is a way to circumvent both the oft-withheld Congressional approval needed for US military involvement abroad - and unwelcome media scrutiny.

The US Army, in the framework of LOGCAP (Logistics Civil Augmentation Program), "preplans during peacetime for the use of civilian contractors to perform selected services in wartime and other contingencies. Utilization of contractors, in a theater of operation, will release military units for other missions or fill shortfalls." The ubiquitous MPRI is LOGCAP's main contractor.

Bahamas-incorporated Sandline also claimed British Foreign Office tacit approval of its mission in Sierra Leone. Most PMC's are self-regulating and selective. They won't render their services to organized crime, drug cartels, rogue states, terrorists, illegal arms traders, and regimes known for flagrant violations of human rights.

The privatization of hitherto exorbitantly costly peacekeeping and humanitarian operations would bestow legitimacy upon these outfits and entice them to adhere to strict regulatory codes. Still, the exercise of violence is a prerogative of states and a hallmark of often hard-gained sovereignty. Many do not take kindly to the encroachment of morally-neutral private sector replacements upon these hallowed grounds.

David Isenberg wrote in the March 11th issue of "Defense News":

"The only question is how best to address concerns about accountability, threats to a nation's sovereignty (i.e., usurping the state's prerogative of having a monopoly on violence), having a vested interest in perpetuating a conflict, violating human rights or acting as government proxies. The consensus opinion is that this is best accomplished through regulation."

The imperceptible line between "military advisors" and combatants is often crossed. According to the Los Angeles Times, Vinnell employees may have joined Saudi National Guard units in battle against the invading army of Saddam Hussein in 1991.

MPRI personnel are alleged by Ken Silverman in his book "Private warriors" and by numerous media - from the British journalist Paul Harris on Australia's Radio National's "Background Briefing" to The Scotsman - to have helped plan the Croatian occupation and ethnic cleansing of Serb-populated Krajina in 1995. Even the Foreign Military Training Report published by both the State Department and Department of Defence in May refers to these allegations against MPRI not entirely disparagingly.

Sanchez describes what happened in Papua New Guinea:

"When citizens of Papua New Guinea learned that their government signed a $27 million contract with EO (should be Sandline - SV) to train the Army to fight a secessionist rebel uprising it set off five days of rioting and protests. Even the Army commander (later convicted on unrelated corruption charges - SV) refused to work with the South African firm.

States that hire private firms for security are usually financially poor but mineral rich. They often pay for services by offering concessions earned through diamond mining, oil drilling or other natural resources. An enterprising military firm may end up exploiting a poor nation of its modest resources. As a result there may be a new 'Scramble for Africa' over resources where no government exists or is desperate for help..."

Few PMC's if any consent to any form of payment, except cash. Mineral concessions require heavy investments and existing mines require a logistical infrastructure often way beyond the expertise and financial wherewithal of the average PMC. PMC's may be involved in influence peddling on behalf of mineral extractors or receive introduction fees and commissions from multinationals, though. PMC's also make a lot of money on arms sales to their client states.

Consider Sandline International. It was never a shareholder in Branch Energy, DiamondWorks, or any other real or imaginary mining firm it was associated with by sloppy researchers and journalists. Nor was it the successor to Executive Outcomes. Yet, the same people acted as directors, or advisors in all these firms.

This incestuous setup led to the false assertions that Sandline - and EO before it - looted the mineral wealth of countries such as Sierra Leone and Angola. That many

PMC's render security services to mining firms - both statal and private - adds to the confusion.

"The Financial Times" mentioned the positive role "Southern Cross Security" played in keeping Sierra Leone's titanium-dioxide mines intact throughout the war. Others wrongly accused it of being an EO offshoot out to pillage the minerals it sought to protect.

Even Sanchez acknowledges that "(others think that) a private company can deploy forces rapidly, avoid the difficulties of ad-hoc multinational forces (command is streamlined and cohesive), they usually have standing logistics for transport, appear to be cost-effective, and are willing to sustain loss of life".

Isenberg concurs:

"It is time to recognize that today's PMCs are far different from the ad hoc organizations of the past. As experts such as professor Herb Howe of Georgetown University have noted, many of today's companies exhibit a distinct corporate nature and a desire for good public relations. The companies' goal of obtaining contracts encourages them to control their employees' actions. Private firms have a large pool of qualified applicants, due to worldwide political realignments and defense cutbacks since 1989 ... One thing is clear: The need for security from the private sector is going to increase dramatically. And PMCs are going to fulfill that need."

PMC's have embarked on a concerted effort to alter their penumbral image. MPRI - its Web site replete with literary quotes lifted from the works of Marcel Proust and other renowned soldiers of fortune - has contracted with

Enterprise Strategies and Solutions under the Department of Defence's Mentor-Protégé program. MPRI explains:

"ESSI's emphasis on economic well-being, technology transfer, corporate social investing, business incubation, and knowledge management complement the vital safety and security roles performed by MPRI. MPRI has the added advantage of being able to utilize the skill sets of a small, woman-owned, veteran-owned business. MPRI and ESSI form a comprehensive team that enables them to perform on a wide range of projects that would otherwise be inaccessible for one or the other."

MPRI branched out to offer corporate leadership programs that include the re-enactment of historical battles. It is a major provider of training, support, and "other services" - such as strategic planning and leader development - to the US armed forces, Department of Defense, the corporate sector, and "non-DoD government agencies." Its Web site - a sincere stab at transparency - lists dozens of military and semi-military contracts.

Its military contracts notwithstanding, it emphasizes the humanitarian side of its operations. It "shipped more than $900,000,000 worth of donated food and medical supplies to the newly independent states of the former Soviet Union over a five year period ... has provided peace keeping monitors for both the Department of Defense and the Department of State" and engaged in other charitable deeds, like demining.

In the Winter 2002 issue of "Harvard International Review", Sean Creehan summed up this shift in public perceptions:

"Today's mercenaries still fight for money, but in the context of global capitalism, some groups are becoming less morally objectionable. The organization of mercenaries into corporations that function like consulting firms has put distance between them and their activities. Mercenary corporations' increasing efficiency and self-regulation is influencing the way legitimate governments view mercenaries as instruments of state policy."

In a BBC poll conducted in the wake of the British government's Green Paper about regulating "soldiers of fortune", a reader named Katie raised important points regarding the corporate structure and liabilities of PMC's:

"The UK has a rather poor record of holding corporate officers responsible in any way for their actions ... Maybe military 'companies' should actually be restricted to being partnerships where the owners have unlimited liability similar to a lawyer's practice? Maybe a special class of company needs to be created, for this purpose so they can be audited and tracked and to clarify their relationship with the government (for whom they act). Essentially ... the directors of the company can be held responsible for war crimes as would ranking officers in the army. To some extent the 'corporate veil' needs to be thinner for these companies."

The United Kingdom - and Australia - promote a complete re-think of the concept of national defense. Britain's public-private partnership dubbed the "Private Finance Initiative" revolves around "paying privately for the defence we cannot afford publicly". Thus, transport planes, ships, trucks, training, and accommodation - may all be on long term leases from private firms. The equipment will be leased to other customers during down time, reports the BBC.

After all, when rich countries pay poor countries to send their ill-disciplined, ill-equipped, and ill-trained soldiers on peacekeeping operations - isn't this a mercenary system in all but name? And atrocities are not the preserve of "dogs of war". American regular soldiers committed them in Kosovo and Japan, Nigerian conscripts perpetrated them all over West Africa, "national armies" are feared by their own civilians more than any mercenary troupe. Time to rid ourselves of self-righteous myths and privatize peace as we, alas too often, did war.

Interview granted to Barry Zellen, INTERSEC (UK), February 2008

1. Since the end of the cold war, what has been the role of private contractors in the conduct of war? Has it been on the rise?

A. Private contracting of military functions has been on the rise since the first Gulf War (1991). With the collapse of the USSR, the militaries of the main Western protagonists, the USA and the UK, have been drastically scaled back, a process known as the "peace dividend". At the same time, economists and politicians throughout the world embarked on an ambitious plan involving the privatization of state-owned firms and functions. Inevitably, the two fads coalesced and huge chunks of hitherto state-monopolized warfare were contracted out, outsourced, and even offshored.

2. What have been the primary functions for contractors

in war zones, and how has this aided the war efforts of states?

A. Third World countries have always leveraged mercenaries to subdue adversaries at home and abroad. Many armies in Africa and Asia and even in certain parts of Europe (such as the Balkans) were or are being run by third party contractors who sometimes also actively participate in the fighting.

As far as the USA and UK are concerned, until the Iraq war, private contractors were mainly responsible for logistics, training, and security tasks. This narrow definition of their roles is in flux, though. Private soldiers of fortune may yet be hired and rented out even by the governments of the West, though I regard this as extremely unlikely.

3. With the demise of the USSR and the end of bipolarity in international affairs, most of the wars have been to some degree asymmetrical contests between unequal adversaries. Do private contractors help states sustain their warfighting efforts during asymmetrical, protracted and low-intensity conflicts when a full military mobilization is politically and/or economically unfeasible? How would you describe the current role of private contractors in GWOT (Global War on Terror) operations? The numbers appear to be large, perhaps over 100,000 contractors in Iraq alone: what does this tell us about the transformation of war?

A. Though it would make eminent sense, I am not aware of such a role. Granted, private military companies are involved in the provision of logistical, training, and security support to forces on the ground and they also collaborate with field agents of secret services (such as the CIA). But, asymmetrical warfare is still carried out largely by regular armies, backed by intelligence gathered by state-run agencies.

Actual combat is not being transformed by the influx of private contractors. We are simply reverting to earlier times and models when war was a public-private partnership and military camps incorporated entrepreneurial suppliers, contractors, service providers, and hangers-on. The attempt to render modern armies self-sufficient and self-sustaining has clearly failed.

4. Part of Secretary Rumsfeld's Transformation program was a trend toward a decreasing size of our armed forces, and a continued shift toward superior technology to defeat the enemy. Does the increasing role of contractors enable defense organizations to shift their resources on the higher-tech functions, effectively "outsourcing" the lesser skilled functions? Is the "privatization" of the warfighting functions consistent with the Transformation and the Revolution in Military Affairs, as we shift toward leaner, higher-tech, armed forces?

A. Not in my view. Lean, technology-rich armies are an inevitable outcome of budgetary constraints and ever more sophisticated gadgetry. The Transformation program is a response to these trends**,** not to the changing face of war. Truth be told, the USA has always faced low-intensity asymmetrical warfare. It rarely found itself engaged in conventional battles, mainly in the European theatre.

Private contractors merely substitute for existing structures. Their functions are not always low-skilled, quite the contrary. Moreover, the army duplicates the functions of private contractors. This redundancy may appear wasteful but it stems from the deep and justified distrust professional soldiers hold towards civilian contractors.

5. Looking ahead to the future, will we see an even more prominent role of private companies in future wars?

A. Quantitatively, yes, but not qualitatively. PMCs and private contractors will grow in number, stature, and contribution to the war effort. But they are unlikely to replace the professional soldier in actual combat or the field agent in HUMINT. Their functions will remain largely limited to logistical support and training.

6. What does this private/public partnership mean in terms of the ability of states to engage in multiple engagements at once without a general mobilization - is an 'outsourcing model' smart economics? And what about the political and diplomatic implications -- are there dangers of the perception of too great a role of private contractors in the conduct of war, and potential problems with the chain of command? Back to the GWOT and its emphasis on low-intensity conflict, counter-terrorist and counter-insurgent operations, and pre-emptive strikes against rogue states and non-state actors, does the role of private contractors complement the war aims of the coalition of states aligned in the "long war" against terrorism?

A. Private contractors are not GIs. They provide no substitute for the fighting men and women of the armed services. I doubt if they ever will. Thus, they do not alter the military equation in any meaningful way. Their involvement has no bearing on whether to draft and mobilize fighting age conscripts.

Incredibly, there are no serious studies that decide the question whether private contracting is a clever move, from the pecuniary point of view. Anecdotal evidence suggests that it is not and that waste and corruption are as rife there as among the traditional state bureaucracy.

Chain of command issues are inevitable. This is especially true when contractors are granted immunity to the consequences of their delinquency, crime, waste, and venality. There is no love lost between the fighting corps and private contractors. As we have seen in Iraq, the involvement of PMCs is often resented by host governments and leads to diplomatic and other incidents.

The solution, of course, is to hold private contractors accountable for their actions and misdeeds.

7. I was thinking about how Xenophon and many of the battle-hardened Greek warriors hired themselves out to the Persians in an effort to foster regime change there 2.5 millennia ago -- resulting in his infamous "march of the 10,000" back to Greece after the effort failed. It seems that there has been a very long history of private entities participating in warfare -- lots of military theorists have examined the topic, Machiavelli comes to mind. I am curious your thoughts on this long history -- in some ways it seems like an old phenomenon; but then again, something seems new as well. With Napoleon's levee-en-masse transforming the conduct of modern warfare, resulting in the emergence of total war, and

later a series of world wars, I am wondering, does the recent trend toward "privatization" suggest a return to the classical roots of war seen in ancient and early modern days, and a shift away from total war toward more limited engagements -- or might this be temporary, until a new peer adversary such as China rises to shift things back toward mass warfare?

A. The modern armies that emerged after the Crimea War are a historic aberration. With the exception of the last 150 years, armed forces throughout history were composed of professional soldiers for hire augmented by ad hoc, short-term bodies of conscripted vassals or citizenry or militias. The erstwhile fighting corpus in its camp incorporated hordes of suppliers of goods and services ("private contractors" in today's parlance)**.**

The attempt to render modern armies self-sufficient and self-sustaining by getting rid of these "parasites" has clearly failed. We are back to where we started: the traditional army.

It is also completely wrong to postulate that "Total War" is a modern phenomenon. It is at least as old as the Bible. The ancient Hebrews were instructed by God to eradicate their enemies, men, women, and children and to confiscate the property of their vanquished foes. How more Total can it get?

Mankind has always cycled between geographically-limited, guerrilla type skirmishes and all-out warfare. Top-heavy Goliath forces, armed with the latest technologies always faced pebble-slinging, nimble, "low intensity" Davids. There's nothing new about that. We are simply in an interim period between two classical wars. Call it a respite.

Professions (of Future)

Predicting the future is a tricky business. There have been countless ridiculous failures at identifying the trends and products which will determine the future shape of our life and our environment. Even more difficult is trying to guess which of us will be deemed a useful member of the community – and which an obsolete relic. To a large extent, the answer to this question lies in determining the useful professions of the future. This is an age when people are determined, defined and categorized in strict accordance with their professions. Whereas during the Renaissance, a person might have been defined by his range of interests (remember the likes of Leonardo da Vinci), by his familial, religious, or ethnic affiliations, by his or her gender and so on – today the first and foremost question is a person's profession. The first question that we must provide a clear answer to is: What constitutes a profession (as opposed to a hobby), a vocation (as opposed to an avocation)? To qualify as a profession, the act must bear the following hallmarks:

a. It must be continuous and pursued for a long time.

b. It must occupy most of the waking hours.

c. It must yield earnings or compensation whether in money or in kind.

d. The person must have an advantage in that field of knowledge or activity, at least over laymen. In other words, the categories of laymen and expert –

which are the result of highly specific education – must exist and prevail.

e. It must be hierarchically layered with clear flows of professional authorities and responsibilities and with a clear career path (progressing up the professional ladder).

The second relevant question is: What are the trends which determine our future? It is useless to look at microtrends. These are too volatile and, in principle, unpredictable. Much more important are the trends that last for hundreds or even thousands of years. These are usually not the results of technological conjuncture or geopolitical upheavals. Rather, they are the outcomes of characteristic human activities which are uninterrupted. Healthcare, for instance, is such a human activity. Humans – terrified of death and infirmity – always wanted and are very likely to continue to want to improve their health and thus to postpone the inevitable and better the quality of what is available. Another such overriding tendency is education: this is a part of the human survival kit. By educating oneself, by studying a profession, by learning more about the world – one better one's chances to survive. Out of this set of human, almost deterministic activities, a group of overriding trends emerges:

From Less Mobility to More Mobility

People, goods and, lately, information became and become, daily, more and more mobile. Physical distance has been shrunk. A global marketplace has formed. Information is almost instantly available anywhere. This was described as the global village – an outdated concept which might soon be replaced by the global home. All the professions which has to do with more mobility will benefit and represent preferred professions of the future. The moving of people: pilots, drivers, the car industry, sophisticated traffic planners and automotive innovators, tourism related professions and so on. The moving of goods: shipping, trucking, air and modern train travel. This area is already so specialized that I do not consider it as offering opportunities in the future (put differently, I do not regard it as a growth industry). The moving of information (today dubbed: "The Service Industries"): Trading systems, the Internet, Networking and communications related professions, the field of communications within the computer industries, telecommunications, entertainment related professions, technologies of banking. The creation of destinations for people, goods and information (commonly known as Markets or Marketplaces): advertising, marketing, trading, design, image and public relations experts.

The Age Polarization of Society

Better medicine will lead to a polarization of the age structure of society: there will be more older people and more younger people. Gradually, as birth rates fall and contraception becomes widespread, a reverse pyramid will be formed: most people will be middle aged and old. This offers a clear view of professions which will be required in the future: Professionals to take care of older and younger people (which have very similar needs): nurses, paramedics, nannies, entertainers, leisure time professionals, companions, specialized equipment manufacturers, operators of homes for the very old or for the very young, pension planners, manufacturers of specialized medical and paramedical needs and products for both age groups, legal and accounting specialists in pension and inheritance laws and tax planning. Virtually every industry and field of human activity will have to adapt themselves to these demographic changes. Age-related expertise will develop in each one of them. This applies to the arts (mainly music and cinema) as well as to the crafts, to industry as well as to agriculture, to infrastructure as well as to government. Human society will be enormously influenced by these shifts.

The Fragmentation of Society

Initially, society was composed of very large units. People belonged to tribes "nations". These were groupings of up to hundreds of thousands of people. They felt amply defined by this belonging. Nothing was left out when you said that a certain person was "Hebrew". Nothing needed to be added. Stereotypes were more than sufficient and, usually accurate.

Later, the concept of family fully emerged. First, in a very extended form: the family comprised a few generations and all removed family (blood) connections. Gradually, the family shed more and more layers. People began to be called by family names only 250 years ago. The nuclear family was an invention of the 19^{th} century, when the industrial revolution and modern methods of transport and communication broke families apart. Even this relatively small units came under a debilitating attack in the last 50 years and the nuclear family underwent a nuclear implosion, it disintegrated. Today, the basic unit of society, its cell, its atom, is the individual.

People will tend to isolate themselves: stay more at home, work from it with flexitime, form and break up short term attachments to other humans or be engaged in noncommittal activities with others, activities which will not threaten their absolute freedom and mobility. Solitary media will be predominant: the Internet is a one-user medium (television was a family medium).

The professions which will cater to the needs of individuals and separate them from society (while maintaining the survival need to communicate) will be the professions of the future: Internet, entertainment (especially customized), telecommunication, singles-related industries (dating and couple matching, for instance, single's bars, to mention another), virtual reality, small businesses which can be run from home, agencies for temporary work placement and other professions catering to the conflicting human needs of being together while being alone.

All the other seeming trends are recurrent illusions. Thee have been ages of more or less democracy, more or less market orientation, more or less polarization between rich and poor people. The human race experienced numerous forms of government, of marriage, of economy, of management, of residence, of production, even of trying to predict the future. It was the wisest of all men, King Solomon, who said: "There is nothing new under the sun". True, but it is getting stronger.

Five thousand years ago, people were still roaming the earth as nomads. They carried along their few precious possessions in their hands and on their backs. They hunted and gathered food at random.

Then came the Agricultural Revolution: people settled down and got attached - physically, emotionally and legally - to specific plots of land. They grew their food in accordance with a pre-meditated plan. They domesticated animals. This new pattern of human existence led to enormous shifts in demographic patterns.

It took yet another 4500 years before the dawn of the next Revolution: the Industrial one. Its main achievement was to separate the raw materials and the means of production from the land. It also created the need to have an educated workforce. This Revolution brought in its wake the formation of cities (which supplied workers to mega-factories), mass education systems and leisure.

For the first time in history, people began to have free time on their hands.

Numerous organizations, firms and institutions sprang up in an effort to satisfy the insatiable desire for entertainment and the necessity to cope with the ever growing complexity of social and economic institutions.

Contrary to common opinion, the service oriented society was - and still is - an inseparable part of the industrial world.

Today, we are in the eye of the biggest storm ever: the Third Wave (to borrow Alvin Toffler's excellent coinage). This is the Information and Knowledge Revolution. It is leading to an economy which will be based on the accumulation, the processing and the delivery of information (the equivalent of raw materials) and of knowledge (the equivalent of processed goods). All these will be made accessible to ever widening strata of society.

This, indeed, is what separates this Revolution from its predecessors:

(1) It is equitable - anyone and everyone can partake in it.

To participate in the previous two Revolutions - large amounts of capital were needed. Where capital was amiss - raw force was used to obtain raw materials, capital goods, land and other means of production (including very cheap labour in the form of slavery).

This Revolution is different: all that is needed is good ideas, some (ever lessening) technical background and ever cheaper infrastructure.

So, this Revolution is open to young people in home garages (this is how computer giants such as Apple Computers and Microsoft were established).

It is non-discriminating: age, gender, race, colour, nationality, sexual preferences - they all do not matter. This Revolution is the Great Equalizer.

(2) This is the first time in human history that raw materials, production processes, finished products and marketing and distribution channels are one and the same. Let us examine the example of the sales of products (e.g., software) through the Internet:

Software is written on computers using programming languages - a manipulation of electronic bits in a virtual environment. Thus, the product (=the software), the production processes (=the programming languages), the raw materials (mental algorithms translated to electronic bits) and the channels of marketing and distribution (the electronic bit streams of the Internet) - they are all made of the same elements and components.

This is why the technology is so cheap. This is why the products of the forthcoming Revolution will be disseminated so easily. To manufacture and to distribute will become mundane - rather than arcane - operations.

(3) Only some of our forefathers have been influenced by the Agricultural Revolution. Only some of them have been influenced by the Industrial Revolution. Gradually, the percentage of the population working the land decreased from well over 60% to less than 3% (in the USA, for instance). An equal drop can be discerned among the part of population engaged in industry.

But this is not the case with the third Revolution:

There is not a single human on earth who is not influenced by the third, biggest Revolution of all: the Information / Knowledge Revolution.

All of us are exposed to radio, television, computers, cellular phones, the Internet. These products and services are becoming cheaper and more available and accessible by the month. The new Revolution is all- pervasive and all-encompassing.

(4) All the above characteristics brought about a new form of economic development: non-centralised, high value added, fast progressing with quick business cycles. It is the first non-mercantilist, non-colonial phase in human history. All economic activity in the past was characterized by the importation of raw products at low prices from the very same markets that absorbed the final products (produced from those raw materials) at much higher prices.

This form of exploitation will gradually become impossible. Today, it is no longer important where goods are produced. The demarcation lines between finished products and raw materials are so blurred (even where old-fashioned industrial products are concerned) - that the old distinctionbetween "colonizer" and "colony" has all but vanished.

This holds a great promise for less-developed and developing countries.

In the (near) past, they would have needed huge amounts of capital and other, non-monetary, resources to equate themselves with the more developed part of the World. Today, much less investment is needed to achieve the same results. The world is finally becoming what the sage of Western media, Marshall McLuhan called: "The Global Village". It matters less WHERE you are - it matters more WHAT you think. A global economic premium is placed on innovation, creativity, improvisation and the entrepreneurial spirit.

These - the new mental commodities - are abundantly and equally available to all the countries in the world: poor and rich, off-center and on-center, developed, developing and less developed.

The old economic conception of an evolution: from the agricultural to the industrial to the service economies is being replaced. The new breed of economic thinking encourages countries - such as Macedonia - to move directly from the Agricultural phase to the Third Wave: that of Information and Knowledge industries. Macedonia can better accommodate this type of industries: they are affordable, accessible, easy to understand and to implement, highly profitable, ever evolving and progressing.

Macedonia will not be the first country to implement such a daring policy of leaping forward and skipping the Industrial stage - straight into the age of Information. Israel has done it before and so have Switzerland, Hong-Kong, Singapore and (to a certain and hesitant extent) India. All these countries were naturally under-privileged. Some of them are mere deserts, others isolated, barren islands or severely overpopulated. But they all managed to get heavily involved in the unfolding revolution. All of them (with the exception of India which is a new, half-hearted, entrant) possess the highest per capita GNP in the world.

The gamble has paid off.

But there is a fascinating side-benefit to such a choice.

The shift from industry to the information technology and knowledge industries - is a shift from dealing with reality to dealing with symbols. The techniques used to manipulate symbols are the very same - no matter what the symbols are. If a country is successful at developing trained operators of symbols - they will know how to manipulate, operate and transform any kind of symbol.

This is also true when it comes to the biggest symbol of all: to Money.

Money - as we all know - is a symbol. It represents an agreement reached amongst members of a group of people. It has no intrinsic value. The same techniques which are used for the manipulation of information are easily applicable to the manipulation of the symbol called money.

THE MORE ADEPT A COUNTRY IS AT PROCESSING SYMBOLS (=INFORMATION) - THE MORE ADEPT IT IS IN FINANCIAL TRANSACTIONS OF ALL KINDS. It is more likely to attract investments, to develop flourishing stock exchanges and money markets, to train young professionals, to trade and in general: to get enmeshed in the very fabric of the modern international economy.

Public Goods

"We must not believe the many, who say that only free people ought to be educated, but we should rather believe the philosophers who say that only the educated are free."
-- Epictetus (AD 55?-135?), Greek Stoic philosopher

I. Public Goods, Private Goods

Contrary to common misconceptions, public goods are not "goods provided by the public" (read: by the government). Public goods are sometimes supplied by the private sector and private goods - by the public sector. It is the contention of this essay that technology is blurring the distinction between these two types of goods and rendering it obsolete.

Pure public goods are characterized by:

I. ***Nonrivalry*** - the cost of extending the service or providing the good to another person is (close to) zero.

Most products are rivalrous (scarce) - zero sum games. Having been consumed, they are gone and are not available to others. Public goods, in contrast, are accessible to growing numbers of people without any additional marginal cost. This wide dispersion of benefits renders them unsuitable for private entrepreneurship. It is impossible to recapture the full returns they engender. As Samuelson observed, they are extreme forms of positive externalities (spillover effects).

II. ***Nonexcludability*** - it is impossible to exclude anyone from enjoying the benefits of a public good, or from defraying its costs (positive and negative externalities). Neither can anyone willingly exclude himself from their remit.

III. ***Externalities*** - public goods impose costs or benefits on others - individuals or firms - outside the marketplace and their effects are only partially reflected in prices and the market transactions. As Musgrave pointed out (1969), externalities are the other face of nonrivalry.

The usual examples for public goods are lighthouses - famously questioned by one Nobel Prize winner, Ronald Coase, and defended by another, Paul Samuelson - national defense, the GPS navigation system, vaccination programs, dams, and public art (such as park concerts).

It is evident that public goods are not necessarily provided or financed by public institutions. But governments frequently intervene to reverse market failures (i.e., when the markets fail to provide goods and services) or to reduce transaction costs so as to enhance consumption or supply and, thus, positive externalities. Governments, for instance, provide preventive care - a non-profitable healthcare niche - and subsidize education because they have an overall positive social effect.

Moreover, pure public goods do not exist, with the possible exception of national defense. Samuelson himself suggested [Samuelson, P.A - Diagrammatic Exposition of a Theory of Public Expenditure - Review of Economics and Statistics, 37 (1955), 350-56]:

"... Many - though not all - of the realistic cases of government activity can be fruitfully analyzed as some kind of a blend of these two extreme polar cases" (p. 350) - mixtures of private and public goods. (Education, the courts, public defense, highway programs, police and fire protection have an) ***"element of variability in the benefit that can go to one citizen at the expense of some other citizen"*** (p. 356).

From Pickhardt, Michael's paper titled ***"Fifty Years after Samuelson's 'The Pure Theory of Public Expenditure': What Are We Left With?"***:

"... It seems that rivalry and nonrivalry are supposed to reflect this "element of variability" and hint at a continuum of goods that ranges from wholly rival to wholly nonrival ones. In particular, Musgrave (1969, p. 126 and pp. 134-35) writes:

'The condition of non-rivalness in consumption (or, which is the same, the existence of beneficial consumption externalities) means that the same physical output (the fruits of the same factor input) is enjoyed by both A and B. This does not mean that the same subjective benefit must be derived, or even that precisely the same product quality is available to both. (...) Due to

non-rivalness of consumption, individual demand curves are added vertically, rather than horizontally as in the case of private goods".

"The preceding discussion has dealt with the case of a pure social good, i.e. a good the benefits of which are wholly non-rival. This approach has been subject to the criticism that this case does not exist, or, if at all, applies to defence only; and in fact most goods which give rise to private benefits also involve externalities in varying degrees and hence combine both social and private good characteristics' ".

II. The Transformative Nature of Technology

It would seem that knowledge - or, rather, technology - is a public good as it is nonrival, nonexcludable, and has positive externalities. The New Growth Theory (theory of endogenous technological change) emphasizes these "natural" qualities of technology.

The application of Intellectual Property Rights (IPR) alters the nature of technology from public to private good by introducing excludability, though not rivalry. Put more simply, technology is "expensive to produce and cheap to reproduce". By imposing licensing demands on consumers, it is made exclusive, though it still remains nonrivalrous (can be copied endlessly without being diminished).

Yet, even encumbered by IPR, technology is transformative. It converts some public goods into private ones and vice versa.

Consider highways - hitherto quintessential public goods. The introduction of advanced "on the fly" identification and billing (toll) systems reduced transaction costs so dramatically that privately-owned and operated highways are now common in many Western countries. This is an example of a public good gradually going private.

Books reify the converse trend - from private to public goods. Print books - undoubtedly a private good - are now available online free of charge for download. Online public domain books are a nonrivalrous, nonexcludable good with positive externalities - in other words, a pure public good.

III. Is Education a Public Good?

Education used to be a private good with positive externalities. Thanks to technology and government largesse it is no longer the case. It is being transformed into a nonpure public good.

Technology-borne education is nonrivalrous and, like its traditional counterpart, has positive externalities. It can be replicated and disseminated virtually cost-free to the next consumer through the Internet, television, radio, and on magnetic media. MIT has recently placed 500 of its courses online and made them freely accessible. Distance learning is spreading like wildfire. Webcasts can host - in principle - unlimited amounts of students.

Yet, all forms of education are exclusionary, at least in principle. It is impossible to exclude a citizen from the benefits of his country's national defense, or those of his county's dam. It is perfectly feasible to exclude would be students from access to education - both online and offline.

This caveat, however, equally applies to other goods universally recognized as public. It is possible to exclude certain members of the population from being vaccinated, for instance - or from attending a public concert in the park.

Other public goods require an initial investment (the price-exclusion principle demanded by Musgrave in 1959, does apply at times). One can hardly benefit from the weather forecasts without owning a radio or a television set - which would immediately tend to exclude the homeless and the rural poor in many countries. It is even conceivable to extend the benefits of national defense selectively and to exclude parts of the population, as the Second World War has taught some minorities all too well.

Nor is strict nonrivalry possible - at least not simultaneously, as Musgrave observed (1959, 1969). Our world is finite - and so is everything in it. The economic fundament of scarcity applies universally - and public goods are not exempt. There are only so many people who can attend a concert in the park, only so many ships can be guided by a lighthouse, only so many people defended by the army and police. This is called "crowding" and amounts to the exclusion of potential beneficiaries (the theories of "jurisdictions" and "clubs" deal with this problem).

Nonrivalry and nonexcludability are ideals - not realities. They apply strictly only to the sunlight. As environmentalists keep warning us, even the air is a scarce commodity. Technology gradually helps render many goods and services - books and education, to name two - asymptotically nonrivalrous and nonexcludable.

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Public Procurement

In every national budget, there is a part called "Public Procurement". This is the portion of the budget allocated to purchasing services and goods for the various ministries, authorities and other arms of the executive branch. It was the famous management consultant, Parkinson, who once wrote that government officials are likely to approve a multi-billion dollar nuclear power plant much more speedily that they are likely to authorize a hundred dollar expenditure on a bicycle parking device. This is because everyone came across 100 dollar situations in real life - but precious few had the fortune to expend with billions of USD.

This, precisely, is the problem with public procurement: people are too acquainted with the purchased items. They tend to confuse their daily, household-type, decisions with the processes and considerations which should permeate governmental decision making. They label perfectly legitimate decisions as "corrupt" - and totally corrupt procedures as "legal" or merely "legitimate", because this is what was decreed by the statal mechanisms, or because "this is the law".

Procurement is divided to defence and non-defence spending. In both these categories - but, especially in the former - there are grave, well founded, concerns that things might not be all what they seem to be.

Government - from India's to Sweden's to Belgium's - fell because of procurement scandals which involved bribes paid by manufacturers or service providers either to individual in the service of the state or to political parties. Other, lesser cases, litter the press daily. In the last few years only, the burgeoning defence sector in Israel saw two such big scandals: the developer of Israel's missiles was involved in one (and currently is serving a jail sentence) and Israel's military attache to Washington was implicated - though, never convicted - in yet another.

But the picture is not that grim. Most governments in the West succeeded in reigning in and fully controlling this particular budget item. In the USA, this part of the budget remained constant in the last 35(!) years at 20% of the GDP.

There are many problems with public procurement. It is an obscure area of state activity, agreed upon in "customized" tenders and in dark rooms through a series of undisclosed agreements. At least, this is the public image of these expenditures.

The truth is completely different.

True, some ministers use public money to build their private "empires". It could be a private business empire, catering to the financial future of the minister, his cronies and his relatives. These two plagues - cronyism and nepotism - haunt public procurement. The spectre of government official using public money to benefit their political allies or their family members - haunts public imagination and provokes public indignation.

Then, there are problems of plain corruption: bribes or commissions paid to decision makers in return for winning tenders or awarding of economic benefits financed by the public money. Again, sometimes these moneys end in secret bank accounts in Switzerland or in Luxembourg. At other times, they finance political activities of political parties. This was rampantly abundant in Italy and has its place in France. The USA, which was considered to be immune from such behaviours - has proven to be less so, lately, with the Bill Clinton alleged election financing transgressions.

But, these, with all due respect to "clean hands" operations and principles, are not the main problems of public procurement.

The first order problem is the allocation of scarce resources. In other words, prioritizing. The needs are enormous and ever growing. The US government purchases hundreds of thousands of separate items from outside suppliers. Just the list of these goods - not to mention their technical specifications and the documentation which accompanies the transactions - occupies tens of thick volumes. Supercomputers are used to manage all these - and, even so, it is getting way out of hand. How to allocate ever scarcer resources amongst these items is a daunting - close to impossible - task. It also, of course, has a political dimension. A procurement decision reflects a political preference and priority. But the decision itself is not always motivated by rational - let alone noble - arguments. More often, it is the by product and end result of lobbying, political hand bending and extortionist muscle. This raises a lot of hackles among those who feel that were kept out of the pork barrel. They feel underprivileged and discriminated against. They fight back and the whole system finds itself in a quagmire, a nightmare of conflicting interests. Last year, the whole budget in the USA was stuck - not approved by Congress - because of these reactions and counter-reactions.

The second problem is the supervision, auditing and control of actual spending. This has two dimensions:

1. How to make sure that the expenditures match and do not exceed the budgetary items. In some countries, this is a mere ritual formality and government departments are positively expected to overstep their procurement budgets. In others, this constitutes a criminal offence.

2. How to prevent the criminally corrupt activities that we have described above - or even the non criminal incompetent acts which government officials are prone to do.

The most widespread method is the public, competitive, tender for the purchases of goods and services.

But, this is not as simple as it sounds.

Some countries publish international tenders, striving to secure the best quality in the cheapest price - no matter what is its geographical or political source. Other countries are much more protectionist (notably: Japan and France) and they publish only domestic tenders, in most cases. A domestic tender is open only to domestic bidders. Yet other countries limit participation in the tenders on various backgrounds:

the size of the competing company, its track record, its ownership structure, its human rights or environmental record and so on. Some countries publish the minutes of the tender committee (which has to explain WHY it selected this or that supplier). Others keep it a closely guarded secret ("to protect commercial interests and secrets").

But all countries state in advance that they have no obligation to accept any kind of offer - even if it is the cheapest. This is a needed provision: the cheapest is not necessarily the best. The cheapest offer could be coming from a very unreliable supplier with a bad past performance or a criminal record or from a supplier who offers goods of shoddy quality.

The tendering policies of most of the countries in the world also incorporates a second principle: that of "minimum size". The cost of running a tender is prohibitive in the cases of purchases in small amounts.

Even if there is corruption in such purchases it is bound to cause less damage to the public purse than the costs of the tender which is supposed to prevent it!

So, in most countries, small purchases can be authorized by government officials - larger amounts go through a tedious, multi-phase tendering process. Public competitive bidding is not corruption-proof: many times officials and bidders collude and conspire to award the contract against bribes and other, noncash, benefits. But we still know of no better way to minimize the effects of human greed.

Procurement policies, procedures and tenders are supervised by state auditing authorities. The most famous is, probably, the General Accounting Office, known by its acronym: the GAO.

It is an unrelenting, very thorough and dangerous watchdog of the administration. It is considered to be highly effective in reducing procurement - related irregularities and crimes. Another such institutions the Israeli State Reviser. What is common to both these organs of the state is that they have very broad authority. They possess (by law) judicial and criminal prosecution powers and they exercise it without any hesitation. They have the legal obligation to review the operations and financial transactions of all the other organs of the executive branch. Their teams select, each year, the organs to be reviewed and audited. They collect all pertinent documents and correspondence. They cross the information that they receive from elsewhere. They ask very embarrassing questions and they do it under the threat of perjury prosecutions. They summon witnesses and they publish damning reports which, in many cases, lead to criminal prosecutions.

Another form of review of public procurement is through powers granted to the legislative arm of the state (Congress, Parliament, Bundestag, or Knesset). In almost every country in the world, the elected body has its own procurement oversight committee. It supervises the expenditures of the executive branch and makes sure that they conform to the budget. The difference between such supervisory, parliamentary, bodies and their executive branch counterparts - is that they feel free to criticize public procurement not only in the context of its adherence to budget constraints or its cleanliness - but also in a political context. In other words, these committees do not limit themselves to asking HOW - but also engage in asking WHY. Why this specific expense in this given time and location - and not that expense, somewhere else or some other time. These elected bodies feel at liberty - and often do - intervene in the very decision making process and in the order of priorities. They have the propensity to alter both quite often.

The most famous such committee is, arguably, the Congressional Budget Office (CBO). It is famous because it is non-partisan and technocratic in nature. It is really made of experts which staff its offices.

Its apparent - and real - neutrality makes its judgements and recommendations a commandment not to be avoided and, almost universally, to be obeyed. The CBO operates for and on behalf of the American Congress and is, really, the research arm of that venerable parliament. Parallelly, the executive part of the American system - the Administration - has its own guard against waste and worse: the Office of Management and Budget (OMB).

Both bodies produce learned, thickset, analyses, reports, criticism, opinions and recommendations. Despite quite a prodigious annual output of verbiage - they are so highly regarded, that virtually anything that they say (or write) is minutely analysed and implemented to the last letter with an air of awe.

Only a few other parliaments have committees that carry such weight. The Israeli Knesset have the extremely powerful Finance Committee which is in charge of all matters financial, from appropriations to procurement. Another parliament renowned for its tight scrutiny is the French Parliament - though it retains very few real powers.

But not all countries chose the option of legislative supervision. Some of them relegated parts or all of these functions to the executive arm.

In Japan, the Ministry of Finance still scrutinizes (and has to authorize) the smallest expense, using an army of clerks. These clerks became so powerful that they have the theoretical potential to secure and extort benefits stemming from the very position that they hold. Many of them suspiciously join companies and organizations which they supervised or to which they awarded contracts - immediately after they leave their previous, government, positions. The Ministry of Finance is subject to a major reform in the reform-bent government of Prime Minister Hashimoto. The Japanese establishment finally realized that too much supervision, control, auditing and prosecution powers might be a Pyrrhic victory: it might encourage corruption - rather than discourage it.

Britain opted to keep the discretion to use public funds and the clout that comes with it in the hands of the political level. This is a lot like the relationship between the butter and the cat left to guard it. Still, this idiosyncratic British arrangement works surprisingly well. All public procurement and expenditure items are approved by the EDX Committee of the British Cabinet (=inner, influential, circle of government) which is headed by the Ministry of Finance. Even this did not prove enough to restrain the appetites of Ministers, especially as quid pro quo deals quickly developed. So, now the word is that the new Labour Prime Minister will chair it- enabling him to exert his personal authority on matters of public money.

Britain, under the previous, Tory, government also pioneered an interesting and controversial incentive system for its public servants as top government officials are euphemistically called there. They receive, added to their salaries, a portion of the savings that they effect in their departmental budgets. This means that they get a small fraction of the end of the fiscal year difference between their budget allowances and what they actually spent. This is very useful in certain segments of government activity - but could prove very problematic in others. Imagine health officials saving on medicines, or others saving on road maintenance or educational consumables. This, naturally, will not do.

Needless to say that no country officially approves of the payment of bribes or commission to officials in charge of public spending, however remote the connection is between the payment and the actions.

Yet, law aside many countries accept the intertwining of elites - business and political - as a fact of life, albeit a sad one. Many judicial systems in the world even make a difference between a payment which is not connected to an identifiable or discernible benefit and those that are. The latter - and only the latter - are labelled "bribery".

Where there is money - there is wrongdoing. Humans are humans - and sometimes not even that.

But these unfortunate derivatives of social activity can be minimized by the adoption of clear procurement policies, transparent and public decision making processes and the right mix of supervision, auditing and prosecution. Even then the result is bound to be dubious, at best.

Public Sector, Future of

What is: big, hated, outdated and indispensable? Answer: the Public Sector.

Everyone likes to complain about the deterioration of services provided by the Government and about how it obstructs the development of the Private Sector.

The Public Sector is composed of two elements:

1. **Public Utilities -** giant monopolies which supply electricity, water, sewage, communication services (PTT) and even banking. To qualify as public sector - these enterprises have to be owned by the state.

2. **Local Authorities -** Municipal, regional and state authorities. The Federal Republic of Germany is made of 16 LANDER. Each LAND has its own government and even Parliament. Each LAND collects taxes from its citizens and has its own fiscal budget. The same is true for the USA with more than 50 STATES and three levels of taxation: Federal, State and municipal.

Some analysts include the Government and its activities in the Public Sector as well.

The Public Sector has a very bad image in the West nowadays. It is fashionable to deride and devalue it. Everyone - including the American Democrat President, Bill Clinton - is against "Big Government". The former British Prime Minister, Margaret Thatcher, started all this with her Privatisation policies. She sold many British state owned firms to the public and broke the power of the trade unions. Her efforts were so successful that they were copied and emulated throughout the world.

Yet, even after one decade of privatizing the public sector, the figures are still alarming. We measure the involvement of the public sector in the national economy as a percentage of the Gross Domestic Product (GDP). In the European Union it accounts for 42% to 59% of the GDP.

That means that the public sector consumes between 42 and 59 Dollars of every 100 Dollars produced by the national economy. In Japan and the USA the corresponding number is 35%.

The public sector used to be 8% of GDP in the USA in 1920. It used to be 24% of GDP in Japan in 1955 - when the GDP was 12% of the current one. This means that the public sector in Japan grew by 400% in real terms in 40 years!

Singapore and Hong Kong are not in much better shape with 19%.

But what is wrong with having a large public sector?

To answer this question, let us review three historical "accidents".

In 1946 Germany was divided into West and East. Both parts had an identical economic starting point. Yet, 44 years later - West Germany was producing 6 times as much as East Germany, per capita.

In 1953 Korea was divided into South and North. Both parts had an identical economic starting point. Yet, 44 years later South Korea produces 40 (!) times more than its Northern neighbour.

Needless to mention the difference between these initially identical twins: one had an enormous public sector with central economic planning (East Germany and North Korea) - the other has a well developed private sector (West Germany and South Korea).

During the 1980s, British Telecom and British Steel - two state owned firms - were handed over to private hands. Their productivity now outstrips the output of state owned utilities by a factor of 6 (per employee).

The West has developed a few methods of coping with this unwelcome situation:

Privatization

There are three forms of passing the ownership of a state enterprise - or the control of it - to private hands:

(1) The sale of the control of the business to private investors. The latter purchase an amount of shares of the privatized firm which is sufficient to ensure their control of its operations (a controlling stake or "nucleus"). The rest of the shares are sold to the same investors at higher prices in the future, as the performance of the firm is considerably improved under the new management. Alternatively, the rest of the shares are sold in various stock exchanges at prices reflecting a premium attributable to the introduction of new management and new capital to the firm. Privatization in the USA is typically carried out in this way.

Some critics of this method say that it is inequitable. The enterprise belongs to the citizens of the country. When its value is determined by a group of bureaucrats in the

Ministry of Finance (even if they are assisted by outside experts, the final decision at what price to sell is theirs) - there is room for big mistakes or even for corruption. This way, a select, tiny group of well-connected businessmen (or former managers of the firm, who led it to its sorry state) will buy the privatized firm at a fraction of its true value and thus deprive the people of what is rightfully theirs.

A second approach was devised and implemented (mainly in Great Britain) to try and overcome these objections.

(2) The sale of the control of the enterprise to the wide public by offering (=selling) its shares in the local stock exchange. Another way is to give each and every citizen a warrant which carries the right to purchase shares in privatized firms (Poland, Russia, Czechoslovakia).

This way the public wealth is equally accessible to anyone who wishes to share in it.

The disadvantage: this is not real privatization - the firm passes from one public hand to the other. The true control of the firm will remain in the hands of its old managers, who will continue doing the same as long as they can.

(3) The third approach - adopted by Israel and France - is undoubtedly the worst. It includes the sale of the operations and management of the firm to a select group of investors at a value determined by bureaucrats at the government. But through special arrangements - commonly known as "golden shares" - the state maintains its grip over the prices at which the products of the firm are sold, its labour policies, its political affiliation and so on. This is usually done under the pretext that the firm

utilizes "national natural resources" or that its continued operations are a matter of national security or social interest.

De-Regulation

Governments are doing their citizens a much better service when they de-regulate.

This also has three forms to it:

(1) Divestiture - the breaking up of big state owned or even private firms which are monopolistic in nature, into smaller regional and / or operational units. These units will compete among themselves in the same markets. The usual result: lower prices, better service, more technological innovation. Famous cases: the breaking up of the telecommunications (privately owned) giant AT&T into small regional phone operators ("Baby Bells") in 1984.

Shortly Japan will follow suit with the breaking up of NTT, another (private) telecommunications behemoth.

(2) The easing or cancelling of regulations which inhibit or prohibit domestic competition.

A famous example: lately, the Cable TV operators in the USA were allowed to compete in the telecommunications markets. They were permitted to transfer phone calls over their infrastructure of lines and modems. This will make them formidable competitors to the local phone companies. The end result for the end user: lower prices, better service.

(3) Adopting free trade policies is a way of de-regulating the markets. When custom tariffs are reduced and other, non-tariff, trade barriers are lowered - this fosters foreign competition.

Economic research and theory demonstrate the benefits of free trade: more efficient allocation of resources, lower prices, better products and services, faster economic cycles resulting in technological innovation.

Securitization

In the West, the provider of credits takes some risk that the credits will not be paid back. These risks associated with credits are called "assets", in banking lingo.

When a person buys real estate property in the West he takes a loan ("mortgage") to finance part of his purchase cost. His loan is packaged together with other loans and sold to the public in the form of a bond.

The terms and conditions of the bond (maturity, interest payable, etc.) accurately reflect the terms and conditions of the assets (=credits, loans) underlying the bond.

The same is done with car loans and with many other forms of credits yielding regular streams of income to the creditor. This way, the creditor spreads his risks among many bondholders.

This process is called "securitization" - the transformation of financial assets (=credits) into securities which are sold in the stock exchanges to the wide public.

The public sector - and especially public utilities which have a stable stream of income - can sell their future income to the markets. This is done by issuing bonds to the public and selling them through the stock exchange. Another way is to sell these bonds directly to institutional investors, such as pension funds.

The bonds are paid back from income generated by the sale of electricity, water, etc. to the public - or by income generated by specific projects which is pledged to the bondholders.

Hidden Assets

The public sector possesses many assets which are either intangible or cannot be presented in ordinary accounting books. These assets can be put to productive use and generate income.

Examples abound:

Railroad companies own the land in which their railways run. They can lease these strips of land to various users: store-owners, cable TV companies, phone operators.

Electricity utilities have the exclusive rights to use the air through which their physical lines go. These rights can be leased to would-be users. For instance: cable TV companies can run their cables and piggyback on the lines of the electricity company.

Arguably the most well-known case is that of airwaves. The USA government is selling the rights to use the airwaves (radio frequencies) for cellular communication in special tenders conducted once every few months. The revenues from the sale of these intangible assets amount to billions of USD.

Innovative Supply and Demand Patterns

The public sector is developing innovative patterns of supplying its products and services - and of generating demand for them. A well-known example: everyone in North America can produce electricity in his home and in his spare time. He can use wind energy or even the energy in his muscles to produce electricity. The electricity companies are obliged to purchase the electricity thus generated from the small producers at a fixed price. This way, they secure diversified sources of supply and plow back a part of its income to the community.

Publishing, Print

The circulation of print magazines has declined precipitously in the last 24 months. This dissolution of subscriber bases has accelerated dramatically as economic recession set in. But a diminishing wealth effect is only partly to blame. The managements of printed periodicals - from dailies to quarterlies - failed miserably to grasp the Internet's potential and potential threat. They were fooled by the lack of convenient and cheap e-reading devices into believing that old habits die hard. They do - but magazine reading is not habit forming. Readers' loyalties are fickle and shift according to content and price. The Web offers cornucopial and niche-targeted content - free of charge or very cheaply. This is hard to beat and is getting harder by the day as natural selection among dot.bombs spares only quality content providers.

Real Estate Leasing in Macedonia

The subprime mortgage crisis in the United States is spreading into Europe, notably the United Kingdom. Real estate values are deemed inflated throughout the continent. One exception may be Macedonia. Purchase prices here have stagnated in the last few years and rental rates have actually declined considerably. There is good reason to think this will change and soon: new financing vehicles are on offer and, as real incomes increase, there is a stark mismatch between geometrically-growing demand and arithmetically-increasing supply.

Moreover, impressive improvements in the business climate led to the entry into retail, manufacturing, and services of global giants as foreign direct investors. These need or build shopping malls, office space, and parking lots.

Peter Roth, the General Manager of Soravia Macedonia, which bought the Business Center in Skopje last year, predicted, in a statement quoted in "Vecer", a Macedonian daily: " I expect the development of real estate, bigger competition, but also higher prices. I think that in the future investments will flow not only to Skopje, but also to Ohrid, Gevgelija and other cities, near the border with Greece." "In the near future small shops in buildings will disappear, problems with parking spots would be overcome, and expensive rents would grow further," - concluded the exuberant article.

This may all depend on the introduction of real estate leasing. Currently, it is a negligible portion of the activities of companies such as NLB Leasing and Hypo Hypo Alpe Adria Leasing. The latter's brochure doesn't even mention it.

"Under the terms of current legislation, we are able to offer leasing." - says Maja Lape Trajkova, director of NLB Leasing, which was established in 2000 and is owned by NLB Group, essentially a Slovenian bank. Gjorgje Vojnovik and Oliver Zintl, the Macedonian and Austrian managers of Hypo Alpe Adria Leasing agree. Their firm is owned and fully capitalized by an Austria (Klagenfurt) based multinational which operates in 14 countries.

NLB Leasing offers financial and operational leases of up to 15 years to firms and individuals, on all types of properties, second-hand and new: residential, commercial, and industrial. Hypo Alpe Adria Leasing is more selective and limits its financing to new construction. Equity ranges from 10 (Hypo Alpe Adria Leasing) to 30 (NLB Leasing) percent, depending on the creditworthiness of the lessee. Financing is procured from various sources, but mostly from the mother companies, NLB and Hypo Alpe Adria Leasing, respectively.

NLB Leasing's "typical leasing contract is with fixed rates and not with adjustable ones, (but) a change (in the) previously agreed terms is possible, of course. When it comes to being flexible and to adjusting to the client's financing needs, the whole package is considered: period, equity, rates, IR, etc."- says Trajkova. Hypo Adria Adria Leasing prefers the safer route of sticking to fixed rates exclusively.

So, why hasn't real estate leasing taken off, as it has in many other developing countries? Macedonia's banks offer mortgage financing but under onerous terms: multiple collaterals and guarantors, high fees, and an immediate transfer of the title (and of the risk associated with it) to the client. On paper, leasing is a more attractive proposition.

The problem is a quirk in the tax laws: lessees pay VAT up front on the entire amount of the contract, interest included. There is no VAT payable on interest payments made to banks, the leasing companies main competitors. "The law still protects the three major banks with a 75% share of the market," complains Vojnovik. Zintl concurs: "he private customer is at a tax disadvantage".

Even worse, expounds Trajkova: as far as the VAT law goes, financial leasing is a taxable exchange of goods. While firms can deduct the VAT or reclaim it (in one year's time or longer, if the firm has just commenced doing business in Macedonia), individuals incur it as a net out of pocket expense.

Additionally, all lessees have to pay a "real estate turnover tax" twice: once when they have signed the contract and once when they receive title to the property, having paid the lease in full. The turnover (or transfer) tax ranges between 3 and 5 percent, depending on the municipality. This and similar problems render certain types of leases (such as lease contracts incorporating leaseback or buyback options) untenable.

Trajkova compares this costly double taxation to the situation in Slovenia, where individuals pay only a property tax once. She met with officials at the Ministry of Finance, but they had no information as to when this hindrance will be removed. She claims to have formed a joint lobby, within the Chamber of Commerce, together with Hypo Alpe Adria Leasing and others. Hypo Alpe Adria Leasing beg to differ: they decry the lack of coordinated initiative by other leasing companies and in their own meetings "with this business-friendly government", as Vojnovik puts it, they were reassured that the problem will be solved in the first quarter of 2008.

Trajkova notes a growing awareness of leasing even among individual buyers of residential property, owing to a string of scandals involving swindlers who took advantage of Macedonia's chaotic and incomplete cadastre (the central registrar of land and real estate property). "People trust us and are willing to pay more," - she explains.

Vojnovik and Zintl also describe an overwhelming interest: the foreign ownership of leasing companies, the fact that title (and the risk it brings) remains with them until the end of the lease, their clean record, and their plans to enter the real estate scene as contractors and financiers have drawn considerable interest from would-be buyers.

Still, foreigners are not allowed to own land in Macedonia - I observe - although local subsidiaries of foreign firms are treated as domestic entities and can freely transact in both land and real estate.

This renders cross-border transactions somewhat complicated - Trajkova and Vojnovik agree, though Zintl adds that "there are no legal obstacles" to cross-border financing and that such transactions have come to dominate the portfolios of leasing companies in countries such as Croatia (1.7 billion euros annually) and even Serbia (with 1 billion euros a year).

How does one go about leasing real estate in Macedonia? - I enquire.

The procedure is simple: the applicant must produce an extract from the cadastre (called "property list"), proof of monthly income (Hypo Alpe demands proof of the income of the entire family), and some other basic and easy to obtain documents. Companies provide business plans with detailed projections. Lessees sign promissory notes on their monthly income and on the property. This covers the leasing company in case the property's value declines, "for instance, as a result of arson," - says Trajkova. As opposed to practice in the West, in Macedonia, it is the client who must insure the property. On the bright side, these conservative practices guarantee that Macedonia will not experience its own version of a subprime mortgage crisis.

Yet, while the leasing contract itself can be signed within days, dealings with the tax authorities and the cadastre can stretch into 3 months or more. This red tape poses difficulties as "sellers want their money immediately," - sighs Trajkova.

Moreover, only 60% of all real estate in Macedonia is registered with the cadastre. About one third of owners have no proof of ownership. Existing liens are not updated anywhere. Much of the land is owned by the state and is designated as agricultural. The processing of requests for construction licenses is tortuously long.

Both NLB Leasing and Alpe Adria emphasize commercial, office, and industrial real-estate, but regard residential property, including single family housing, as the area of future growth. Both leasing companies embarked on their own construction projects. This spring, NLB Leasing will start constructing residential property in Skopje's coveted center. They act as principals, both in financing and in contracting the work, thus avoiding having to pay taxes. Hypo Alpe Adria Leasing has similar plans, but they intend to rent the property out. The projects will be completed in about 2 years time.

Zintl describes the varied activities of the Austria-based Hypo Alpe Adria Leasing group in building and managing shopping malls and hotels. The availability of leasing in Macedonia will facilitate the entry of foreign investors, including his own group, replete with Austrian anchors in its newly constructed shopping malls, - he says.

Are residential real estate prices in Macedonia inflated? Are we witnessing an American-style bubble?

"Prices are exaggerated in terms of average monthly wages and taking into consideration macroeconomic conditions," - says Vojnovik. "Still, there is a big mismatch between demand and supply" and the scandal-ridden scene has made it difficult to find property with clean provenance and credentials. "When the leasing companies will enter, prices will go down."

Recessions, Economic

The fate of modern economies is determined by four types of demand: the demand for consumer goods; the demand for investment goods; the demand for money; and the demand for assets, which represent the expected utility of money (deferred money).

Periods of economic boom are characterized by a heightened demand for goods, both consumer and investment; a rising demand for assets; and low demand for actual money (low savings, low capitalization, high leverage).

Investment booms foster excesses (for instance: excess capacity) that, invariably lead to investment busts. But, economy-wide recessions are not triggered exclusively and merely by investment busts. They are the outcomes of a shift in sentiment: a rising demand for money at the expense of the demand for goods and assets.

In other words, a recession is brought about when people start to rid themselves of assets (and, in the process, deleverage); when they consume and lend less and save more; and when they invest less and hire fewer workers. A newfound predilection for cash and cash-equivalents is a surefire sign of impending and imminent economic collapse.

This etiology indicates the cure: reflation. Printing money and increasing the money supply are bound to have inflationary effects. Inflation ought to reduce the public's appetite for a depreciating currency and push individuals, firms, and banks to invest in goods and assets and reboot the economy. Government funds can also be used directly to consume and invest, although the impact of such interventions is far from certain.

Reference Works, Publishing of

The Wikipedia was touted as the greatest reference work in history. A collaborative effort of contributors and editors across time and space, it bloated into hundreds of thousands of articles on subjects both deserving and risible. Anyone with a connection to the Internet and a browser can edit the Wikipedia, regardless of his or her qualifications to do so.

Events in 2005-6 exposed the underbelly and weaknesses of this mammoth enterprise. Entries are routinely vandalized, libel and falsities often find their way into existing articles as a way to settle scores, manipulate public opinion, or express outrage.

The prestigious magazine "Nature" studied Wikipedia articles on the sciences and found them similar in quality to peer reviewed and edited encyclopedias. Indeed, the problems cluster around the entries that deal with the softer edges of the human experience (where everyone feels qualified to comment and edit): the social "sciences", the humanities, arts and entertainment, politics, current affairs, celebrities, and the like. It is there that "edit wars" and thrashing are most ripe. The result is that nigh close to 90% of the Wikipedia contain highly dubious material and attract the least qualified "experts" and "editors".

This seems to prove the point that the gaining and preservation of knowledge should not be subjected to a democratic process (or, as in the Wikipedia's case, mob rule). As the promoters of "intelligent design" are finding out, what we learn cannot and must not be decided by vocal protests and voting.

The acquisition of expertise and its propagation across the generations by means of works of reference should remain an elitist endeavor. The mechanisms of peer-review and editorial board are far from fail-proof. But they do guarantee a modicum of accuracy and objectivity which the Wikipedia gravely fails to do.

There are examples of online encyclopedias that actually adhere to basic principles: their authors and editors are qualified to write about the topics they have chosen or have been assigned, and the entries are largely accurate and unbiased. The Stanford Encyclopedia of Philosophy (SEP) is one example. The Open Site Encyclopedia is a hybrid, a cross between the Wikipedia and the SEP models.

The Wikipedia is often contrasted with the crown jewel of encyclopedias, the Britannica.

There is no source of reference remotely as authoritative as the Encyclopaedia Britannica. There is no brand as venerable and as veteran as this mammoth labour of knowledge and ideas established in 1768. There is no better value for money. And, after a few sputters and bugs, it now comes in all shapes and sizes, including two CD-ROM versions (standard and deluxe) and an appealing and reader-friendly web site. So, why does it always appear to be on the brink of extinction?

The Britannica provides for an interesting study of the changing fortunes (and formats) of vendors of reference. As late as a decade ago, it was still selling in a leather-imitation bound set of 32 volumes. As print encyclopaedias went, it was a daring innovator and a pioneer of hyperlinked-like textual design. It sported a subject index, a lexical part and an alphabetically arranged series of in-depth essays authored by the best in every field of human erudition.

When the CD-ROM erupted on the scene, the Britannica mismanaged the transition. As late as 1997, it was still selling a sordid text-only compact disc which included a part of the encyclopaedia. Only in 1998, did the Britannica switch to multimedia and added tables and graphs to the CD. Video and sound were to make their appearance even later. This error in trend analysis left the field wide open to the likes of Encarta and Grolier. The Britannica failed to grasp the irreversible shift from cumbersome print volumes to slender and freely searchable CD-ROMs. Reference was going digital and the Britannica's sales plummeted.

The Britannica was also late to cash on the web revolution - but, when it did, it became a world leader overnight. Its unbeatable brand was a decisive factor. A failed experiment with an annoying subscription model gave way to unrestricted access to the full contents of the Encyclopaedia and much more besides: specially commissioned articles, fora, an annotated internet guide, news in context, downloads and shopping. The site enjoys healthy traffic and the Britannica's CD-ROM interacts synergistically with its contents (through hyperlinks).

Yet, recently, the Britannica had to fire hundreds of workers (in its web division) and return to a pay-for-content model. What went wrong again? Internet advertising did. The Britannica's revenue model was based on monetizing eyeballs, to use a faddish refrain. When the perpetuum mobile of "advertisers pay for content and users get it free" crumbled - the Britannica found itself in familiar dire straits.

Is there a lesson to be learned from this arduous and convoluted tale? Are works of reference not self-supporting regardless of the revenue model (subscription, ad-based, print, CD-ROM)? This might well be the case.

Classic works of reference - from Diderot to the Encarta - offered a series of advantages to their users:

1. Authority - Works of reference are authored by experts in their fields and peer-reviewed. This ensures both objectivity and accuracy.

2. Accessibility - Huge amounts of material were assembled under one "roof". This abolished the need to scour numerous sources of variable quality to obtain the data one needed.

3. Organization - This pile of knowledge was organized in a convenient and recognizable manner (alphabetically or by subject).

Moreover, authoring an encyclopaedia was such a daunting and expensive task that only states, academic institutions, or well-funded businesses were able to produce them. At any given period there was a dearth of reliable encyclopaedias, which exercised a monopoly on the dissemination of knowledge. Competitors were few and far between. The price of these tomes was, therefore, always exorbitant but people paid it to secure education for their children and a fount of knowledge at home. Hence the long gone phenomenon of "door to door encyclopaedia salesmen" and instalment plans.

Yet, all these advantages were eroded to fine dust by the Internet. Wikipedia aside, the web offers a plethora of highly authoritative information authored and released by the leading names in every field of human knowledge and endeavour. The Internet, is, in effect, an encyclopaedia - far more detailed, far more authoritative, and far more comprehensive that any encyclopaedia can ever hope to be. The web is also fully accessible and fully searchable. What it lacks in organization it compensates in breadth and depth and recently emergent subject portals (directories such as Yahoo! or The Open Directory) have become the indices of the Internet. The aforementioned anti-competition barriers to entry are gone: web publishing is cheap and immediate. Technologies such as web communities, chat, and e-mail enable massive collaborative efforts. And, most important, the bulk of the Internet is free. Users pay only the communication costs.

The long-heralded transition from free content to fee-based information may revive the fortunes of online reference vendors. But as long as the Internet - with its 5,000,000,000 (!) visible pages (and 5 times as many pages in its databases) - is free, encyclopaedias have little by way of a competitive advantage.

These are momentous times in the digital content industry. Within the past 60 days, Barnes and Noble withdrew from the e-books business, peddling its electronic publishing house to iUniverse and terminating the sale of digital titles from its barnesandnoble.com Web site. It then proceeded to take private its publicly listed online arm.

To the consternation of many authors, Amazon, its chief Internet competitor, introduced a "search inside the book" feature with an initial database of 120,000 titles. It was preceded by eBooks.com's less comprehensive but otherwise similar search engine.

Project Gutenberg - the pioneering and largest depository of free, mostly "plain-vanilla" (text only) e-books - added the 10,000-th title to its unsurpassed collection. In the meantime, e-book aggregators, such as blackmask.com, now proffer tens of thousands of free titles for download in up to 8 file formats. Even Microsoft has spent the last few months offering a free weekly selection of 3 commercial titles each, exclusively readable on its MS-Reader application.

Buffeted by these winds of e-commerce, vendors of online reference - textbooks, dictionaries, and encyclopedias - are eyeing the market warily and wearily.

Patrick Spain is Chairman and CEO of Alacritude, publisher of eLibrary and Encyclopedia.com. eLibrary is a digital archive of more than 13 million documents culled from over 2000 publications. It includes newswires, newspapers, magazines, journals, transcripts, photographs, maps and books - major works of literature, art, and reference.

Troy Williams founded Questia in 1998 and has served as its President & CEO ever since. Questia is a massive online library of over 400,000 books, journals, and articles organized into more than 4000 research topics. It caters mainly to students and offers cool features such as online annotation, page printing for free, and bibliography generator.

Tom Panelas is the Director of Corporate Communications of the Encyclopaedia Britannica - the Rolls Royce of reference works. It has been available online for a few years now - the 32 volumes, an interactive atlas, a student's version, a links directory, and a topical compilation of thousands of magazine articles and multimedia. The Britannica has alternated between revenue models: subscriptions only, then free access with advertising, and back to subscriptions.

First I asked these pivotal industry players how they saw the future of paid access to online reference works, textbooks, and scholarly material?

Spain: Online reference is being consumerized or "Wal-Marted." That which used to be delivered to a limited audience of thousands (librarians and large companies) is now available to a huge audience in the tens, maybe hundreds, of millions. This affects prices, business models, and the very structure of the industry. Many generic reference materials (encyclopedias, dictionaries, thesauri, etc.) are available for free and will remain so for the indefinite future. They serve either to market print and other electronic products or they generate advertising. Good models do both. Some very specialized titles with limited audiences may continue to be able to charge. But most cannot. This means that people won't pay or won't pay much for "content" - but they will pay small amounts for services that help them find, organize and publish answers to their questions especially when those relate to wealth (finance and career), health, and certain types of entertainment.

Panelas: We've seen in the past three years a reaction to the meme of the middle- and late-1990s, that all information on the Internet has to be free and that people won't pay for it. For a few years it held somewhat true, but as the Internet population became more experienced, their interests and preferences inevitably changed.

People who were using free information on the Web eventually became fed up. Many of the sites they used disappeared because they had no self-sustaining economic model. Much of the information online was worthless. It became difficult to tell whether information on the Web was reliable.

As a result we've seen a growing realization among Internet users that not all types of information are equal, that authoritative information is valuable, somewhat rare, costs money to create, and for these reasons it's worth paying for. Many more people are willing to pay for high-quality information on the Internet than four years ago, especially since the price of online reference is at a nadir. We see online as the area that will grow the fastest, as far as the vending of reference goes. Many people will subscribe through third-party organizations such as Internet service providers with whom we have established relationships. Subscribers to SBC Yahoo! DSL service, for example, can choose a subscription to Britannica.com along with their service. In the future, publishers will probably provide one kind of service to such third-party distributors and create others, with better, premium offerings, for customers who pay them directly, since there's more revenue in such subscriptions.

Increasingly, information Web sites will "aggregate" content - that is, incorporate sources that go well together but could not be integrated before the Internet. Britannica.com, for example, includes three encyclopedias, magazines and journals, a guide to the best Web sites on various subjects, and other information. Thus sources that were previously spread throughout the library stacks, requiring the wearing out of much shoe leather to bring them together, now come to rest in one place, on the screen of your computer. This trend will no doubt continue.

Williams: Online reference resources, i.e., eLibraries, will become an indispensable part of education over the next 20 years. There are a number of discernible trends: first, electronic access will be the primary method of accessing scholarly information within a decade or two. It removes the need to be near a physical copy of the title one needs to access, it resolves multiple-user issues, and greatly increases the ability of a researcher to find what he or she is looking for.

Second, online access to scholarly information is an integral part of the trend towards online and distance education. The undergraduate population is diversifying and now includes students enrolled in distance learning programs, rural students without physical access to an adequate library, and older, community college students who work or have family obligations that prevent them from spending time in their campus library.

Third, the Internet has engendered a powerful trend toward personalization. Elibraries such as Questia enables its users to personalize their library. Notes and highlights in various colors in each book and article can be saved for future reference. Documents, “virtual bookshelves” and even previous term papers and bibliographies can be saved online and organized in various folders.

Fourth, people increasingly expect complete mobility. ELibraries such as Questia enables researchers to access their personalized copies of books and journals as well as old term papers and current work-in-progress from anywhere.

Q: Who are Alacritude's main competitors?

Spain: Alacritude competes with Google on the low end and Nexis on the high end. Google is in the throes of creating a marketplace and, only incidentally, allows its users to find knowledge. Nexis provides very specialized (and expensive) information services to enterprises. Alacritude's eLibrary helps our users to locate pretty good answers inexpensively. We are different in that we are evolving our service to tightly integrate tools and content and to let our customers search anywhere, even other services, from a single easy-to-use online research interface.

Q. Questia competes with the likes of NetLibrary and Alacritude's eLibrary. What differentiates it from its competitors?

Williams: Questia's and netLibrary's collections are very different. The Questia collection was developed specifically for undergraduate research in the humanities and social sciences. A staff of academic librarians determined which books are most important and useful for undergraduate coursework in these fields. Digital copyrights were negotiated with the publishers or author of the titles. Many publishers feared e-books and digital copies of their titles would cannibalize their hard copy print sales. Making them understand the benefits of placing their titles in the Questia online library was an education process.

Having obtained the digital copyrights we digitized the books since most of the content was unavailable in electronic format. The resultant book collection contains the complete text and original pagination of more than 45,000 books from the 19th through the 21st centuries. Our goal is to build a collection that includes important works from all time periods and provides our users with a full range of resources just as any quality library does. We want to build a true research collection, not just a compilation of recent publications. The entire Questia collection has more than 400,000 titles – including 360,000 journal, magazine, and newspaper articles.

In contrast, the 37,000-title netLibrary collection was developed by incorporating books that were already available in electronic formats. As a result, it lacks many important retrospective titles. Additionally, netLibrary was developed with the view of selling individual titles. Consequently, although it has titles in a broader range of subjects than Questia, it was not developed as a "collection." Questia specifically excludes titles in the natural sciences, technical and medical fields. We have a strong focus on "collection development" so that we can support rigorous academic research in thousands of social science and humanities specific topic areas.

A second important point of difference is the business model. Questia's is direct to the consumer. Individuals purchase subscriptions. We do not sell institutional site licenses to colleges or universities. NetLibrary sells to institutions. Public, private, and academic libraries, or consortia thereof, buy specific titles that it vends, similar to the way they purchase print copies.

Third, with Questia, there is no limit on the number of simultaneous users for any given book or article. No book is ever checked out or unavailable to a subscriber. With NetLibrary, the number of users is restricted to the number of electronic copies of a book purchased by a library.

The advantage of netLibrary is that it significantly reduces the costs of owning and maintaining books, i.e. the overhead associated with shelf-space such as lighting, the costs of checking books in and out manually, reshelving them, rebinding them, lost and misplaced copies, etc.

Lastly, the research environment is very different. Questia provides a set of tools that enable a user to do better research and organize their work - to highlight, jot down notes or bookmark a page, look up items in a dictionary, encyclopedia, and thesaurus, and create properly formatted citations and bibliographies in MLA, APA, ASA, Chicago, and Turabian styles. All these can be filed in a user's customizable personal workspace, which is akin to an online filing cabinet. Users can create multiple project folders to organize their research, "shelve" frequently accessed books or articles, and refer back to their bookshelf at any time.

NetLibrary offers four dictionaries as a reference tool but does not provide the type of customizable personal research environment that Questia does.

Alacritude's eLibrary is a subscription-based reference tool with newspapers, magazines, books, and transcripts. Their collection is not a research library but rather a compilation of recently published content on a variety of subjects. eLibrary can be used as an informational supplement. It seems to me to be more focused at the junior high school level or as an inexpensive alternative to Lexis.

Q: The Britannica has three types of products - print, online and digital-offline (CD-ROM/DVD). Do they augment each other - or cannibalize each other's sales?

Panelas: In the past decade we've seen huge increases in sales of all electronic formats at the expense of print, which has declined. The proportions have stabilized, however, and most people are choosing their medium based on the way they like to look for information. Prices of electronic encyclopedias are lower than print, but the value proposition of print is different, and people who continue to buy print do so because they like it. Meanwhile the declining price of reference information in general has put reference works in many more homes than before. So today rather than cannibalization, there's an expansion of the overall market, with more people buying reference products than ever before and people choosing the form they prefer.

Q: The web offers a plethora of highly authoritative information authored and released by the leading names in every field of human knowledge and endeavor. Some say that the Internet, is, in effect, an Encyclopaedia - far more detailed, far more authoritative, and far more comprehensive that any Encyclopaedia can ever hope to be. The web is also fully accessible and fully searchable. What it lacks in organization it compensates in breadth and depth and recently emergent subject portals (directories such as Google, Yahoo! or The Open Directory) have become the indices of the Internet. The aforementioned anti-competition barriers to entry are gone: web publishing is cheap and immediate. Technologies such as web communities, chat, and e-mail enable massive collaborative efforts. And, most important, the bulk of the Internet is free. Users pay only the communication costs. The long-heralded transition from free content to fee-based information may revive the fortunes of online reference vendors. But as long as the Internet - with its 2,000,000,000 visible pages (and 5 times as many pages in its databases) - is free, encyclopedias have little by way of a competitive advantage. Could you please comment on these statements?

Spain: I agree. Still, Open Directories and free powerful search engines (which, let's remember, make their money by trying to sell you goods and services relating to the keywords used in your search) only constitute 5% (or less) of what amounts to "research." First you have to find it; we have made good progress here. Then you have to organize it; there are few good tools for this. Finally you have to publish it, likely using one of Microsoft's applications. This entire process from search results to answers delivered in publishable form remains painful and time consuming. The opportunity lies in making research as easy as search. It seems simple, but it's very hard.

Williams: The real issue here is previously published material. There is certainly a lot of information on the Internet and that is a wonderful thing. However, there is virtually no place an individual who is not part of a major college or university can go online and find the full-text of books, including contemporary and recent ones. To say that the information that is available online is equivalent to the information stored in the Library of Congress is absurd. I'm not talking only about the range of information but also about the value of the editorial process. There is clearly a huge difference between someone posting something on a website and someone rigorously researching a book for five or ten years and then submitting it to peer review and the careful attention of editors. Virtually none of the fruits of this serious research and editorial process is available on the Web. The material on the Net suffers from a chronic issue of questionable credibility and is ephemeral. The material published by leading publishers is reliable and has lasting importance.

Panelas: It simply isn't true that the Internet is an encyclopedia. It's an aggregation of information by anyone who wants to put it up there. An encyclopedia is the product of a unified idea, a single editorial intelligence. The people who create it are skilled in their craft. It seeks to cover all areas of human knowledge and to do so in a way that both gives each area its due proportion and integrates it all so the various parts work well together. It reflects many choices that are made consciously and in a consistent way, and since it represents a summary of human knowledge rather than its sum total, the choices editors make about what to leave out are as important as the ones about what to put in.

True, there are people who are hostile to this idea, and, again, we saw some of this in the '90s enthusiasm for the Internet and the related belief that it would literally transform every aspect of life overnight. A sophisticated world such as ours, which relies on knowledge and information to function, can tolerate only so much bad information before problems arise, and we saw some of that in the early years of the Web, which is why more people today see the virtues of an encyclopedia than did a few years ago.

The collaborative possibilities of the Internet are very interesting, and we'll see in due time what their implications are for publishing. Some people are predicting that everything will be utterly transformed, but that usually doesn't happen.

Q: What are eLibrary's future plans regarding online reference?

Spain: Alacritude, through its encyclopedia.com, Researchville and eLibrary services is already addressing head on the need to create an easy to use and cost effective research service for individuals.

Q: What are the Britannica's future plans regarding online reference?

Panelas: We plan to keep improving what we offer, with new sources of information, more "non-text media," better search and navigation, and ease of use.

Q. What are Questia's future plans regarding online reference?

Williams: We are not focused on the traditional reference area. Reference books tend to be far more costly to acquire rights to. In addition, they are far more difficult to get into a web-ready format. As a result, we do not feel that the benefits warrant focusing on this area today. Our strategy is simple. We want to build a massive online library of carefully selected high-quality, full-text books.

Q. There are rumors about Questia's (lack of) financial muscle. Its future is said to be in doubt. Is there truth to it?

Questia is in the best financial position that it has ever been in. We are cash flow positive. We more than tripled revenue last year and we will nearly do so again this year. Today we have subscribers in 170 countries. In the

US, we have individual subscribers on over 2,000 college and university campuses. And those are just the ones we know of. Most of our users don't give us that information. Our customer satisfaction levels are extremely high as you can see from the feedback on our site. We see the result of that high satisfaction in that once someone subscribes, typically they stay subscribed for quite a while. Any recent rumors about Questia are probably the echoes of older stories from a few years ago and would not be accurate.

Religion

Ever since the French Revolution and its anti-clerical, confiscatory, policies, running a church is bad business.

Consider the 10 sq. miles (26 sq. km.) Mecca in Saudi Arabia. Originally the crossing point of all major caravan routes (from the Mediterranean to Saudia, from east Africa to south Africa), its stature declined - paradoxically - since the 7th century and Islam's military ascendance. Today, much reduced economically, its main line of business is the hajj (and the lesser umra), the pilgrimage all devout Moslems attempt at least once in a lifetime. Billions of dollars were invested in clearing the derelict areas around the shrines, in building residential properties, in enlarging existing mosques, in connecting Mecca to other parts of the kingdom and the peninsula, and in providing enhanced sanitation and transportation (a well developed bus system).

Yet, the 2 million (mostly destitute) pilgrims who visit it annually leave behind only $100 million. Deduct the costs - mainly in damaged infrastructure and enhanced security (following a few massacres and political demonstrations) - and the hajj may not be such an enticing proposition. Perhaps as a result, the city has no railway system or airport to speak of and still consumes flood waters from the numerous wadis around it. Its 650,000 inhabitants occupy its old quarters and eke out a living by manufacturing furniture, eating utensils, and textiles. A few cultivate the little arable land there is - to little effect. Foreigners are banned from entering the city, which probably explains the dearth of FDI.

Mecca is poor and economically insignificant, its religious significance notwithstanding.

The keys to economic success seem to be diversification - and compartmentalization. Both are practiced admirably in Jerusalem. Despite decades of strife, partition, and a questionable legal status - the city is flourishing. It has been a centre of scholarship and research since 1918 when the Hebrew University was founded. It is home to the renowned Hadassah Medical Centre and the site of numerous (and well-funded) archeological expeditions. It has always been the administrative centre (first in British ruled Palestine and then in the State of Israel). Twenty years of higher education, NASDAQ listings, and venture capital resulted in a hi-tech strip straddling the new settlements and the neighbourhoods surrounding the city's older kernel. With dot.coms bombing all over the place, Jerusalem's luster as a hi-tech Mecca is off. But politically-motivated multi-billion dollar investments in residential construction, transportation, and infrastructure in and around the city keep it vibrant. Its population exceeds Tel-Aviv's now.

The Palestinians of East Jerusalem constitute a pool of cheap, well educated labour - and captive consumers with their hinterland (the West Bank) severed. Jerusalem even has ethnically mixed industries (though it is far from being integrated economically): shoes, textiles, pharmaceuticals, metal products, and printing houses. Still, as opposed to Mecca, religion is a small and insignificant part of its economy, far outweighed by tourism and services. Religion is wisely not allowed to disrupt the city's economic pulse.

Even the Vatican, with its less than 1000 "citizens", is not a religious monoculture. With revenues and expenditures almost balanced at $200 million p.a. - it derives most of its income from tourism (admission fees), and the sale of postage stamps, coins, and publications. One should not underestimate the attractions of the Vatican. In 2000, more than 2 million young people attended the misnamed six day fest, "World Youth Day". Donations from Catholic congregations the world over come next. Despite "full disclosure" reports published since the early 1980's, no one knows how much the Vatican earns on its legendary investment portfolio (until the late 1980's, the Holy See was heavily involved in the decidedly unholy Italian banking and financial scene).

There is no income tax in the Vatican and funds are imported and exported freely - which makes the Vatican a potential haven for money laundering. It pays its (c. 3000) lay workers very handsomely. Vatican City dabbles in the manufacturing of textiles (its own uniforms) and mosaics and in media enterprises (radio, TV, Internet, multimedia). It had its own Vatican lire - but it went the way of the Italian lire and was replaced by the euro. It also has its own postal and telephone systems, post office, astronomical observatory, banks, and pharmacies. The famous Swiss Guards safeguard the pope since 1506. And despite the fact that the Vatican imports all its food, electricity, and water - it is financially self sufficient, a prime example of commercialized religion.

But perhaps the epitome of co-existence between secular, sacred, and sacrilegious- is Salt Lake City.

Scene of the Winter Olympics this year, the city attained notoriety with what came perilously close to bribing International Olympic Committee officials to make the right choice. Despite the omnipresent, near omnipotent, and always flush Church of Jesus Christ of the Latter-day Saints (Mormon), alcohol is now easier to buy. But this, according to "The Economist", may not be the only sin. The city is also the capital of junk financing in the form of a vehicle known as "Industrial Loan Corporations" (ILC). These lend to "less qualitative" firms at usurious interest rates while enjoying FDIC insurance and no supervision (technically, they are not banks). Such "assets" are rumored to exceed $90 billion (up from $2 in 1994). ILC's in Salt Lake City are managed by the likes of Merrill Lynch, General Electric and Pitney Bowes.

Like Jerusalem, Salt Lake City was home to a hi-tech bubble inflated by mobile Californian entrepreneurs in search of quality of life. It deflated more gently than in California, though. Hi-tech and publishing are still major source of income and employment. As a result, more than half the city's denizens are not Mormons. Crime of every kind has risen to dizzying proportions as has an unsustainable construction boom. From basketball courts to courthouses, from stadiums to conference centers, from railways to hotels - the 1990's has been the decade of the masons.

The city turned its back on traditional (and still important) smokestack industries - defense, mining - and agriculture, and adopted wholeheartedly the services, starting with Delta Airlines, the financial industry (e.g., American Express), and winter tourism. Annual job growth averaged more than 4% since 1985. Things haven't been smooth all along, though. Salt Lake City caught the Asian flu in 1998-9 and its exports (and wages) dropped precipitously ever since. The technology bust and a series of mergers and acquisitions fostered a glut of office space. But overall, getting rid of religion as the only source of economic activity turned out to have been prescient.

The Winter Olympics may prove to be the city's undoing. It has gambled the shop on the games' economic effects ($3 billion in revenues) and after-effects. But in the post-September 11 environment, the only after effects are likely to be a capacity hangover: empty hotel rooms and infrastructure (roads, slopes, convention centers) falling into disuse. Even the Church's fabulous (and rather mysterious) portfolio (c. $20-40 billion) will be unable to provide sufficient counter-cyclical impetus. It has just dispensed with $300 million in cash to build a new Assembly Hall. Many similarly large undertakings will be required to offset a property bust. This may be beyond even the power of latter day saints.

Risk

Risk transfer is the gist of modern economies. Citizens pay taxes to ever expanding governments in return for a variety of "safety nets" and state-sponsored insurance schemes. Taxes can, therefore, be safely described as insurance premiums paid by the citizenry. Firms extract from consumers a markup above their costs to compensate them for their business risks.

Profits can be easily cast as the premiums a firm charges for the risks it assumes on behalf of its customers - i.e., risk transfer charges. Depositors charge banks and lenders charge borrowers interest, partly to compensate for the hazards of lending - such as the default risk. Shareholders expect above "normal" - that is, risk-free - returns on their investments in stocks. These are supposed to offset trading liquidity, issuer insolvency, and market volatility risks.

In his recent book, "When all Else Fails: Government as the Ultimate Risk Manager", David Moss, an associate professor at Harvard Business School, argues that the all-pervasiveness of modern governments is an outcome of their unique ability to reallocate and manage risk.

He analyzes hundreds of examples - from bankruptcy law to income security, from flood mitigation to national defense, and from consumer protection to deposit insurance. The limited liability company shifted risk from shareholders to creditors. Product liability laws shifted risk from consumers to producers.

And, we may add, over-generous pension plans shift risk from current generations to future ones. Export and credit insurance schemes - such as the recently established African Trade Insurance Agency or the more veteran American OPIC (Overseas Private Investment Corporation), the British ECGD, and the French COFACE - shift political risk from buyers, project companies, and suppliers to governments.

Risk transfer is the traditional business of insurers. But governments are in direct competition not only with insurance companies - but also with the capital markets. Futures, forwards, and options contracts are, in effect, straightforward insurance policies.

They cover specific and narrowly defined risks: price fluctuations - of currencies, interest rates, commodities, standardized goods, metals, and so on. "Transformer" companies - collaborating with insurance firms - specialize in converting derivative contracts (mainly credit default swaps) into insurance policies. This is all part of the famous Keynes-Hicks hypothesis.

As Holbrook Working proved in his seminal work, hedges fulfill other functions as well - but even he admitted that speculators assume risks by buying the contracts. Many financial players emphasize the risk reducing role of derivatives. Banks, for instance, lend more - and more easily - against hedged merchandise.

Hedging and insurance used to be disparate activities which required specialized skills. Derivatives do not provide perfect insurance due to non-eliminable residual risks (e.g., the "basis risk" in futures contracts, or the definition of a default in a credit derivative). But as banks and insurance companies merged into what is termed, in French, "bancassurance", or, in German, "Allfinanz" - so did their hedging and insurance operations.

In his paper "Risk Transfer between Banks, Insurance Companies, and Capital Markets", David Rule of the Bank of England flatly states:

"At least as important for the efficiency and robustness of the international financial system are linkages through the growing markets for risk transfer. Banks are shedding risks to insurance companies, amongst others; and life insurance companies are using capital markets and banks to hedge some of the significant market risks arising from their portfolios of retail savings products ... These interactions (are) effected primarily through securitizations and derivatives. In principle, firms can use risk transfer markets to disperse risks, making them less vulnerable to particular regional, sectoral, or market shocks. Greater inter-dependence, however, raises challenges for market participants and the authorities: in tracking the distribution of risks in the economy, managing associated counterparty exposures, and ensuring that regulatory, accounting, and tax differences do not distort behavior in undesirable ways."

If the powers of government are indeed commensurate with the scope of its risk transfer and reallocation services - why should it encourage its competitors? The greater the variety of insurance a state offers - the more it can tax and the more perks it can lavish on its bureaucrats. Why would it forgo such benefits? Isn't it more rational to expect it to stifle the derivatives markets and to restrict the role and the product line of insurance companies?

This would be true only if we assume that the private sector is both able and willing to insure all risks - and thus to fully substitute for the state.

Yet, this is patently untrue. Insurance companies cover mostly "pure risks" - loss yielding situations and events. The financial markets cover mostly "speculative risks" - transactions that can yield either losses or profits. Both rely on the "law of large numbers" - that in a sufficiently large population, every event has a finite and knowable probability. None of them can or will insure tiny, exceptional populations against unquantifiable risks. It is this market failure which gave rise to state involvement in the business of risk to start with.

Consider the September 11 terrorist attacks with their mammoth damage to property and unprecedented death toll. According to "The Economist", in the wake of the atrocity, insurance companies slashed their coverage to $50 million per airline per event. EU governments had to step in and provide unlimited insurance for a month. The total damage, now pegged at $60 billion - constitutes one quarter of the capitalization of the entire global reinsurance market.

Congress went even further, providing coverage for 180 days and a refund of all war and terrorist liabilities above $100 million per airline. The Americans later extended the coverage until mid-May. The Europeans followed suit. Despite this public display of commitment to the air transport industry, by January this year, no re-insurer agreed to underwrite terror and war risks. The market ground to a screeching halt. AIG was the only one to offer, last March, to hesitantly re-enter the market. Allianz followed suit in Europe, but on condition that EU governments act as insurers of last resort.

Even avowed paragons of the free market - such as Warren Buffet and Kenneth Arrow - called on the Federal government to step in. Some observers noted the "state guarantee funds" - which guarantee full settlement of policyholders' claims on insolvent insurance companies in the various states. Crop failures and floods are already insured by federal programs.

Other countries - such as Britain and France - have, for many years, had arrangements to augment funds from insurance premiums in case of an unusual catastrophe, natural or man made. In Israel, South Africa, and Spain, terrorism and war damages are indemnified by the state or insurance consortia it runs. Similar schemes are afoot in Germany.

But terrorism and war are, gratefully, still rarities. Even before September 11, insurance companies were in the throes of a frantic effort to reassert themselves in the face of stiff competition offered by the capital markets as well as by financial intermediaries - such as banks and brokerage houses.

They have invaded the latter's turf by insuring hundreds of billions of dollars in pools of credit instruments, loans, corporate debt, and bonds - quality-graded by third party rating agencies. Insurance companies have thus become backdoor lenders through specially-spun "monoline" subsidiaries.

Moreover, most collateralized debt obligations - the predominant financial vehicle used to transfer risks from banks to insurance firms - are "synthetic" and represent not real loans but a crosscut of the issuing bank's assets. Insurance companies have already refused to pay up on specific Enron-related credit derivatives - claiming not to have insured against a particular insurance events. The insurance pertained to global pools linked and overall default rates - they protested.

This excursion of the insurance industry into the financial market was long in the making. Though treated very differently by accountants - financial folk see little distinction between an insurance policy and equity capital. Both are used to offset business risks.

To recoup losses incurred due to arson, or embezzlement, or accident - the firm can resort either to its equity capital (if it is uninsured) or to its insurance. Insurance, therefore, serves to leverage the firm's equity. By paying a premium, the firm increases its pool of equity.

The funds yielded by an insurance policy, though, are encumbered and contingent. It takes an insurance event to "release" them. Equity capital is usually made immediately and unconditionally available for any business purpose. Insurance companies are moving resolutely to erase this distinction between on and off balance sheet types of capital. They want to transform "contingent equity" to "real equity".

They do this by insuring "total business risks" - including business failures or a disappointing bottom line. Swiss Re has been issuing such policies in the last 3 years. Other insurers - such as Zurich - move into project financing. They guarantee a loan and then finance it based on their own insurance policy as a collateral.

Paradoxically, as financial markets move away from "portfolio insurance" (a form of self-hedging) following the 1987 crash on Wall Street - leading insurers and their clients are increasingly contemplating "self-insurance" through captives and other subterfuges.

The blurring of erstwhile boundaries between insurance and capital is most evident in Alternative Risk Transfer (ART) financing. It is a hybrid between creative financial engineering and medieval mutual or ad hoc insurance. It often involves "captives" - insurance or reinsurance firms owned by their insured clients and located in tax friendly climes such as Bermuda, the Cayman Islands, Barbados, Ireland, and in the USA: Vermont, Colorado, and Hawaii.

Companies - from manufacturers to insurance agents - are willing to retain more risk than ever before. ART constitutes less than one tenth the global insurance market according to "The Economist" - but almost one third of certain categories, such as the US property and casualty market, according to an August 2000 article written by Albert Beer of America Re. ART is also common in the public and not for profit sectors.

Captive.com counts the advantages of self-insurance:

"The alternative to trading dollars with commercial insurers in the working layers of risk, direct access to the reinsurance markets, coverage tailored to your specific needs, accumulation of investment income to help reduce net loss costs, improved cash flow, incentive for loss control, greater control over claims, underwriting and retention funding flexibility, and reduced cost of operation."

Captives come in many forms: single parent - i.e., owned by one company to whose customized insurance needs the captive caters, multiple parent - also known as group, homogeneous, or joint venture, heterogeneous captive - owned by firms from different industries, and segregated cell captives - in which the assets and liabilities of each "cell" are legally insulated. There are even captives for hire, known as "rent a captive".

The more reluctant the classical insurance companies are to provide coverage - and the higher their rates - the greater the allure of ART. According to "The Economist", the number of captives established in Bermuda alone doubled to 108 last year reaching a total of more than 4000. Felix Kloman of Risk Management Reports estimated that $21 billion in total annual premiums were paid to captives in 1999.

The Air Transport Association and Marsh, an insurer, are in the process of establishing Equitime, a captive, backed by the US government as an insurer of last resort. With an initial capital of $300 million, it will offer up to $1.5 billion per airline for passenger and third party war and terror risks.

Some insurance companies - and corporations, such as Disney - have been issuing high yielding CAT (catastrophe) bonds since 1994. These lose their value - partly or wholly - in the event of a disaster. The money raised underwrites a reinsurance or a primary insurance contract.

According to an article published by Kathryn Westover of Strategic Risk Solutions in "Financing Risk and Reinsurance", most CATs are issued by captive Special Purpose Vehicles (SPV's) registered in offshore havens. This did not contribute to the bonds' transparency - or popularity.

An additional twist comes in the form of Catastrophe Equity Put Options which oblige their holder to purchase the equity of the insured at a pre-determined price. Other derivatives offer exposure to insurance risks. Options bought by SPV's oblige investors to compensate the issuer - an insurance or reinsurance company - if damages exceed the strike price. Weather derivatives have taken off during the recent volatility in gas and electricity prices in the USA.

The bullish outlook of some re-insurers notwithstanding, the market is tiny - less than $1 billion annually - and illiquid. A CATs risk index is published by and option contracts are traded on the Chicago Board of Trade (CBOT). Options were also traded, between 1997 and 1999, on the Bermuda Commodities Exchange (BCE).

Risk transfer, risk trading and the refinancing of risk are at the forefront of current economic thought. An equally important issue involves "risk smoothing". Risks, by nature, are "punctuated" - stochastic and catastrophic. Finite insurance involves long term, fixed premium, contracts between a primary insurer and his re-insurer. The contract also stipulates the maximum claim within the life of the arrangement. Thus, both parties know what to expect and - a usually well known or anticipated - risk is smoothed.

Yet, as the number of exotic assets increases, as financial services converge, as the number of players climbs, as the sophistication of everyone involved grows - the very concept of risk is under attack. Value-at-Risk (VAR) computer models - used mainly by banks and hedge funds in "dynamic hedging" - merely compute correlations between predicted volatilities of the components of an investment portfolio.

Non-financial companies, spurred on by legislation, emulate this approach by constructing "risk portfolios" and keenly embarking on "enterprise risk management (ERM)", replete with corporate risk officers. Corporate risk models measure the effect that simultaneous losses from different, unrelated, events would have on the well-being of the firm.

Some risks and losses offset each others and are aptly termed "natural hedges". Enron pioneered the use of such computer applications in the late 1990's - to little gain it would seem. There is no reason why insurance companies wouldn't insure such risk portfolios - rather than one risk at a time. "Multi-line" or "multi-trigger" policies are a first step in this direction.

But, as Frank Knight noted in his seminal "Risk, Uncertainty, and Profit", volatility is wrongly - and widely - identified with risk. Conversely, diversification and bundling have been as erroneously - and as widely - regarded as the ultimate risk neutralizers. His work was published in 1921.

Guided by VAR models, a change in volatility allows a bank or a hedge fund to increase or decrease assets with the same risk level and thus exacerbate the overall hazard of a portfolio. The collapse of the star-studded Long Term Capital Management (LTCM) hedge fund in 1998 is partly attributable to this misconception.

In the Risk annual congress in Boston two years ago, Myron Scholes of Black-Scholes fame and LTCM infamy, publicly recanted, admitting that, as quoted by Dwight Cass in the May 2002 issue of Risk Magazine: "It is impossible to fully account for risk in a fluid, chaotic world full of hidden feedback mechanisms." Jeff Skilling of Enron publicly begged to disagree with him.

Last month, in the Paris congress, Douglas Breeden, dean of Duke University's Fuqua School of Business, warned that - to quote from the same issue of Risk Magazine:

" 'Estimation risk' plagues even the best-designed risk management system. Firms must estimate risk and return parameters such as means, betas, durations, volatilities and convexities, and the estimates are subject to error. Breeden illustrated his point by showing how different dealers publish significantly different prepayment forecasts and option-adjusted spreads on mortgage-backed securities ... (the solutions are) more capital per asset and less leverage."

Yet, the Basle committee of bank supervisors has based the new capital regime for banks and investment firms, known as Basle 2, on the banks' internal measures of risk and credit scoring. Computerized VAR models will, in all likelihood, become an official part of the quantitative pillar of Basle 2 within 5-10 years.

Moreover, Basle 2 demands extra equity capital against operational risks such as rogue trading or bomb attacks. There is no hint of the role insurance companies can play ("contingent equity"). There is no trace of the discipline which financial markets can impose on lax or dysfunctional banks - through their publicly traded unsecured, subordinated debt.

Basle 2 is so complex, archaic, and inadequate that it is bound to frustrate its main aspiration: to avert banking crises. It is here that we close the circle. Governments often act as reluctant lenders of last resort and provide generous safety nets in the event of a bank collapse.

Ultimately, the state is the mother of all insurers, the master policy, the supreme underwriter. When markets fail, insurance firm recoil, and financial instruments disappoint - the government is called in to pick up the pieces, restore trust and order and, hopefully, retreat more gracefully than it was forced to enter.

The state would, therefore, do well to regulate all financial instruments: deposits, derivatives, contracts, loans, mortgages, and all other deeds that are exchanged or traded, whether publicly (in an exchange) or privately. Trading in a new financial instrument should be allowed only after it was submitted for review to the appropriate regulatory authority; a specific risk model was constructed; and reserve requirements were established and applied to all the players in the financial services industry, whether they are banks or other types of intermediaries.

Why are the young less risk-averse than the old?

One standard explanation is that youngsters have less to lose. Their elders have accumulated property, raised a family, and invested in a career and a home. Hence their reluctance to jeopardize it all.

But, surely, the young have a lot to forfeit: their entire future, to start with. Time has money-value, as we all know. Why doesn't it factor into the risk calculus of young people?

It does. Young people have more time at their disposal in which to learn from their mistakes. In other words, they have a longer horizon and, thus, an exponentially extended ability to recoup losses and make amends.

Older people are aware of the handicap of their own mortality. They place a higher value on time (their temporal utility function is different), which reflects its scarcity. They also avoid risk because they may not have the time to recover from an erroneous and disastrous gamble.

Romania, Economy of

Romanians like to compare their country to the heart of Europe. If so, Europe has been in a continuous state of cardiac arrest. Romania is still so backward and corrupt that even venerable foreign leaders get entangled in its sleaze.

According to various press reports (e.g., in "Ananova"), on July 23, 2001, Tony Blair sent a letter to the Romanian Prime Minister, Adrian Nastase, regarding the privatization of Sidex, a nationalize steel mill with $1.2 billion in accumulated debts. In his missive, Blair made it abundantly clear that Britain's support of Romania's accession to the EU would be considerably enhanced should Romania choose to sell Sidex to LNM, owned by a major contributor to the Labour Party in the UK. Sure enough, two days later, LNM won the bid.

Yet another Romanian false dawn - when the "social democrat" Iliescu was elected for president and the "Thatcherite" Nastase was elected Prime Minister in late 2000 - had ended penumbrally.

In his first days in office, Nastase, the head of the largest party in parliament, succeeded to reschedule $4 billion in debts and to infuse the nation with hope, purpose, and concrete (and painful) reforms - in the face of strong objections by vested interests, such as the militant trade unions.

The EU was suddenly talking about Romania, with its 23 million poverty stricken citizens, as part of its "first intake", together with the likes of Hungary and the Czech Republic (it ultimately joined the EU in January 2007, together with another paragon of rectitude and capitalism, Bulgaria).

The EBRD doubled its lending in Romania to $250 million in 2001. Its portfolio there reached $1.8 billion. The EBRD further held its 2002 annual meeting in Bucharest. "(Romania) could be the Poland of the region (Balkan)", gushed The Economist.

But that was then.

In January 2002, the Italian weekly "Panorama" accused Romania's secret service (SRI) of collusion in the sale of arms from the breakaway Dnestr region in Moldova to terrorist organizations and Arab countries, members of the "Axis of Evil" (accusations it vehemently, though unconvincingly, denied).

The Prime Minister admitted that members of the opposition parties were hounded under the cover of an anti-corruption campaign which got off to a "bad start". Parliament cleared the head of the SRI of allegations of involvement in illegal financial dealings. AC International, a software distributor in Romania, said that the country lost $450 million in revenues due to its thriving black markets in pirated software and other intellectual property. The Speaker of the Senate denied charges that he authorized illicit bank transfers while he was president of the Romanian Investment and Development Bank (BID). And a nuclear reactor was shut down due to a "minor malfunction".

It is telling that c. $700 million of $3.3 billion (in 30 projects) committed by the World Bank to Romania since 1991 - went towards the design of "Economic Policy". This is equal to the World Bank's investments in Romania's transportation and finance combined and 25% more than it invested in agriculture. Evidently, Romania has failed to come up with viable economic policies on its own.

The 2001-4 CAS (Country Assistance Strategy) envisaged another $1.5 billion in investments. Romania was included in the then pilot CDF (Comprehensive Development Framework) - a series of public consultations with stakeholders in the country's economy and politics. The Bank's main concerns are the mitigation of the disastrous and destabilizing social consequences of privatization and the support of a nascent private sector and SME's (small and medium enterprises).

Despite acrimonious notes ("We are not prepared to accept recipes, to be told exactly what we have to do" - thundered Romania's Prime Minister), the IMF declared itself satisfied with Romania's economic performance - perhaps because it set its sights low to start with.

Partly thanks to an exchange rate policy of managed float, administered ably by the central bank, inflation dropped to

30% annually in 2002 (down from 41% in 2000). The trade deficit was "less than 6% of GDP" (i.e., tripled to $1.5 billion in the first half of 2001), foreign exchange reserves have increased (to c. $5 billion, or 3 months of imports), and the fiscal system has been revamped with a new VAT law and the elimination of discretionary tax exemptions.

A great surge in farming activity and in domestic demand led to a rise of 5% in GDP (at the expense of stagnating industrial activity). Budget deficit targets were largely met - mainly due to a cut of 3% in state salaries and in energy subsidies ("not nearly enough", retorted the IMF).

But the upbeat press releases hide a disturbing reality.

The average monthly salary in Romania is still less than $120 ($150-250 in urban centers), the price of a good restaurant meal for one in Washington, the IMF's domicile. Most wages are indexed which makes disinflation a daunting task. GDP per head is lower than Macedonia's at $1600. More than 13% of the workforce are unemployed (officially, only 8%). Social unrest is seething. GDP is growing only in nominal terms. The share of industry in the national economy was halved to 28% in 1999. Agriculture and forestry similarly declined. Despite its low foreign debt at 32% of GDP - the legacy of Ceausescu's inane policies - Romania's debt to service ratio, at 20%, is higher than Bulgaria's, Ukraine's, Hungary's, or Slovakia's.

Relationships with the IMF are stormy. Five years ago, for example, the IMF mission left Bucharest without waiting for a Romanian letter of intent - though it promised to return soon and to release the second tranche of the stand-by arrangement on time, the next month.

Privatization - with the exception of the much maligned Sidex - ground to a halt, in contravention of Romania's October 2001 IMF stand-by arrangement. The Law on Privatization was recently amended to disallow non-cash payments for state assets. Romanian Speed News report that the Privatization Agency is involved in over 14,000 lawsuits. The property rights of minority shareholders are still widely abused.

Tax revenues (and payments for heating and electricity) have deteriorated sharply. The agricultural sector - composed of inefficient smallholders - has not been touched. Close to 100,000 homeless children roam the streets. Romania's external environment has worsened perceptibly as all its trade partners were hit by a global recession between 2000-2005.

In a flailing attempt to open up new markets and to revive moribund old ones - Romanian high officials have signed agreements or met with decision makers from the likes of Bulgaria, Serbia, Pakistan, and Vietnam. Romania, Bulgaria, and (occasionally) Greece regularly co-ordinate their stances on EU issues (such as the EU's agricultural policy).

Romania's economic policies are dictated by the EU and the IMF. But there is a wilder card at play: the Hungarian minority.

The Socialists often find themselves in coalition with the Hungarian Democratic Union in Romania (HDUR). A few years ago, they have signed an agreement with the

HDUR regarding the Hungarian "Status Law" (which grants employment preferences in Hungary to Magyars who reside in neighboring countries, such as Romania and Ukraine). This did not stop one third of the parliamentary deputies of HDUR from defecting and setting up the "Civic Wing", thus seriously destabilizing the political status quo. Nastase's government has at least made the right sounds and did push a few important reforms through. When it unravelled, Romania was cast back to darker - and, alas, more familiar - days.

Romanian President, Ion Iliescu, contested his homeland's geography. In April 2003, at a joint press conference with Bulgaria's President Parvanov, he cast both countries as "central-south European" rather than the derogatory "Balkan". Both joined NATO in 2004 and the European Union in January 2007 - though the former organisation expressed reservations after embarrassing leaks of classified military data in both Bucharest and Sofia.

Romania - a signatory of a strongly worded letter supporting the war in Iraq - has pledged 278 soldiers within nuclear, biological and chemical decontamination units, medical and engineering corps and military police. Close to 100 of them are already deployed in the Gulf. Romania also opened its airspace and a Black Sea air base near Constanta to 1000 U.S. troops. It shared with the coalition intelligence about Iraqi infrastructure, which it helped construct in communist times.

The United States, peeved by the recalcitrant pacifism of the French and Germans, intends to shift some air bases from Old Europe to east Bulgaria, Poland and Romania. This could signal the revival of the region's moribund defense industries. Potential buyers are taking note.

Colonel-General Safar Abiyev, then Azeri Defense Minister, visited Romania in April 2003 to discuss "military cooperation" - mainly training, technology transfer, a scholarship programs and interoperability exercises within NATO's East European program "Partnership for Peace". Romania's trimmed forces participate in peacekeeping operations in Kosovo, Afghanistan and Bosnia.

Romania's Social Democratic government led by Prime Minister Adrian Nastase was elected in January 2001 and immediately embarked on a revamp of the country's obsolete armed forces. The NATO-compatible Romanian army in 2005 comprised 112,000 mostly professional elite soldiers and 28,000 civilians - a shadow of its former bloated self. The Ministry of National Defense was further depleted by the transfer of the soon to be completely privatized armaments industry to the Ministry of Industry and Resources.

The defense budget - at c. $1 billion or one fortieth of gross domestic product - barely covers one quarter of the armed forces' procurement needs. Hence the constant stream of welcome donations: in 2001, Germany handed over a Gepard antiaircraft system and the U.S. - four C-130B aircraft, part of an Excess Defense Article transfer. Canada and Norway followed suit. The Defense Ministry resorts to frequency spectrum sales to the private sector to make ends meet.

Still, Romania is investing heavily in a military communications network and in the modernization and upgrading of its antiquated tank and armored vehicles fleets. The defense industry is collaborating with the Israelis to produce ammunition for its antiaircraft artillery and to upgrade its ageing MIG-21 "Lancer" fighters. Air traffic management and air space control are also priorities as are attack helicopters.

Romania's outdated weapons manufacturers used to supply 70 to 85 percent of the country's needs and export some $1 billion annually, mostly to other Warsaw Pact members and to Arab and African clients. More than 200,000 people were employed in the sector. Romania even has its own materiel trade fair - Expomil.

The remnants of the industry reap the benefits of the military's all-pervasive overhaul - but the decrepitude is evident. The Ministry of Industry and Resources explains:

"Starting with 1990, following the structural changes in the world arms market and the politic economic and social transformation in Romania, this sector has entered an increasing decline. The drastic decrease of the demand on the world market and lack of local orders, the low level of technology automation and labour productivity, associated with an improper management were the main factors which have lead to this situation. Privatization was started, with some performing companies sold to private local investors."

The sector is undergoing a wrenching restructuring with non-core activities spun off or closed, employees made redundant as functions are outsourced and 12 companies slated for privatization, including manufacturers of ammunition, vehicles, optoelectronics, electronics, airspace companies and a shipyard.

The remaining 15 firms and a research institute are owned by ROMARM, an opaque and ubiquitous statal holding group. Romania also sports 11 contractors in private hands. They are members of PATROMIL, a non-governmental trade association.

But the sector's only hope of survival is foreign. It is a predicament shared by all post-communist applicants and candidates in Central and East Europe. Joint ventures, co-production, technology transfer, offset programs (promoted by the Offset Law) - allow indigenous makers to leap into NATO's lean and mean, hi-tech 21st century. Eurocopter and DaimlerChrysler, for instance, serve as strategic partners to Romanian production facilities.

Aware of this nascent market, Western companies, backed by the political and pecuniary muscle of their countries, are aggressive bidders. In 2003, BEA Systems won a $190 million contract to refit two frigates for the Romanian navy. The deal is insured by the British government's Export Credits Guarantee Department (ECGD). The London offices of Deutsche Bank and ABN Amro Bank tackled the financing.

To its delight, Romania is becoming somewhat of a regional defense hub. In 2003, the premiers of five other ex-communist states that were invited to join NATO in 2004 (Bulgaria, Estonia, Latvia, Lithuania and Slovakia) as well as the foreign minister of a sixth (Slovenia), met near Bucharest to discuss their accession.

Together with Greece, Turkey and Bulgaria, Romania is a contributor to the South-Eastern Europe Brigade (SEEBRIG), established in 1998 by the South-Eastern Europe Defense Ministerial (SEDM), an informal group of the area's defense ministers from Albania, Bulgaria, Croatia, Greece, Italy, Macedonia, Romania, Slovenia, Turkey and the United States. The United States, Slovenia and Croatia serve as mere observers.

Yet, its growing stature aside, Romania is still besieged by its old ills. According to defense analysts, rogue Romanian arms dealers sold weapons to pariah states such as Iraq. Members of the vicious and discredited security service Securitate permeate the upper echelons of the country's defense establishment.

In May 2002, when the media published a non-flattering article translated from the "Wall Street Journal", the Ministry of National Defense sent a statement to several Romanian newspapers, reminding journalists that "life is short" and they should not "endanger their health by launching stressful debates". Faced with a storm of protest, a Defense Ministry official, George Christian Maior, dubbed the intimidating passages "satirical."

Russia (as Creditor)

Russia is notorious for its casual attitude to the re-payment of its debts. It has defaulted and re-scheduled its obligations more times in the last decade than it has in the preceding century. Yet, Russia is also one of the world's largest creditor nations. It is owed more than $25 billion by Cuba alone and many dozens of additional billions by other failed states. Indeed, the dismal quality of its forlorn portfolio wouldn't shame a Japanese bank. In the 18 months to May 2001, it has received only $40 million in repayments.

It is still hoping to triple this trifle amount by joining the Paris Club - as a creditor nation. The 27 countries with Paris Club agreements owe roughly half of what Russia claims. Some of them - Algeria in cash, Vietnam in kind - have been paying back intermittently. Others have abstained.

Russia has spent the last five years negotiating generous package deals - rescheduling, write-offs, grace periods measured in years - with its most obtuse debtors. Even the likes of Yemen, Mozambique, and Madagascar - started coughing up - though not Syria which owes $12 billion for weapons purchases two decades ago. But the result of these Herculean efforts is meager. Russia expects to get back an extra $100 million a year. By comparison, in 1999 alone Russia received $800 million from India.

The sticking point is a communist-era fiction. When the USSR expired it was owed well over $100 billion in terms of a fictitious accounting currency, the "transferable ruble". At an arbitrary rate of 0.6 to the US dollar, protest many debtors, the debt is usuriously inflated. This is disingenuous. The debtors received inanely subsidized Russian goods and commodities for the transferable rubles they so joyously borrowed.

Russia could easily collect on some of its debts simply by turning off the natural gas tap or by emitting ominous sounds of discontent backed by the appropriate military exercises. That it chooses not to do so - is telling. Russia has discovered that it could profitably leverage its portfolio of defunct financial assets to geopolitical and commercial gain.

On March 25, 2002 Russia's prime minister and erstwhile lead debt negotiator, Kasyanov, has "agreed" with his Mongolian counterpart, Enkhbayar, to convert Mongolia's monstrous $11.5 billion debt to Russia - into stakes in privatized Mongolian enterprises.

Mongolia's GDP is minuscule (c. $1 billion). Should the Russian behemoth, Norilsk Nickel, purchase 49% of Erdenet, Mongolia's copper producer, it will have bagged 20% of Mongolia's GDP in a single debt conversion. A similar scheme has been concluded between Armenia and Russia. Five enterprises will change hands and thus eliminate Armenia's $94 million outstanding debt to Russia.

Identical deals have been struck with other countries such as Algeria which owes Russia c. $4 billion. The Algerians gave Gazprom access to Algeria's natural gas exports.

Russia's mountainous credit often influences its foreign policies to its detriment. Prior to the Iraq (Second Gulf) war, It has noisily resisted every American move to fortify sanctions against Iraq and make them "smarter". Russia is owed $8 billion by that shredded country and tried to recoup at least a part of it by trading with the outcast or by gaining lucrative oil-related contracts. The sanctions regime was in its way - hence its apparent obstructionism. Its recent weapons deals with Syria are meant to compensate for its unpaid past debts to Russia - at the cost of destabilizing the Middle East and provoking American ire.

Russia uses the profusion of loans gone bad on its tattered books to gain entry to international financial fora and institutions. Its accession to the Paris Club of official bilateral creditors is conditioned on its support for the HIPC (Highly Indebted Poor Countries) initiative.

This is no trifling matter. Sub-Saharan debt to Russia amounted to c. $14 billion and North African debt to yet another $11 billion - in 1994. These awesome figures will have swelled by yet another 25% by 2001. The UNCTAD thinks that Russia intentionally under-reports these outstanding obligations and that Sub-Saharan Africa actually owed Russia $17 billion in 1994.

Russia would have to forgo at least 90% of the debt owed it by the likes of Angola, Ethiopia, Guinea, Mali, Mozambique, Somalia, Tanzania, and Zambia. Russian debts amount to between one third and two thirds of these countries' foreign debt. Moreover, its hopes to offset money owed it by countries within the framework of the Paris Club against its own debts to the Club were dashed in 2001. Hence its incentive to distort the data.

Other African countries have manipulated their debt to Russia to their financial gain. Nigeria is known to have re-purchased, at heavily discounted prices, large chunks of its $2.2 billion debt to Russia in the secondary market through British and American intermediaries. It claims to have received a penalty waiver "from some of its creditors".

Russia has settled the $1.7 billion owed it by Vietnam in 2001. The original debt - of $11 billion - was reduced by 85 percent and spread over 23 years. Details are scarce, but observers believe that Russia has extracted trade and extraction concessions as well as equity in Vietnamese enterprises.

But Russia is less lenient with its former satellites. Five years ago, Ukraine had to supply Russia with sophisticated fighter planes and hundreds of cruise missiles incorporating proprietary technology. This was in partial payment for its overdue $1.4 billion natural gas bill. Admittedly, Ukraine is also rumored to have "diverted" gas from the Russian pipeline which runs through it.

The Russians threatened to bypass Ukraine by constructing a new, Russian-owned, pipeline to the EU through Poland and Slovakia. Gazprom has been trying to coerce Ukraine for years now to turn over control of the major transit pipelines and giant underground storage tanks to Russian safe hands. Various joint ownership schemes were floated - the latest one, in 1999, was for a pipeline to Bulgaria and Turkey to be built at Ukrainian expense but co-owned by Gazprom.

After an initial period of acquiescence, Ukraine recoiled, citing concerns that the Russian stratagem may compromise its putative sovereignty. Already UES, Russia's heavily politicized electricity utility, has begun pursuing stakes in debtor Ukrainian power producers.

Surprisingly, Russia is much less aggressive in the "Near Abroad". It has rescheduled Kirghizstan's entire debt (c. $60 million) for a period of 15 years (including two years grace) with the sole - and dubious - collateral of the former's promissory notes.

Russia has no clear, overall, debt policy. It improvises - badly - as it goes along. Its predilections and readiness to compromise change with its geopolitical fortunes, interests, and emphases. As a result it is perceived by some as a bully - by others as a patsy. It would do well to get its act together.

Russia, Economy of

Contrary to recent impressions, Russia's Western (American-German) orientation is at least as old as Gorbachev's reign. It was vigorously pursued by Yeltsin. Still, 2002 marks the year in which Russia became merely another satellite of the United States - though one armed with an ageing nuclear arsenal.

Russia's economy has revived remarkably after the 1998 crisis, but it is still addicted to Western investments, aid and credits. Encircled by NATO to its West and US troops stationed in its central Asian hinterland, Russia's capitulation is complete. In the aftermath of conflicts to be engineered by the United States in Afghanistan, Iraq, North Korea, Iran, Syria and, potentially, Cuba - Russia may feel threatened geopolitically as well as economically. Both Iran and Iraq, for instance, are large trading partners and leading export destinations of the Russian Federation.

If anything can undo the hitherto impressive personality cult of Russia's new "strong man", Vladimir Putin, it is this injured pride among the more penumbral ranks of the country's security services. Russia's history is littered with the bloodied remains of upheavals wrought by violent ideological minorities and by assorted conspirators.

Hence Putin's tentative - and reluctant - attempts to team up with China and India to establish a multi-polar world and his closer military cooperation with Kyrgyzstan and Armenia - both intended to counter nationalistic opposition at home.

Luckily, the sense of decline is by no means prevalent.

Russians polled by the American Pew Research Center admitted that they feel much better in a world dominated by the United States as a single superpower. The KGB and its successors - Putin's former long-term employers - actually engineered Russia's opening to the West and the president's meteoric ascendancy. And no one in the army seriously disputes the need for reform, professionalization and merciless trimming of the bloated corps.

Reforms - of the military, Russia's decrepit utilities, dilapidated infrastructure and housing, inflated and venal bureaucracy, corrupt judiciary and civil service, choking monopolies and pernicious banking sector - depend on the price of oil. Russia benefited mightily from the surge in the value of the "black gold". But the windfall has helped mask pressing problems and allowed timid legislators and officials to postpone much needed - and fiercely resisted - changes.

Russia's "economic miracle" - oft-touted by the "experts" that brought you "shock therapy" and by egregiously self-interested, Moscow-based, investment bankers - is mostly prestidigitation. As the European Bank for Reconstruction and Development (EBRD) correctly noted in November, Russia's 20 percent growth in the last three years merely reflects enhanced usage of capacity idled by the ruination of 1998.

Neutering the positive externality of rising oil prices, one is left with no increase in productivity since 1999. Industrial production - outside the oil sector - actually slumped. As metropolitan incomes rise, Russians revert to imports rather than consume shoddy and shabby local products.

This, in turn, adversely affects the current account balance and the viability of local enterprises, some of which are sincerely attempting to restructure. According to Trud, a Russian business publication, two fifths of the country's businesses are in the red. Russia's number of small and medium enterprises peaked at 1 million in 1995-6. They employ less than one fifth of the workforce (compared to two thirds in the European Union and in many other countries in transition).

Thus, falling oil prices - though detrimental to Russia's ability to repay its external debt and balance its budget - are a blessing in disguise. Such declines will force the hand of the Putin administration to engage in some serious structural reform - even in the face of parliamentary elections in 2003 and presidential ones the year after.

Russians - wrongly - feel that their standard of living has stagnated. Gazeta.ru claims that 39 million people are below the poverty line. Many pensioners survive on $1 a day. In truth, real income per capita is actually up by more than 8 percent this year alone. Income inequality, though, has, indeed, gaped.

Responding to these concerns, though, in a "coattails" effect, the president is expected to carry pro-Kremlin parties back into power in 2003 - a modicum of elections-inspired bribing is inevitable. State wages and pensions will outpace inflation. The energy behemoths - major sources of campaign financing - will be rewarded with rises in tariffs to match cost of living increases.

Russia faces more than merely a skewed wealth distribution or dependence on mineral wealth. Its difficulties are myriad. On cue from Washington, it is again being hyped in the Western press as a sure-fire investment destination and a pair of safe geostrategic hands. But the dismal truth is that it is a third world country with first world pretensions (and nuclear weapons). It exhibits all the risks attendant to other medium-sized developing countries and emerging economies.

External debt repayments next year will exceed $15 billion. It can easily afford them with oil prices anywhere above $20 and foreign exchange reserves the highest since 1991. Russia even prepaid some of its debt mountain this year. But if its export proceeds were to decline by 40 percent in the forthcoming 3-4 years, Russia will, yet again, be forced to reschedule or default. Every $1 dollar decline in Ural crude prices translates to more than $1 billion lost income to the government.

Russia's population is both contracting and ageing. A ruinous pension crisis is in the cards unless both the run-down health system and the abysmally low birthrate recover. Immigration of ethnic Russians from the former republics of the USSR to the Russian Federation has largely run its course. According to Pravda.ru, more than 7 million people emigrated from the Federation in the last decade.

Russia's informal sector is a vital, though crime-tainted, engine of growth. Laundered money coupled with reinvested profits - from both legitimate and illicit businesses - drive a lot of the private sector and underlie the emergence of an affluent elite, especially in Moscow and other urban centers. According to the Economist Intelligence Unit, Goskomstat - the State Statistics

Committee - regularly adjusts the formal figures up by 25 percent to incorporate estimates of the black economy.

Russia faces a dilemma: to quash the economic underground and thus enhance both tax receipts and Russia's image as an orderly polity - or to let the pent-up entrepreneurial forces of the "gray sectors" work their magic?

Russia is slated to join the World Trade Organization in 2004. This happy occasion would mean deregulation, liberalization and opening up to competition - all agonizing moves. Russian industry and agriculture are not up to the task. It took a massive devaluation and a debilitating financial crisis in 1998 to resurrect consumer appetite for indigenous goods.

Farming is mostly state-owned, or state-sponsored. Monopolies, duopolies and cartels make up the bulk of the manufacturing and mining sectors - especially in the wake of the recent tsunami of mergers and acquisitions. The Economist Intelligence Unit quotes estimates that 20 conglomerates account for up to 70 percent of the country's $330 billion GDP. The oligarchs are still there, lurking. The banks are still paralyzed and compromised, though their retail sector is reviving.

Russians are still ambivalent about foreigners. Paranoid xenophobia was replaced by guarded wariness. Recently, Russia revoked the fast track work permit applications hitherto put to good use by managers, scholars and experts from the West. Foreign minority shareholders still complain of being ripped-off by powerful, well-connected - and minacious - business interests.

With the bloody exception of Chechnya, Putin's compelling personality has helped subdue the classic tensions between center and regions. But, as Putin himself admitted in a radio Q-and-A session on December 19, this peaceful co-existence is fraying at the edges.

The president will try to reach a top-down political settlement in the renegade province prior to the 2004 elections, but will fail. Reform is anathema to many suborned governors of the periphery and the Kremlin's miserly handouts are insufficient to grant it a decisive voice in matters provincial. Devolution - a pet Putin project - is more about accepting an unsavory reality than about re-defining the Russian state.

The economic disparity between rural and urban is striking. The Economist Intelligence Unit describes this chasm thus:

"The processing industry is concentrated in the cities of Moscow, St Petersburg, Yekaterinburg and Nizhny Novgorod. These larger cities have managed the transition relatively well, as size has tended to bring with it industrial diversity; smaller industrial centers have fared far worse. The Soviet regime created new industrial centers such as Tomsk and Novosibirsk, but Siberia and the Russian Far Eastern regions remain largely unindustrialised, having traditionally served as a raw materials and energy base. Owing to the boundless faith of Soviet planners in the benefits of scale, one massive enterprise, or a small group of related enterprises, often formed the basis for the entire local economy of a substantial city or region. This factor, compounded by the absence of unemployment benefits, makes the closure of bankrupt enterprises a politically difficult decision."

The politically incorrect truth is that Russia's old power-structure is largely intact, having altered only its ideological label. It is as avaricious, nefarious and obstructive as ever. Nor does the Russian state sport any checks and balances. Its institutions are suspect, its executive untouchable, its law enforcement agencies delinquent.

Russians still hanker after "men of iron" and seek tradition rather than innovation, prefer unity to pluralism, and appreciate authority more than individualism. Russia - a ramshackle amalgamation of competing turfs - is still ill-suited for capitalism or for liberal democracy, though far less than it was only ten years ago.

Conspicuous consumption of imported products by vulgar parvenus is no substitute to true modernity and a functioning economy. Russia is frequently praised by expats with vested interests and by international financial institutions, the long arms of its newfound ally, the United States.

But, in truth, "modern", "stable", Russia is merely a glittering veneer beneath which lurk, festering, the old ills of authoritarianism, lawlessness, oligarchy, aggression, ignorance, superstition, and repression mingled with extremes of poverty and disease. Here is one safe prediction: none of these will diminish next year.

Russian President Vladimir Putin warned on Tuesday, in an interview he granted to TF1, a French television channel, that unilateral American-British military action against Iraq would be a "grave mistake" and an "unreasonable use of force". Russia might veto it in the Security Council, he averred. In a joint declaration with

France and Germany, issued the same day, he called to enhance the number of arms inspectors in Iraq as an alternative to war.

Only weeks ago Russia was written off, not least by myself, as a satellite of the United States. This newfound assertiveness has confounded analysts and experts everywhere. Yet, appearances aside, it does not signal a fundamental shift in Russian policy or worldview.

Russia could not resist the temptation of playing once more the Leninist game of "inter-imperialist contradictions". It has long masterfully exploited chinks in NATO's armor to further its own economic, if not geopolitical, goals. Its convenient geographic sprawl - part Europe, part Asia - allows it to pose as both a continental power and a global one with interests akin to those of the United States. Hence the verve with which it delved into the war against terrorism, recasting internal oppression and meddling abroad as its elements.

As Vladimir Lukin, deputy speaker of the Duma observed recently, Britain having swerved too far towards America - Russia may yet become an intermediary between a bitterly disenchanted USA and an irked Europe and between the rich, industrialized West and developing countries in Asia. Publicly, the USA has only mildly disagreed with Russia's reluctance to countenance a military endgame in Iraq - while showering France and Germany with vitriol for saying, essentially, the same things.

The United States knows that Russia will not jeopardize the relevance of the Security Council - one of the few remaining hallmarks of past Soviet grandeur - by vetoing an American-sponsored resolution. But Russia cannot be seen to be abandoning a traditional ally and a major customer (Iraq) and newfound friends (France and Germany) too expediently.

Nor can Putin risk further antagonizing Moscow hardliners who already regard his perceived "Gorbachev-like" obsequiousness and far reaching concessions to the USA as treasonous. The scrapping of the Anti Ballistic Missile treaty, the expansion of NATO to Russia's borders, America's presence in central Asia and the Caucasus, Russia's "near abroad" - are traumatic reversals of fortune.

An agreed consultative procedure with the crumbling NATO hardly qualifies as ample compensation. There are troubling rumblings of discontent in the army. A few weeks ago, a Russian general in Chechnya refused Putin's orders publicly - and with impunity. Additionally, according to numerous opinion polls, the vast majority of Russians oppose an Iraqi campaign.

By aligning itself with the fickle France and the brooding and somnolent Germany, Russia is warning the USA that it should not be taken for granted and that there is a price to pay for its allegiance and good services. But Putin is not Boris Yeltsin, his inebriated predecessor who over-played his hand in opposing NATO's operation in Kosovo in 1999 - only to be sidelined, ignored and humiliated in the postwar arrangements.

Russia wants a free hand in Chechnya and to be heard on international issues. It aspires to secure its oil contracts in Iraq - worth tens of billions of dollars - and the repayment of $9 billion in old debts by the postbellum government. It seeks pledges that the oil market will not be flooded by a penurious Iraq. It desires a free hand in Ukraine, Armenia and Uzbekistan, among others. Russia wants to continue to sell $4 billion a year in arms to China, India, Iran, Syria and other pariahs unhindered.

Only the United States, the sole superpower, can guarantee that these demands are met. Moreover, with a major oil producer such as Iraq as a US protectorate, Russia becomes a hostage to American goodwill. Yet, hitherto, all Russia received were expression of sympathy, claimed Valeri Fyodorov, director of Political Friends, an independent Russian think-tank, in an interview in the Canadian daily, National Post.

These are not trivial concerns. Russia's is a primitive economy, based on commodities - especially energy products - and an over-developed weapons industry. Its fortunes fluctuate with the price of oil, of agricultural produce and with the need for arms, driven by regional conflicts.

Should the price of oil collapse, Russia may again be forced to resort to multilateral financing, a virtual monopoly of the long arms of US foreign policy, such as the International Monetary Fund (IMF). The USA also has a decisive voice in the World Trade Organization (WTO), membership thereof being a Russian strategic goal.

It was the United States which sponsored Russia's seat at table of the G8 - the Group of Eight industrialized states - a much coveted reassertion of the Russian Federation's global weight. According to Rossiiskaya Gazeta, a Russian paper, the USA already announced a week ago that it is considering cutting Russia off American financial aid - probably to remind the former empire who is holding the purse strings.

But siding with America risks alienating the all-important core of Europe: Germany and France. Europe - especially Germany - is Russia's largest export destination and foreign investor. Russia is not oblivious to that. It would like to be compensated generously by the United States for assuming such a hazard.

Still, Europe is a captive of geography and history. It has few feasible alternatives to Russian gas, for instance. As the recent $7 billion investment by British Petroleum proves, Russia - and, by extension, central and east Europe - is Europe's growth zone and natural economic hinterland.

Yet, it is America that captures the imagination of Russian oligarchs and lesser businesses.

Russia aims to become the world's largest oil producer within the decade. With this in mind, it is retooling its infrastructure and investing in new pipelines and ports. The United States is aggressively courted by Russian officials and "oiligarchs" - the energy tycoons. With the Gulf states cast in the role of anti-American Islamic militants, Russia emerges as a sane and safe - i.e., rationally driven by self-interest - alternative supplier and a useful counterweight to an increasingly assertive and federated Europe.

Russia's affinity with the United States runs deeper that the confluence of commercial interests.

Russian capitalism is far more "Anglo-Saxon" than Old Europe's. The Federation has an educated but cheap and abundant labor force, a patchy welfare state, exportable natural endowments, a low tax burden and a pressing need for unhindered inflows of foreign investment.

Russia's only hope of steady economic growth is the expansion of its energy behemoths abroad. Last year it has become a net foreign direct investor. It has a vested interest in globalization and world order which coincide with America's. China, for instance, is as much Russia's potential adversary as it is the United State's.

Russia welcomed the demise of the Taliban and is content with regime changes in Iraq and North Korea - all American exploits. It can - and does - contribute to America's global priorities. Collaboration between the two countries' intelligence services has never been closer. Hence also the thaw in Russia's relations with its erstwhile foe, Israel.

Russia's population is hungry and abrasively materialistic. Its robber barons are more American in spirit than any British or French entrepreneur. Russia's business ethos is reminiscent of 19th century frontier America, not of 20th century staid Germany.

Russia is driven by kaleidoscopically shifting coalitions within a narrow elite, not by its masses - and the elite wants money, a lot of it and now. In Russia's unbreakable cycle, money yields power which leads to more money. The country is a functioning democracy but elections there do not revolve around the economy. Most taxes are evaded by most taxpayers and half the gross national product is anyhow underground. Ordinary people crave law and order - or, at least a semblance thereof.

Hence Putin's rock idol popularity. He caters to the needs of the elite by cozying up to the West and, in particular, to America - even as he provides the lower classes with a sense of direction and security they lacked since 1985. But Putin is a serendipitous president. He enjoys the aftereffects of a sharply devalued, export-enhancing, imports-depressing ruble and the vertiginous tripling of oil prices, Russia's main foreign exchange generator.

The last years of Yeltsin have been so traumatic that the bickering cogs and wheels of Russia's establishment united behind the only vote-getter they could lay their hands on: Putin, an obscure politician and former KGB officer. To a large extent, he proved to be an agreeable puppet, concerned mostly with self-preservation and the imaginary projection of illusory power.

Putin's great asset is his pragmatism and realistic assessment of the shambles that Russia has become and of his own limitations. He has turned himself into a kind of benevolent and enlightened arbiter among feuding interests - and as the merciless and diligent executioner of the decisions of the inner cabals of power.

Hitherto he kept everyone satisfied. But Iraq is his first real test. Everyone demands commitments backed by actions. Both the Europeans and the Americans want him to put his vote at the Security Council where his mouth is. The armed services want him to oppose war in Iraq. The intelligence services are divided. The Moslem population inside Russia - and surrounding it on all sides - is restive and virulently anti-American.

The oil industry is terrified of America' domination of the world's second largest proven reserves - but also craves to do business in the United States. Intellectuals and Russian diplomats worry about America's apparent disregard for the world order spawned by the horrors of World War II. The average Russian regards the Iraqi stalemate as an internal American affair. "It is not our war", is a common refrain, growing commoner.

Putin has played it admirably nimbly. Whether he ultimately succeeds in this impossible act of balancing remains to be seen. The smart money says he would. But if the last three years have taught us anything it is that the smart money is often disastrously wrong.

Russia, Agricultural Sector of

In Soviet times, Kremlinologists used to pore over grain harvest figures to divine the fortunes of political incumbents behind the Kremlin's inscrutable walls. Many a career have ended due to a meager yield. Judging by official press releases and interviews, things haven't changed that much. The beleaguered Vice-Premier and Minister of Agriculture of the Russian Federation admitted openly last October that what remains of Russia's agriculture is "in a critical situation" (though he has since hastily reversed himself). With debts of $9 billion, he may well be right. Russian decision makers recently celebrated the reversal of a decade-old trend: meat production went up 1% and milk production - by double that.

But the truth is, surprisingly, a lot rosier. Agricultural output has been growing for four years now (last year by more than 5%). Even much maligned sectors, such as food processing, show impressive results (up 9%). As the private sector takes over (government procurement ceased long ago, though not so regional procurement), agriculture throughout Russia (especially in its western parts) is being industrialized. Even state and collective farms are reviving, though haltingly so. In a recently announced deal, Interros will invest $100 million in cultivating a whopping million acres. Additionally, Russia is much less dependent on food imports than common myths have it - it imports only 20% of its total food consumption.

Despite this astounding turnaround - foreign investors are still shy. The complex tariff and customs regulations, the erratic tax administration, the poor storage and transport infrastructure, the vast distances to markets, the endemic lawlessness, the venal bureaucracy, and, above all, the questionable legal status of the ownership of agricultural land - all serve to keep them at bay.

Moreover, the agricultural sector is puny and disastrously inefficient. Having fallen by close to half since 1991 (as state subsidies dropped), it contributes only c. 8% to GDP and employs c. 11% of the active labour force (compared to 30% in industry and 59% in services). Agricultural exports (c. $3 billion annually) are one fourth Russia's agricultural imports - despite a fall of 40% in the latter after the 1998 meltdown. The average private farm is less than 50 hectares large. Though in control of 6% of farmland - private farms account for only 2% of agricultural output.

Much of the land (equal to c. 1.8 times the contiguous US) lacks in soil, or in climate, or in both. Thus, only 8% of the land is arable and less than 40,000 sq. km. are irrigated. Pastures make up another 4%. The soil is contaminated by what the CIA calls "improper application of agricultural chemicals". It is often eroded. Ground water is absolutely toxic.

The new law permitting private quasi-ownership of agricultural land may reduce the high rents which (together with a ruble over-valued until 1998) rendered Russian farmers non-competitive - but this is still a long way off. In the meantime, general demand for foodstuffs has declined together with disposable incomes and increasing unemployment.

The main problem nowadays is not lack of knowledge, management, or new capital - it is an unsustainable mountain of debts. Even with a lenient "Law on the Financial Recovery of Agricultural Enterprises" currently being passed through the Duma - only 30% of farms are expected to survive. The law calls for rescheduling current debt payments over ten years.

The sad irony is that Russian agriculture is now much more viable than it ever was. Well over half the active enterprises are profitable (compared to 12% in 1998). The grain harvest exceeded 90 million tons, far more than the 75 million tons predicted by the government (though Russia still imports $8 billion worth of grains a year). The average crop for 1993-7 was 80 million tones (with 88 million in 1997). But grain output was decimated in 1998 (48 million tons) and 1999 (55 million tons).

Luckily, grain is used mostly for livestock feed - Russians consume only c. 20 million tons annually. But by mid 1999, Russian grain reserves declined to a paltry 2 million tons, according to USDA figures. The problem is that the regions of Russia's grain belt restrict imports of this "agricultural gold" and hoard it. Corrupt officials turn a quick profit on the resulting shortage-induced price hikes.

The geographical location of an agricultural enterprise often determines its fate. In a study ("The Russian Food System's Transformation at Close Range") of two Russian regions (oblasts) conducted by Grigori Ioffe (of Radford University) and Tatyana Nefedova (Institute of Geography of the Russian Academy of Sciences) in August 2001, the authors found that:

"... farms in Moscow Province are more productive than farms in equivalent locations in Ryazan Provinces, while farms closer to the central city of either province do better than farms near the borders of that province."

It seems that well-located farms enjoy advantages in attracting both investments and skilled labour. They are also closer to their markets.

But the vicissitudes of Russia's agriculture are of geopolitical consequence. A hungry Russia is often an angry Russia. Hence the food aid provided by the USA in 1998-9 (worth more than $500 million and coupled with soft PL-480 trade credits). The EU also donated a comparable value in food. Russia asked for additional aid in the form of animal feed in the years 2000-2001 - and the USA complied.

Russia's imports are an important prop to the economies of its immediate and far neighbors. Russia is also a major importer of American agricultural products, such as poultry (it consumes up to 40% of all US exports of this commodity). It is a world class importer of meat products (especially from the EU), its livestock inventory having been halved by the transition. If it accedes to the WTO (negotiations have been dragging on since 1995), it may become even more appealing commercially.

It will have to reduce its import tariffs (the tariff on poultry is 30% and the average tariff on agricultural products is 20%). It is also likely to be forced to scale back - albeit gradually - the subsidies it doles out to its own producers (10% of GDP in the USSR, less than 3% of GDP now). Privileged trading by state entities will also be abolished as will be non-tariff obstructions to imports. Whether the re-emergent center will be able to impose its will on the recalcitrant agricultural regions, still remains to be seen.

A series of apocalyptic economic crises forced Russian agriculture to rationalize. Russia has no comparative advantage in livestock and meat processing. Small wonder its imports of meat products skyrocketed. It is questionable whether Russia possesses a comparative advantage in agriculture as a whole - given its natural endowments, or, rather, the lack thereof. Its insistence to produce its own food (especially the High Value Products) has failed with disastrous consequences. Perhaps it is time for Russia to concentrate on the things it does best. Agriculture, alas, is not one of them.

Russia, Devolution in

A centerpiece of President's Putin overhaul of Russia is the reversion to the Kremlin of the power to appoint governors, hitherto voted into office. The popularly elected sort - admittedly a motley and venal crew - seem to have provoked his ire as far too independent and, therefore, impudent.

was Putin right to reassert central control over the unruly provinces?

Russia's history is a chaotic battle between centrifugal and centripetal forces - between its 50 oblasts (regions), 2 cities (Moscow and St. Petersburg), 6 krais (territories), 21 republics, and 10 okrugs (departments) - and the often cash-strapped and graft-ridden paternalistic center. The vast land mass that is the Russian Federation (constituted officially in 1993) is a patchwork of fictitious homelands (the Jewish oblast), rebellious republics (Chechnya), and disaffected districts - all intermittently connected with decrepit lines of transport and communications.

The republics - national homelands to Russia's numerous minorities - have their own constitutions and elected presidents (since 1991). Oblasts and krais used to be run by elected governors until 2005 (a post-Yeltsin novelty introduced in 1997). They are patchy fiefdoms composed of autonomous okrugs. "The Economist" observes that the okrugs (often populated with members of an ethnic minority) are either very rich (e.g., Yamal-Nenets in Tyumen, with 53% of Russia's oil reserves) - or very poor and, thus, dependent on Federal handouts.

In Russia it is often "Moscow proposes - but the governor disposes" - but decades of central planning and industrial policy encouraged capital accumulation is some regions while ignoring others, thus irreversibly eroding any sense of residual solidarity.

In an IMF working paper ("Regional Disparities and Transfer Policies in Russia" by Dabla-Norris and Weber), the authors note that the ten wealthiest regions produce more than 40% of Russia's GDP (and contribute more than 50% of its tax revenues) - thus heavily subsidizing their poorer brethren. Output contracted by 90% in some regions - and only by 15% in others. Moscow receives more than 20% of all federal funds - with less than 7% of the population. In the Tuva republic - three quarters of the denizens are poor - compared to less than one fifth in Moscow. Moscow lavishes on each of its residents 30 times the amount per capita spent by the poorest region.

Nadezhda Bikalova of the IMF notes ("Intergovernmental Fiscal Relations in Russia") that when the USSR imploded, the ratio of budgetary income per person between the richest and the poorest region was 11.6. It has since climbed to 30. All the regions were put in charge of implementing social policies as early as 1994 - but only a few (the net "donors" to the federal budget, or food exporters to other regions) were granted taxing privileges.

As Kathryn Stoner-Weiss has observed in her book, "Local Heroes: The Political Economy of Russian Regional Governance", not all regions performed equally well (or equally dismally) during the transition from communism to (rabid) capitalism. Political figures in the (relatively) prosperous Nizhny-Novgorod and Tyumen regions emphasized stability and consensus (i.e., centralization and co-operation).

Both the economic resources and the political levers in prosperous regions are in the hands of a few businessmen and "their" politicians. In some regions, the movers and shakers are oligarch-tycoons - but in others, businessmen formed enterprise associations, akin to special interest lobbying groups in the West.

Inevitably such incestuous relationships promote corruption, impose conformity, inhibit market mechanisms, and foster detachment from the centre. But they also prevent internecine fighting and open, economically devastating, investor-deterring, conflicts. Economic policy in such parts of Russia tend to be coherent and efficiently implemented.

Such business-political complexes reached their apex in 1992-1998 in Moscow (ranked #1 in creditworthiness), Samara, Tyumen, Sverdlovsk, Tatarstan, Perm, Nizhny-Novgorod, Irkutsk, Krasnoyarsk, and St. Petersburg (Putin's lair). As a result, by early 1997, Moscow attracted over 50% of all FDI and domestic investment and St. Petersburg - another 10%.

These growing economic disparities between the regions almost tore Russia asunder. A clunky and venal tax administration impoverished the Kremlin and reduced its influence (i.e., powers of patronage) commensurately. Regional authorities throughout the vast Federation attracted their own investors, passed their own laws (often in defiance of legislation by the centre), appointed their own officials, levied their own taxes (only a fraction of which reached Moscow), and provided or withheld their own public services (roads, security, housing, heating, healthcare, schools, and public transport).

Yeltsin's reliance on local political bosses for his 1996 re-election only exacerbated this trend. He lost his right to appoint governors in 1997 - and with it the last vestiges of ostensible central authority. In a humiliating - and well-publicized defeat - Yeltsin failed to sack the spectacularly sleazy and incompetent governor of Primorsky krai, Yevgeni Nazdratenko (later "persuaded" by Putin to resign his position and chair the State Fisheries Committee instead).

The regions took advantage of Yeltsin's frail condition to extract economic concessions: a bigger share of the tax pie, the right to purchase a portion of the raw materials mined in the region at "cost" (Sakha), the right to borrow independently (though the issuance of promissory notes was banned in 1997) and to spend "off-budget" - and even the right to issue Eurobonds (there were three such issues in 1997). Many regions cut red tape, introduced transparent bookkeeping, lured foreign investors with tax breaks, and liberalized land ownership.

Bikalova (IMF) identifies three major problems in the fiscal relationship between centre and regions in the Yeltsin era:

"(1) the absence of an objective normative basis for allocating budget revenues, (2) the lack of interest shown by local and regional governments in developing their own revenues and cutting their expenditures, and (3) the federal government's practice of making transfer payments to federation members without taking account of the other state subsidies and grants they receive."

Then came Russia's financial meltdown in August 1998, followed by Putin's disorientating ascendance. A redistribution of power in Moscow's favor seemed imminent. But it was not to be until seven years later.

At first, the recommendations of a committee, composed of representatives of the government, the Federation Council, and the Duma, were incorporated in a series of laws and in the 1999 budget, which re-defined the fiscal give and take between regions and centre.

Federal taxes include the enterprise profit tax, the value-added tax (VAT), excise, the personal income tax (all of it returned to the regions), the minerals extraction tax, customs and duties, and other "contributions". This legislation was further augmented in April-May 2001 (by the "Federalism Development Program 2001-2005").

The regions are still allowed to tax the property of organizations, sales, real estate, roads, transportation, and gambling enterprises, and regional license fees (all tax rates are set by the center, though). Municipal taxes include the land tax, individual property, inheritance, and gift taxes, advertising tax, and license fees.

The IMF notes that "more than 90 percent of sub-national revenues come from federal tax sharing. Revenues actually raised by regional and local governments account for less than 15 percent of their expenditures". The federal government has also signed more than 200 special economic "contracts" with the richer, donor and exporting, regions - this despite the constitutional objections of the Ministry of Justice. This discriminating practice is now being phased out. But it has not been replaced by any prioritized economic policies and preferences on the federal level, as the OECD has noted.

One of Putin's first acts was to submit a package of laws to the State Duma in May 2000. The crux of the proposed legislation was to endow the President with the power to sack regional elected officials at will. The alarmed governors forgot their petty squabbles and in a rare show of self-interested unity fenced the bill with restrictions.

The President can fire a governor, said the final version, only if a court rules that the latter failed to incorporate federal legislation in regional laws, or if charged with serious criminal offenses. The wholesale dismissal of regional legislatures requires the approval of the State Duma. Some republics insisted at the time that even these truncated powers are excessive and Russia's Constitutional Court had to weigh their arguments in its pro-Putin ruling.

Putin then resorted to another stratagem. He established, in 2000, by decree, a bureaucratic layer between centre and regions: seven administrative mega-regions whose role is to make sure that federal laws are both adopted and enforced at the local level. The presidential envoys report back to the Kremlin but, otherwise, are fairly harmless - and useless. They did succeed, however, in forcing local elections upon the likes of Ingushetiya - and to organize all federal workers in regional federal collegiums, subordinated to the Kremlin.

The war in Chechnya was meant to be another unequivocal message that cessation is not an option, that there are limits to regional autonomy, and that the center - as authoritative as ever - is back. It, too, flopped painfully when Chechnya evolved into a second - internal - Afghani quagmire.

Having failed thrice, Putin is lately leaning in favor of restoring and even increasing the Federation Council's erstwhile powers at the expense of the (incensed) Duma. Governors have sensed the changing winds and have acted to trample over democratic institutions in their regions. Thus, the Governor of Orenburg has abolished the direct elections of mayors in his oblast. Russia's big business is moving in as well in an attempt to elect its own mayors (for instance, in Irkutsk).

Regional finances are in bad shape. Only 40 out 89 regions managed, by February 2002, to pay their civil servants their December 2001 salaries (raised 89% - or 1.5% of GDP - by the benevolent president). Many regions had to go deeper into deficit to do so. Salaries make three quarters of regional budgets.

The East-West Institute reports that arrears have increased 10% in January 2002 alone - to 33 billion rubles (c. $1 billion). The Finance Ministry considered to declare seven regions bankrupt. Yet another committee, headed by Deputy Head of the Presidential Administration, Dimitri Kozak, was on the verge of establishing an external administration for insolvent regions. The recent housing reform - which would force Russians to pay market prices for their apartments and would subsidize the poor directly (rather than through the regional and municipal authorities) - is likely to further weaken regional balance sheets.

This culminated in the Putin putsch - the actual abolition of independent centres of power outside the Kremlin. Disobedient oligarchs were smashed, imprisoned, or exiled. Governors were sacked. Elections were cancelled. Once again, the Kremlin appears to reign supreme.

Luckily for Russia, the regions are less cantankerous and restive now. The emphasis has shifted from narcissistic posturing to economic survival and prosperity. The Moscow region still attracts the bulk of Russian domestic and foreign investments, leaving the regions to make do with leftovers.

Sergei Kirienko, a former short lived Prime Minister, and then the president's envoy to the politically mighty Volga okrug, attributes this gap, in a comment to Radio Free Europe, to non-harmonized business legislation (between center and regions). Boris Nemtsov, a member of the Duma (and former Deputy Prime Minister) thinks that the problem is a "lack of democratic structures" - press freedom, civil society, and democratic government. Others attribute the deficient interest to a dearth of safety and safe institutions, propagated by entrenched interest groups.

Small business is back in fashion after years of investments in behemoths such as Gazprom and Lukoil. Politicians make small to medium enterprises a staple of their speeches. The EBRD has revived its moribund small business funds (and grants up to $125,000 loans to eligible enterprises).

Bank lending is still absent (together with a banking system) - but foreign investment banks and retail banks are making hesitant inroads into the regional markets. Small businessmen are more assertive and often demonstrate against adverse tax laws, high prices, and poor governance.

Russia is at a crossroad. It must choose which of the many models of federalism to adopt. It can either strengthen the center at the expense of the regions, transforming the latter into mere tax collectors and law enforcement agents - or devolve more powers to tax and spend to the regions. The pendulum swings. Putin appears sometimes to be an avowed centralist - and at other times a liberal.

Contrary to reports in the Western media, Putin failed to completely subdue the regions. The donors and exporters among them are as powerful as ever. But he did succeed to establish a modus vivendi and is working hard on a modus operandi. He also weeded out the zanier governors. Russia seems to be converging on an equilibrium of sorts - though, as usual, it is a precarious one.

Russia, Energy Sector of

The pension fund of the Russian oil giant, Lukoil, a minority shareholder in TV-6 (owned by a discredited and self-exiled Yeltsin-era oligarch, Boris Berezovsky), forced, in February 2002, the closure of this television station on legal grounds. Thus was fired the opening shot in the re-politicization of the lucrative (and economically pivotal) energy sector in Russia.

Gazprom (Russia's natural gas monopoly) has done the same to another television station, NTV, in 2001 (and then proceeded to expropriate it from its owner, Vladimir Gusinsky).

Gazprom is forced to sell natural gas to Russian consumers at 10% the world price and to turn a blind eye to debts owed it by Kremlin favorites.

But the sector is still in flux, reflecting the shifting fortunes of oligarchs and bureaucrats in Putin's Byzantine court.

On May 15, 2005 Gazprom surprisingly announced that it is calling off a Kremiln-supported proposed merger between itself and another Russian oil giant, Rosneft.

The fate of Yuganskneftegaz, the prime subsidiary of the now bankrupted Yukos, is also still undecided - though technically, it was purchased by Rosneft in a pretend "auction".

Mikhail Khodorkovsky, erstwhile oil magnate and largest shareholder-cum-CEO of Yukos, is largely out of the picture, his punishment for having dared to challenge President Putin, however obliquely. But members of President Putin's St. Petersburgh "clan" (clique and camerilla), Gazprom CEO Alexei Miller and Rosneft CEO Sergei Bogdanchikov, are at each others' throats.

It is, therefore, clear that Lukoil and Gazprom are used by the Kremlin as instruments of domestic policy - and by political factions, both pro and anti-Putin as pawns on an ever-shifting chessboard.

But Russian energy companies are also used as instruments of foreign policy.

A few examples:

Russia has resumed oil drilling and exploration in war-ravaged Chechnya. About 230 million rubles have been transferred to the federal Ministry of Energy. A new refinery is in the works.

Three years ago, Russia signed a production agreement to develop oilfields in central Sudan in return for Sudanese arms purchases.

Armenia owes Itera, a Florida based, Gazprom related, oil concern, $35 million. Originally, Itera has agreed to postpone its planned reduction in gas supplies to the struggling republic to February 11, 2002. Then it became a rather permanent arrangement, at the Kremlin's behest.

In January 2002, President Putin called for the establishment of a "Eurasian alliance of gas producers" - probably to counter growing American presence, both economic and military, in Central Asia and the much disputed oil rich Caspian basin. The countries of Central Asia have done their best to construct alternative oil pipelines (through China, Turkey, or Iran) in order to reduce their dependence on Russian oil transportation infrastructure. These efforts largely failed (though a new $4 billion pipeline from Kazakhstan to the Black Sea through Russian territory is in the works, having been inaugurated in early 2002). Russia is now on a charm offensive.

Its PR efforts are characteristically coupled with extortion. Gazprom owns the pipelines. Russia exports 7 trillion cubic feet of gas a year - six times the combined output of all other regional producers put together. Gazprom actually competes with its own clients, the pipelines' users, in export markets. It is owed money by all these countries and is not above leveraging it to political or economic gain.

Lukoil is heavily invested in exploration for new oil fields in Iraq, Algeria, Sudan, and Libya.

Russian debts to the Czech Republic, worth $2.5 billion in face value, have been bought in 2002 by UES, the Russian electricity monopoly, for a fraction of their value and through an offshore intermediary. UES then transferred the notes to the Russian government against the writing off of $1.35 billion in UES debts to the federal budget.

The Russians claim that Paris Club strictures have ruled out a direct transaction between Russia (a member of the Club) and the Czech Republic (not a member).

In the last decade, Russia has been transformed from an industrial and military power into a developing country with an overwhelming dependence on a single category of commodities: energy products. Russia's energy monopolies - whether state owned or private - serve as potent long arms of the Kremlin and the security services and implement their policies faithfully.

The Kremlin (and, indirectly, the security services, the siloviki) maintain a tight grip over the energy sector by selectively applying Russia's tangle of hopelessly arcane laws. This strategy first saw light in January-February 2002, when the Prosecutor General's office charged the president and vice president of Sibur (a Gazprom subsidiary) with embezzlement. They have been detained for "abuse of office".

Another oil giant, Yukos, long before its systematic looting commenced, was forced to disclose documents regarding its (real) ownership structure and activities to the State Property Fund in connection with an investigation regarding asset stripping through a series of offshore entities and a Siberian subsidiary.

Intermittently, questions are raised about the curious relationship between Gazprom's directors and Itera, upon which they shower contracts with Gazprom and what amounts to multi-million dollar gifts (in the from of ridiculously priced Gazprom assets) incessantly.

Gazprom is now run by a Putin political appointee, its former chairman, the oligarch Vyakhirev, ousted in a Kremlin-instigated boardroom coup. But Miller's relationship with Putin is under strain. Miller's natural (and rapacious) competitors are all Russian - his potential investors and clients all Western. This alignment runs counter to Putin's emphasis on autarky and the unprofitable leveraging of economic assets for political and global purposes.

Gazprom defied Putin, for instance, by brawling over natural gas contracts with Turkmenistan, one of the only remaining Central Asian allies of a geopolitically-dilapidated Russia. With 1.45 million bpd (barrels-per-day) in combined output, Rosneft is emerging as a more reliable - and equally weighty - policy tool.

Media stories to the contrary notwithstanding, foreign (including portfolio) investors seem to be happy. Putin's pervasive micromanagement of the energy titans assures them of (relative) stability and predictability and of a reformist, businesslike, mindset. Following a phase of shameless robbery by their new owners, Russian oil firms now seem to be leading Russia - albeit haltingly - into a new age of good governance, respect for property rights, efficacious management, and access to Western capital markets. Khodorkovskyu, the robber-baron, many whisper, had it coming.

The patently dubious UES foray into sovereign debt speculation, for instance, drew surprisingly little criticism from foreign shareholders and board members. "Capital Group", an international portfolio manager, is rumored to have invested close to $700 million in accumulating 10% of Lukoil, probably for some of its clients. Sibneft has successfully floated a $250 million Eurobond (redeemable in 2007 with a lenient coupon of 11.5%). The issue was oversubscribed.

The (probably temporary) cooling of Russia's relationship with the USA is counter-balanced by Russia's acceptance (however belated and reluctant) of its technological and financial dependence on the West. All said and done, the Russian market is an attractive target.

Commercial activity is more focused and often channeled through American diplomatic missions. The watershed year was, again, 2002.

The U.S. Consul General in Vladivostok and the Senior Commercial Officer in Moscow have announced in 2002 that they will "lead an oil and gas equipment and services and related construction sectors trade mission to Sakhalin, Russia from March 11-13, 2002." The oil and gas fields in Sakhalin attract 25% of all FDI in Russia and more than $35 billion in additional investments is expected.

Other regions of interest are the Arctic and Eastern Siberia. Americans compete here with Japanese, Korean, Royal Dutch/Shell, French, and Canadian firms, among others. Even oil multinationals scorched in Russia's pre-Putin incarnation - like British Petroleum which lost $200 million in Sidanco in 11 months in 1997-8 - are back.

Despite Putin's newly-discovered nationalist "Great Peter" streak, takeovers of major Russian players (with their proven reserves) by foreign oil firms have not abated. Russian firms are seriously undervalued - their shares being priced at one third to one tenth their Western counterparts'.

Some Russian oil firms (like Yukos and Sibneft) have growth rates among the highest and production costs among the lowest in the industry. The boards of the likes of Lukoil are packed with American fund managers and British investment bankers. The forthcoming liberalization of the natural gas market (the outcome of an oft-heralded and much needed Gazprom divestiture) is a major opportunity for new - possibly foreign - players.

This gold rush is the result of Russia's prominence as an oil producer, second only to Saudi Arabia. Russia dumps on the world markets c. 4.5 million barrels daily (about 10% of the global trade in oil). It is the world's largest exporter of natural gas (and has the largest known natural gas reserves). It is also the world's second largest energy consumer. In 1992, it produced 8 million bpd and consumed half as much. In 2001, it produced 7 million bpd and consumed 2 million bpd.

Russia has c. 50 billion oil barrels in proven reserves but decrepit exploration and extraction equipment. Its crumbling oil transport infrastructure is in need of total replacement. More than 5% of the oil produced in Russia is stolen by tapping the leaking pipelines. An unknown quantity is lost in oil spills and leakage.

Transneft, the state's oil pipelines monopoly, is committed to an ambitious plan to construct new export pipelines to the Baltic and to China. The market potential for Western equipment manufacturers, building contractors, and oil firms is evidently there.

But this serendipity may be a curse in disguise. Russia is chronically suffering from an oil glut induced by over-production, excess refining capacity, and subsidized domestic prices (oil sold inside Russia costs one third to one half the world price). Russian oil companies are planning to increase production even further. Rosneft plans to double its crude output. Yukos (Russia's second largest oil firm) was planning to increase output by 20% a year when it was decimated and devoured by Rosneft. Surgut will raise its production by 14%.

In early 2002, Russia halved export duties on fuel oil. Export duties on lighter energy products, including gas, were cut in January 2002. As opposed to previous years, no new export quotas were set since then. Clearly, Russia is worried about its surplus and wishes to amortize it through enhanced exports.

Russia also squandered its oil windfall and used it to postpone the much needed restructuring of other sectors in the economy - notably the wasteful industrial sector and the corrupt and archaic financial system. Even the much vaunted plans to break apart the venal and inefficient natural gas and electricity monopolies and to come up with a new production sharing regime have gone nowhere (though some pipeline capacity has been made available to Gazprom's competitors).

Both Russia's tax revenues and its export proceeds (and hence its foreign exchange reserves and its ability to service its monstrous and oft-rescheduled $158 billion in foreign debt) are heavily dependent on income from the sale of energy products in global markets.

More than 40% of all its tax intake is energy-related (compared to double this figure in Saudi Arabia). Gazprom alone accounts for 25% of all federal tax revenues. Almost 40% of Russia's exports are energy products as are 13% of its GDP. Domestically refined oil is also smuggled and otherwise sold unofficially, "off the books".

But, as opposed to Saudi Arabia's or Venezuela's, Russia's budget is always based on a far more realistic price range ($14-18 per barrel in fiscal year 2002/3, for instance). Hence Russia's frequent clashes with OPEC (of which it is not a member) and its decision to cut oil production by only 150,000 bpd in the first quarter of 2002 (having increased it by more than 400,000 bpd in 2001). It cannot afford a larger cut and it can increase its production to compensate for almost any price drop.

Russia's energy minister told the Federation Council, Russia's upper house of parliament, that Russia "should switch from cutting oil output to boosting it considerably to dominate world markets and push out Arab competitors". The Prime Minister told the US-Russia Business Council that Russia should "increase oil production and its presence in the international marketplace".

It may even be that Russia is spoiling for a bloodbath which it hopes to survive as a near monopoly in the energy markets. Russia already supplies more than 25% of all natural gas consumed by Europe and is building or considering to construct pipelines to Turkey, China, and Ukraine. Russia also has sizable coal and electricity exports, mainly to CIS and NIS countries. Should it succeed in its quest to dramatically increase its market share, it will be in the position to tackle the USA and the EU as an equal, a major foreign policy priority of both Putin and all his predecessors alike.

Russia, Financial Sector of

An expatriate relocation Web site, settler-international.com, has this to say about Russian banks: "Do not open a bank account in a Russian bank : you might not see your deposit again." Russia's Central Bank, aware of the dismal lack of professionalism, the venality, and the criminal predilections of Russian "bankers" (and their Western accomplices) - is offering "complementary vocational training" in the framework of its Banking School. It is somewhat ironic that the institution suspected of abusing billions of US dollars in IMF funds by "parking" them in obscure off-shore havens - seeks to better the corrupt banking system in Russia.

I. The Banks

On paper, Russia has more than 1,300 banks. Yet, with the exception of the 20-odd (two new ones were added last year) state-owned (and, implicitly, state-guaranteed) outfits - e.g., the mammoth Sberbank (the savings bank, 61% owned by the Central Bank) - very few provide minimal services, such as corporate finance and retail banking. The surviving part of the private banking sector ("Alfa Bank", "MDM Bank") is composed of dwarfish entities with limited offerings. They are unable to compete with the statal behemoths in a market tilted in the latters' favor by both regulation and habit.

The Agency for the Reconstruction of Credit Organizations (ARCO) - established after the seismic shock of 1998 - did little to restructure the sector and did nothing to prevent asset stripping. More than one third of the banks are insolvent - but were never bankrupted. The presence of a few foreign banks and the emergence of non-bank financing (e.g., insurance) are rays of hope in an otherwise soporific scene.

Despite the fact that most medium and large corporations in Russia own licensed "banks" (really, outsourced treasury operations) - more than 90% of corporate finance in 2000-2001 was in the form of equity finance, corporate bonds, and (mainly) reinvested retained earnings. Some corporate bond issues are as large as $100 million (with 18-months maturity) and the corporate bond market may quintuple to $10 billion in a year or two, reports "The Economist", quoting Renaissance Capital, a Russian investment bank.

Still, that bank credits are not available to small and medium enterprises retards growth, as Stanley Fischer pointed out in his speech to the Higher School of Economics in Moscow, in June 2001, when he was still the First Deputy Managing Director of the IMF. Last week, the OECD warned Russia that its economic growth may suffer without reforms to the banking sector.

Russian banks are undercapitalized and poorly audited. Most of them are exposed to one or two major borrowers, sectors, or commodities. Margins have declined (though to a still high by Western standards 14%). Costs have increased. The vast majority of these fledglings have less than $1 million in capital. This is because shareholders (and, for that matter, depositors) - having been fleeced in the 1998 meltdown - are leery of throwing good money after very bad. The golden opportunity to consolidate and rationalize following the 1998 crisis was clearly missed.

The government's (frail) attempts to reform the sector by overhauling bank supervision and by passing laws which deal with anti-money laundering, deposit insurance, minimum capital and bankruptcy regulations, and mandatory risk evaluation models - did little to erase the memory of its collusion in the all-pervasive, massive, and suspiciously orchestrated defaults of 1998-1999. Russia is notoriously strong on legislation and short on its enforcement.

Moreover, the opaque, overly-bureaucratic, and oligarch-friendly Central Bank is at loggerheads with would be reformers and gets its way more often than not. It supports a minimum capital requirement of less than $5 million. Government sources have gone as high as $200 million. The government retaliates with thinly-veiled threats in the form of inane proposals to replace the Bank with newly-created "independent" institutions.

Viktor Gerashchenko - the current, old-school, Governor - is set to leave on September 2002. He will likely be replaced by someone more Kremlin-friendly. As long as the Kreml is the bastion of reform, these are good news. But a weak Central Bank will remove one of the last checks and balances in Russia. Moreover, a hasty process of consolidation coupled with draconian regulation may decimate private sector Russian banking for good. This, perhaps, is what the Kremlin wants. After all, he who controls the purse strings - rules Russia.

II. The Stock Exchange

The theory of financial markets calls for robust capital markets where banks are lacking and dysfunctional. Equity financing and corporate debt outstrip bank lending as sources of corporate finance even in the West.

But Russia's stock market - the worst performer among emerging markets in 1998, the best one in 2001 - is often cornered and manipulated, prey to insider trading and worse. It is less liquid that the Tel-Aviv Stock Exchange, though the market capitalization of RTS, Russia's main marketplace, is up 430% since 1998 (80% last year alone). Bonds climbed 500% in the same period and a flourishing corporate bonds markets has erupted on the scene. Many regard this surge as a speculative bubble inflated by the high level of oil prices.

Others (mostly Western brokerage houses) swear that the market is undervalued, having fallen by more than 90% in 1998. Russia is different - they say - it is better managed, sports budget and trade surpluses, is less indebted (and re-pays its debts on time, for a change), and the economy is expanding. The same pundits talked the RTS up 180% in 1997 only to see it shrivel in an egregious case of Asian contagion. The connection between Russia's macro and micro is less than straightforward.

Whatever the truth, investors are clearly more discriminating. Both the New York Times and The Economist cite the example of Yukos Oil (up 190%) versus Lukoil (up a mere 30%). The former is investor friendly and publishes internationally audited accounts. The latter has no investor relations to speak of and is disclosure-averse. Still, both firms - as do a few pioneering others - seek to access Western capital markets.

The intrepid investor can partake by purchasing mutual funds dedicated, wholly or partially, to Russia - or by trading ADR's of Russian firms on NYSE (10-20 times the US dollar volume of the RTS). ADR's of smaller firms are traded OTC and, according to the New York Times, one can short sell Russian securities through offshore vehicles. The latter are also used to speculate in the shares of defunct Russian firms ("shells") traded in the West.

III. Debt Markets

Perhaps the best judges of Russia's officially minuscule economy (smaller than the Netherlands' and less than three times Israel's) - are the Russians. When the author of this article suggested that Russia's 1998 chaos was serendipitous (in "Argumenti i Fakti" dated October 28, 1998), he was derided by Western analysts but supported by Russian ones. In hindsight, the Russians were right. They may be right today as well when they claim that Russia has never been better.

The ruble devaluation (which made Russian goods competitive) and rising oil prices yielded a trade surplus of more than $50 billion last year. For the first time in its modern and turbulent history, Russia was able to prepay both foreign (IMF) and domestic debts (it redeemed state bonds ahead of maturity). It is no longer the IMF's largest debtor. Its Central Bank boasts $40 billion in foreign exchange reserves. Exactly a year ago, Russia tried to extort a partial debt write-off from its creditors (as it has done numerous times in its post-Communist decade). But Russia's oft-abused creditors and investors seem to have surprisingly short memories and an unsurpassed capacity for masochistic self-delusion.

Stratfor.com reports ("Russia Buys Financial Maneuverability" dated January 31, 2002) that "Deutsche Bank Jan. 30 granted Vneshekonombank a $100 million loan, the largest private loan to a Russian bank since the

1998 ruble crisis. As Russia works to reintegrate into the global financial network, the cost of domestic borrowing should drop. That should spur a fresh wave of domestically financed development, which is essential considering Russia's dearth of foreign investment."

The strategic forecasting firm also predicts the emergence of a thriving mortgage finance market (there is almost none now). One of the reasons is a belated November 2001 pension reform which allows the investment of retirement funds in debt instruments - such as mortgages. A similar virtuous cycle transpired in Kazakhstan. Last year the Central Bank allowed individuals to invest up to $75,000 outside Russia.

IV. The Bandits

In August 1999, a year and four days after Moscow's $40 billion default, the New York Times reported a $15 billion money laundering operation which involved, inter alia, the Bank of New York and Russia's first Representative to the IMF.

The Russian Central Bank invested billions of dollars (through an offshore entity) in the infamous Russian GKO (dollar-denominated bonds) market, thus helping to drive yields to a vertiginous 290%.

Staff members and collaborators of the now dismantled brainchild of Prof. Jeffrey Sachs, HIID (Harvard Institute of International Development) - the architect of Russian "privatization" - were caught in potentially criminal conflicts of interest.

Are we to believe that such gargantuan transgressions have been transformed into new-found market discipline and virtuous dealings?

Putin doesn't. Last year, riding the tidal wave of the fight against terror, he formed the Financial Monitoring Committee (KFM). Ostensibly, its role is to fight money laundering and other financial crimes, aided by brand new laws and a small army of trained and tenacious accountants under the aegis of the Ministry of Finance.

Really, it is intended to circumvent irredeemably compromised extant structures in the Ministry of Interior and the FSB and to stem capital flight (if possible, by reversing the annual hemorrhage of $15-20 billion). Non-cooperative banks may lose their licenses. Banks have been transferring 5 daily Mb of encoded reports regarding suspicious financial dealings (and all transactions above 600,000 rubles - equal to $20,000) since February 1 - when the KFM opened for business. So much for Russian bank secrecy ("Did we really have it?" - mused President Putin a few weeks ago).

Last month, Mikhail Fradkov, the Federal Tax Police Chief confirmed to Interfax the financial sector's continued involvement in bleeding Russia white: "...fly-by-night firms usually play a key role in illegal money transfers abroad. Fradkov recalled that 20 Moscow banks inspected by the tax police alone transferred about $5 billion abroad through such firms." ITAR-TASS, the Russian news agency, reports a drop of 60% in the cash flow of Russian banks since anti-money laundering measures took effect, a fortnight ago.

V. The Foreign Exchange Market

Russians, the skeptics that they are, still keep most of their savings (c. $40-50 billion) in foreign exchange (predominantly US dollars), stuffed in mattresses and other exotic places. Prices are often quoted in dollars and ATM's spew forth both dollars and rubles. This predilection for the greenback was aided greatly by the Central Bank's panicky advice (reported by Moscow Times) to ditch all European currencies prior to January 1, 2002. The result is a cautious and hitherto minor diversification to euros. Banks are reporting increased demand for the new currency - a multiple of the demand for all former European currencies combined. But this is still a drop in the dollar ocean.

The exchange rate is determined by the Central Bank - by far the decisive player in the thin and illiquid market. Lately, it has opted for a creeping devaluation of the ruble, in line with inflation. Foreign exchange is traded in eight exchanges across Russia but many exporters sell their export earnings directly to the Central Bank. Permits are required for all major foreign exchange transactions, including currency repatriation by foreign firms. Currency risk is absolute as a 1998 court ruling rendered ruble forwards contracts useless ("unenforceable bets").

VI. The International Financial Institutions (IFI's)

Of the World Bank's $12 billion allocated to 51 projects in Russia since 1992, only $0.6 billion went to the financial sector (compared to 8 times as much wasted on "Economic Planning"). Its private sector arm, the International Finance Corporation (IFC) refrained from lending to or investing in the financial sector from March 1999 to June 2001. It has approved (or is considering) six projects since then: a loan of $20 million to DeltaCredit, a smallish project and residential finance, USAID backed, fund; a Russian pre-export financing facility (with the German bank, WestLB); Two million US dollars each to the Russian-owned Baltiskii Leasing and Center Invest (a regional bank); $2.5 million to another regional bank (NBD) - and a partial guarantee for a $15 million bond issued by Russian Standard Bank. There is also $5 million loan to Probusiness Bank.

Another active player is the EBRD. Having suffered a humiliating deterioration in the quality of its Russian assets portfolio in 1998-2000, it is active there again. By midyear last year, it had invested c. $300 million and lent another $700 million to Russian banks, equity and mutual funds, insurance companies, and pension funds. This amounts to almost 30% of its total involvement in the Russian Federation. Judging by this commitment, the EBRD - a bank - seems to be regarding the Russian financial system as either an extremely attractive investment - or a menace to Russia's future stability.

VII. So, What's Next?

No modern country, however self-deluded and backward, can survive without a banking system. The Central Bank's pernicious and overwhelming presence virtually guarantees a repeat of 1998. Russia - like Japan - is living on time borrowed against its oil collateral. Should oil prices wither - what remains of the banking system may collapse, Russian securities will be dumped, Russian debts "deferred". The Central Bank may emerge either more strengthened by the devastation - or weakened to the point of actual reform.

In the eventuality of a confluence between this financial Armageddon and Russia's entry to the WTO - the crisis is bound to become more ominous. Russia is on the verge of opening itself to real competition from the West - including (perhaps especially so) in the financial sector. It is revamping its law books - but does not have the administrative mechanism it takes to implement them. It has a rich tradition of obstructionism, venality, political interference, and patronage.

Foreign competition is the equivalent of an economic crisis in a country like Russia. Should this be coupled with domestic financial mayhem - Russia may be transformed to the worse. Expect interesting times ahead.

Russia, Oil Sector of

British Petroleum teamed up with the Alfa Group-Access-Renova (AAR) concern to equally form Russia's third largest energy company. The new titan will digest Tyumen Oil Company (TNK) International, Rusia Petroleum and Sidanco Oil, which produce, between them, c. 1.2 million barrels per day. The combined outfit will tap between 5-9 billion barrels of proven oil reserves as well as perhaps 100 trillion cubic feet of gas.

The mix includes lucrative exploration contracts in Sakhalin (an island in Russia's Far East) and in western Siberia as well as 2100 gas stations and five refineries in Russia and Ukraine. Slavneft shares owned by AAR are excluded as are Sibneft's warrants convertible to TNK stock. BP keeps out its interests in various local businesses and its sizable oil trading operations in the Russian Federation.

BP will pay $3 billion for its stake in cash and another $3.75 billion in shares over three years. The market valuation of BP's stock is at an ebb - but some analysts say that, in a world of rising global tensions and surging oil prices, the deal may yet turn out to be a masterstroke. BP's earnings jumped a whopping 49 percent in the fourth quarter, they point out.

But the far likelier scenario is less friendly.

BP was forced - by a series of humiliating revisions to past released figures - not to set a future production growth target, merely claiming to be in a "strong competitive position". Moreover, when the change in the value of its oil inventories is stripped, the company's profits last year are down by a quarter compared to 2001.

Its return on capital also plummeted from 19 percent in 2001 to 13 percent the year after. Dwindling margins in refining and retail - mainly in the USA - threaten the viability of these operations, though they have been improving as of late. Only hefty reserves and a higher dividend cushioned the - widely expected - decline in net earnings.

According to the Dow Jones Newswires, the energy behemoth embarked on an ambitious $2 billion share buyback plan. BP has withdrawn from the Russian market posthaste, having been scorched by shady dealings in Sidanco, a tenth of which it acquired in 1998. At the time, it claimed to have been defrauded by the very partners it has taken on board in the current collaboration.

But it now firmly believes that its Russian re-entry is auspicious: "The deal would be immediately accretive to cashflow, earnings per share and return on capital employed, and it expected to improve performance significantly over the next four years through synergies, cost reductions and output growth."

Alas, life - let alone Russia - are far more complicated.

In the proposed partnership, BP is paying c. $3 per barrel. It stands to gain c. 500,000 barrels per day from the joint venture. Only two fifths of this quantity can be exported as crude and another 15 percent as refined products. The rest must be sold domestically at artificially subdued prices.

Russia is already flooded with c. 170 million barrels of unsold oil, in no small measure due to an ongoing conflict between private producers and the country's state-owned pipeline monopoly, Transneft. LUKoil foresees an increase of yet another 130 million barrels by November, according to the New York Times.

With the indigenous market thus saturated, any post-war plunge in world prices could prove calamitous to BP.

As Venezuela's output recovers, the weather warms, the global recession deepens, and a regime-changed Iraq rejoins the world market, an oil glut is in the cards. Despite crude's currently bloated price, OPEC has been talking about production cuts to sustain a level of $18-20 per barrel.

Russia is unlikely to support such a policy.

Its dependence on oil has matured into a full-fledged addiction in the last three years. Russia's budget assumes an average price of $21.50 per barrel. Its production is also more rigid than Saudi Arabia's. It cannot turn extraction on and off at will. Output increased by 9 percent last year.

Additionally, Russia will gleefully leverage the fortuity of a crumbling and internecine OPEC into gaining the number one oil producer spot by increasing its market share. BP may find this policy reckless and shortsighted but still be forced to cooperate with it to the detriment of its long-term interests.

Analyst Frederick Leuffer of Bear Stearns reiterated his "outperform" recommendation for BP's shares before it embarked on the Russian joint venture. The analyst predicted "restructuring and capital expenditure reduction initiatives shortly ... the company (is expected) to redeploy proceeds and cash flow towards share buybacks and dividend increases." These seem less likely now. BP is also involved in other costly projects in Georgia, Ukraine and the countries of the Caspian Basin.

This pervasive exposure to the east is nothing short of a gamble.

BP's attempts to minimize the weight of its latest foray into Russia is disingenuous. Once concluded and cleared by competition authorities in the Russian Federation and the European Union, this single venture will account for one third of British Petroleum's reserves and one seventh of its production.

BP's traditional haunts in the North Sea, the Gulf of Mexico and Alaska are mature and extraction may become prohibitively expensive at much reduced crude prices. But the company is endowed with massive - and oft-replenished - reserves. it is also geographically diversified. Its output is poised to grow by one fifth, to 4.3 million barrels per day, within 3-4 years.

So, why risk another round of bad governance, venal bureaucracy, oil transport monopoly, obstructive local partners, corrupt judiciary, capricious legislation, restive employees, organized crime and cunning competitors? In short: why risk Russia?

Virtually all other oil majors steered clear of Russia and chose to invest in countries like Kazakhstan, or Azerbaijan. BP's move is driven by an unorthodox assessment that the Caspian is over-rated and that black gold is to be found in the Far East. Russia's low cost of production and its enormous reserves make it as attractive as the Gulf once was.

And Russia is changing for the better. BP implausibly claims that the country is now a stable and promising investment destination. This may be going too far. But alternative crude transport infrastructure is being put in place - from pipelines to deep sea harbors. Corporate governance has improved. The oil sector is almost entirely private. Awareness of property rights has grown.

BP's shares went up a mere 4 percent following the announcement. This cautious welcome reflects the uncertainty surrounding the company's strategy. In ten years time, its managers would be either praised as visionary pioneers - or castigated as gullible dupes who were taken for a second ride by the very same partners. Time will tell.

LUKoil's American Depositary Receipts hardly wavered but its Moscow-traded shares tanked yesterday by 5 percent on news that British Petroleum is pulling out of the Russian energy behemoth. BP was saddled with its share of the Russian oil giant when it bought ARCO two years ago.

LUKoil's oil production topped 75 million tons last year, up 20 percent on 2001. More than one third of its production was exported via Transneft to foreign clients, the bulk of it by sea or through the Druzhba pipeline. LUKoil Overseas Holding presented revenues of $1.4 billion. It produces c. 11 million tons of oil annually.

LUKoil and its subsidiaries also extract and sell natural gas.

LUKoil likes to tout its image as a veritable multinational. But its cross-border expansion strategy is encountering mounting difficulties.

Last April, together with London-based Rotch Energy, it bid c. $1 billion for the Polish state-owned Gdansk Refinery and its web of 300 gasoline stations. The network controls one sixth of the Polish market. The deal was presented as synergetic: the refinery was supposed to process LUKoil's produce and the latter's tankers would be patched at the Gdansk shipyards. LUKoil pledged to purchase $500 million of Polish agricultural goods annually and to expand the capacity of the antiquated refinery by at least two fifths.

Yet, according to Business Week, LUKoil's chances to clinch the deal are "dimming fast", due mainly to a tide of Russophobia. Rotch Energy abandoned the fast sinking ship and joined a competing bid. As European Union membership looms nearer, Russia is relegated by its erstwhile - and distrustful - satellites to niche markets such as Serbia, Ukraine, and Bulgaria. Russia's second largest oil producer, Yukos' $150 million controlling stake in Lithuania's Mazheikiu Nafta refinery may be the only exception.

Even in these manageable, Russophile and traditional markets, LUKoil's performance is far from spectacular.

In December 2001, Russian president, Vladimir Putin, visited Greece, accompanied by LUKoil's chief, Vagit Alekperov. According to the Russian business weekly, Vedomosti, LUKoil expressed interest in purchasing the Greek state-owned oil company Hellenic Petroleum.

Hellenic owns refining assets in Greece, Montenegro and Cyprus. In 1999 it purchased the Okta Refinery in Macedonia but its reputedly murky dealings with the previous government of the tiny, landlocked country led to an on-going judicial and administrative review of the privatization deal.

According to RossBusiness Consulting, LUKoil teamed up with the Greek Latsis-Petrola Group in preparing a joint bid for 23 percent of Hellenic Petroleum at a valuation of c. $2 billion. But the LUKoil/Petrola consortium seems to be in disarray. According to the Greek daily, Kathimerini, it recently asked the Greek government to extend its deadline by one week "so that the consortium partners complete their own talks on sharing responsibilities".

Last month, LUKoil reluctantly disposed of its 10 percent of Azerbaijan's Azeri-Chirag-Guneshli oil field. It sold it for $1.4 billion to Inpex, a Japanese firm. According to the Moscow Times, this may have had to do with Alekperov's unwelcome political aspirations in the host country.

Russian firms are poised to benefit from any development in Iraq. They already secured deals with the tottering regime of Saddam Hussein. The Americans are alleged to have promised Putin to honor some of these commitments in a post-Saddam Iraq in return for Russia's support for a US-led military campaign.

The exception is, yet again, LUKoil. A $3.7 billion exploration and development contract it concluded was recently cancelled unilaterally by the irate Iraqis.

Still, Russian emerging dominance in the global energy market is irresistible - as is its seemingly inexhaustible pile of cash. It has the world's seventh or sixth largest oil reserves. Its cost of production is lower than Indonesia's, or Mexico's, let alone Canada's. Its oil industry is in private hands and, with the exception of LUKoil, run efficiently and rather transparently. Low domestic prices push producers to export.

Gazprom, Russia's gas monopoly, partnered with the German gas supplier Wintershall to create Wingas, a west European gas retailing outfit. It also acquired 10 percent of the UK-Europe gas pipeline and, through its subsidiary, Sibur, some assets in Hungary.

Romania's drilling company Upetrom was bought by the Russian united Heavy Machinery. LUKoil purchased Getty Petroleum and its 1500 gas stations in the United States. Another Russian energy leviathan, Yukos, took over the activities in Britain of the Norwegian oil service firm, Kaverner.

The 3000-mile Transneft Druzhba pipeline, which connects Russia to Ukraine, Belarus and central Europe is slated to link to the Croatian Adria pipeline, by way of Yugoslavia. This will provide Russian oil with improved access to both central European and Balkan markets.

LUKoil is carried by this wave of sectoral restructuring.

Last year, LUKoil won a government tender in Cyprus to develop a network of gas stations. According to Prime-TASS, the company already controls one quarter of the Cypriot market. Alekperov announced that LUKoil intends to branch into oil storage and transportation in this would-be new member of the European Union. It also owns and operates 80 pump stations in Bulgaria and has invested half a billion dollars there.

According to Christopher Deliso of UPI, the $700 million, 175-miles long Bourgas-Alexandroupolis line between the Black and Aegean seas is a joint project of the Russian, Greek and Bulgarian governments. Its capacity is projected to be 40 million tons annually. Both LUKoil - which owns Bourgas' Neftochim refinery - and Yukos are involved.

LUKoil is positioned to enjoy Russia's dawning age of dominance as an oil and gas producer and supplier with a quarter of western markets. But to do so it would need to render itself less fuliginous and better managed. A hostile takeover, with the blessing of the Kremlin, may be in the cards. It cannot be a bad thing as far as LUKoil's shareholders are concerned.

Last week, Russia and Israel - erstwhile bitter Cold War enemies - have agreed to make use of Israel's neglected oil pipeline, known as the Tipline. The conduit, an Iranian-Israeli joint venture completed in 1968 is designed to carry close to a million barrels per day, circumventing the Suez canal.

It rarely does, though. The Shah was deposed in 1979, Egypt became a pivotal Western ally, the Israeli-developed Sinai oil fields were returned to Egypt in the early 1980's, and, in a glutted market, Israel resorted to importing 99 percent of the 280,000 barrels it consumes daily.

According to Stratfor, the Strategic Forecasting consultancy, "tankers bearing Russian crude from the Black Sea port of Novorossiysk would unload at Israel's Mediterranean port of Ashkelon. After that, the oil would traverse the Tipline to Israel's Red Sea port of Eilat, where it would be reloaded onto tankers for shipment to Asia. The Eilat-Ashkelon Pipeline Co. estimates the pipeline will be ready for Russian crude in mid-2003."

Russia is emerging as a major oil supplier and a serious challenge to the hegemony of Saudi Arabia and OPEC. Even the USA increasingly taps the Russian market for crude and derivatives. With Arab countries - including the hitherto unwaveringly loyal Gulf states - progressively perceived as hostile by American scholars and decision makers, Russia arises as a potent alternative. The newfangled Russian-Israeli commercial alliance probably won applause from Washington hardliners, eager to relieve the Saudi stranglehold on energy supplies.

Quoted by the American Foreign Policy Council, Russia's Energy Minister, Igor Yusufov, addressing the Russian-US Energy Forum in Houston, Texas, last month said that "the high degree of economic and political stability that the Russian Federation has achieved makes it a reliable supplier of oil and gas".

He expressed his belief - shared by many analysts - that Russia will become a major exporter of oil to the USA "in the foreseeable future". According to the Dow Jones Newswires, private Russian oil firms, such as Lukoil, are heavily invested in US gas stations and refineries in anticipation of these inevitable developments. As if to underline these, the Financial Times reported, on October 3, a purchase of 300,000 barrels of oil from the Russian Tyumen Oil company.

The deal with Israel will allow Russia to peddle its oil in the Asian market, a major export target and a monopoly of the Gulf producers. Russia is in the throes of constructing several pipelines to Asia through its eastern territories and Pacific coastline - but completion dates are uncertain.

For its part, according to the Department of Energy, Israel extracts natural gas from offshore fields but has no commercial fossil fuel resources of its own. It imports oil from Mexico, Norway, and the United Kingdom and coal from as far away as Australia, Colombia, and South Africa. Israel buys natural gas and oil from Egypt. The bulk of the energy sector is moribund and state-owned, ostensibly for reasons of national security. The deal with Russia is a godsend.

Israel is perfectly located to offer an affordable alternative to expensive and often clogged oil shipping lanes through the Suez Canal or the Cape. A revival of the Trans-Arabian pipeline (Tapline) to Haifa can considerably under-price the politically wobbly Iraqi-Turkish and the costly Suez-Mediterranean (Sumed) alternatives.

With one of every five Israelis a Russian émigré and confronted with the common enemy of Islamic militancy, Israel and Russia have embarked on a path of close cooperation. Prime Minister Sharon's visit to Russia last month was a resounding success. Faced with these millennial geopolitical developments, anti-Semitic conspiracy theorists are having a field day.

The Jewish lobby, they say, is coercing America, its long arm, to hijack the Iraqi oil fields in the forthcoming war and thus to counterbalance surging Russian oil exports. Israel, they aver, planned to carry out, in October 2001, an operation - "Mivtza Shekhina" - to secure southern Iraq's oil fields while also mitigating the threat of weapons of mass destruction aimed at its population centers.

Conspiratorial paranoia notwithstanding, it is unlikely that the USA is motivated by oil interests in its war on Saddam. A battle in Iraq aimed solely at apprehending its crude would be fighting over yesterday's oilfields. Only an easily replaceable one tenth to one eighth of American oil consumption emanates from the Gulf, about a million barrels per day of it from Iraq. Moreover, the war is likely to alienate far more important suppliers, such as Russia - as well as the largest European clients of Gulf oil extracted by American firms. Strictly in terms of oil, a war in Iraq is counterproductive.

Additionally, such a war is likely to push oil prices up. According to the Council on Foreign Relations, "for every dollar-per-barrel increase in oil prices, about $4 billion a year would leave America's $11 trillion economy, and other importing countries would lose another $16 billion per year".

Israel understandably did discuss with the USA its role in a showdown with Iraq. Russia, unsettled as it is by America's growing presence in central Asia and exercised by its determination to take on Iraq - may be trying to lure

Israel away from its automatic support of US goals by dangling the oiled carrot of a joint pipeline.

Russia also hopes to neuter the rapprochement between Israel and the Islamic nations of Turkey and Azerbaijan, traditional adversaries of Moscow. Israel is the second largest buyer of oil from Azerbaijan. It is one of the sponsors of a pipeline from the Baku oilfields to the port of Ceyhan in Turkey. The pipeline stands to compete with a less costly and more hostile to the West Russian-Iranian route.

These are momentous times. Oil is still by far the most strategic commodity and securing its uninterrupted flow is essential to the functioning of both developed and developing countries. There is a discernible tectonic shift in production and proven reserves from the Persian Gulf, the US except Alaska, the North Sea, and Latin America to northern Europe, Russia, and the Caspian Basin. Yet, oil is still a buyers' market. OPEC has long been denuded of its mythical power and oil prices - even at the current interim peak - are still historically low in real terms.

But Russia stands to gain whichever way. Middle East tensions, in Palestine and Iraq, have ratcheted oil prices up resulting in a much-needed budgetary windfall. Russia's mostly-privatized oil industry has cleverly ploughed back its serendipitous profits into pipelines, drilling, and exploration. When the dust settles in the deserts of Arabia, Russia will emerge victorious with the largest oil market share. Israel is not oblivious to this scenario.

Success is the best proselytizer. Faced with the imminent demise of Saddam Hussein's regime, both Russia and Germany - erstwhile champions of peace and the sanctity of international law - expressed their hope yesterday for a swift victory of the hitherto much-decried coalition forces.

But this may be too little and way too late, as far as the United States is concerned. The two prostrates are firmly included in the victors' grey list - if not yet in their black one. The friction is not merely the outcome of sanctimonious hectoring about human rights from the Chechen-bashing Russians. It runs deeper and it turns on more than a dime.

Another German-Russian collaboration may shortly attain the limelight: the $800 million, 1000 megawatt light water reactor in Bushehr, an Iranian Persian Gulf port facing southern Iraq. Abandoned by West Germany in 1979, following the Iranian revolution, it was adopted by the Russians in the 1990s. A second reactor is in the offing. More than 2000 Russians are employed in the site.

Following the discovery by the International Atomic Energy Agency (IAEA) of a uranium enrichment facility near the city of Natanz and an Iranian admission that they are mining their own ore, Alexander Rumyantsev, the Russian Atomic Energy Minister, acknowledged that his country lost control over Iran's nuclear program.

Iran, like Iraq, is a celebrated member of the "Axis of Evil". Thus, the atomic complex, though protected by at least 10 SAM batteries, may well be the target of an attack, Israeli and Russian officials told the Bellona Foundation, a Norwegian environmental group. This will not be without precedent: in a daring air operation, Israeli jets pulverized an Iraqi nuclear power plant in Osirak in 1981.

Ironically, it is America's aggressive stance towards Iraq that drives the likes of Iran and North Korea back into the arms - and nuclear technologies - of the Russian Federation. Russia is positioning itself to become an indispensable channel of communication and intermediary between the USA and what the State Department calls "rogue states".

On March 17, Russia's State Property Minister, Farid Gazizulin, met Iran's Defense Minister, Ali Shamkhani, during a session of the Iran-Russia Economic Commission in Tehran. The host's message was unequivocal: "Cooperation between Iran and Russia is to contribute to sustaining peace and prevent conflicts in the region."

According to Asia Times, in an earlier visit to Tehran, Russia's Foreign Minister, Igor Ivanov, pledged to continue to collaborate with Iran on nuclear energy projects. "Iran has no plans to produce nuclear military projects, this is a fundamental truth." - he insisted.

Nor is the teamwork limited to commercial goods and services. An October 2001 bilateral framework agreement has since fostered more than $400 million in Russian annual military exports to Iran, including air defense systems and fighter jets.

Russia is also increasingly involved in the crisis in the Korean Peninsula. South Korean President Roh Moo-hyun's security adviser, Ra Jong-il, have held talks earlier this week with their counterparts in Moscow and Beijing. Russia, like the United States, opposes the military nuclear efforts of North Korea.

Though vehemently denied by all parties, South Korea floated last week, in an interview Ra granted to the Financial Times, the idea of supplying Pyongyang with Russian natural gas from Siberia or Sakhalin through a dedicated pipeline, as a way to solve the wayward regime's energy problems.

According to the Korean daily, The Chosun Ilbo, Russian Ambassador to Seoul, Teymuraz Ramishvili, revealed that discussions have been held on posting Russian or South Korean troops in the North to protect such a pipeline.

North Korea insists that its atomic reactors are intended merely to forestall severe power shortages, now that the 1994 Agreed Framework, to provide it with fuel and two proliferation-resistant reactors financed by the West, is effectively annulled. Even Beijing, hitherto an unflinching supporter of the Dear Leader, halted oil supplies to the North last month.

The scheme is not new. In February 2002, Russian Deputy Energy Minister Valentin Shelepov declared in Moscow at a meeting of the Russian-South Korean Committee for Cooperation in the Sphere of Energy and Natural Resources that Russia seeks South Korean investments in the coal industry and in oil and gas extraction in Eastern Siberia and the Far Eastern regions.

The Russian daily, Nezavisimaya Gazeta, notes that, together with China, South Korea is already involved in LNG ventures in Irkutsk and the Yurubcheno-Tokhomskaya oblast.

According to Stratfor, the strategic forecasting consultancy, Russia offered in the past to construct nuclear power stations on its side of the border and supply North Korea with electricity.

Russia is close to North Korea. In its previous incarnation as the Soviet Union, in 1965, it built North Korea's infamous Yongbyon facilities. Russia was also instrumental in convincing the North to agree to reactivate a railway line connecting it to South Korea. Kim Jong-il, the North's enigmatic leader, celebrated his 61st birthday, in February, in the Russian embassy in Pyongyang.

The mooted pipeline may be nothing but a pipe dream. Even optimists admit that it would require 4 years to construct - more likely 8 to 10 years. But Russia is in no hurry. Russian gas to the pariah state could yet prove to be a key ingredient in any settlement. Russia intends to drive a hard bargain. It is likely to try to swap gas supplies to the Koreans for the preservation of Iraqi oil contracts signed by Saddam's regime with Russian energy behemoths.

Regardless of geopolitical vicissitudes, Russia views Asia - mainly China, Japan and South Korea - as growth markets for its energy products. By 2008 or 2010, Russia plans to sell 20-30 billion cubic meters a year of gas from the Kovykta field, co-developed by Interros, the Tyumen oil company and British Petroleum, to China, South Korea and, possibly, Mongolia.

According to Asia Times:

"Russia is looking at two competing plans. One, backed by Russia's top oil firm Yukos and China, is a $2.5 billion, 2,400- kilometer extension of the existing network from near Irkutsk to Daqing, China. The other, backed by

Rosneft and Japan, would cost $5.2 billion and circumvent China, running 3,800 kilometers to the Russian Far East city of Nakhodka on the Sea of Japan ... The Russian Energy Ministry eventually recommended that the Japanese and Chinese proposals be combined into one project, a third option to build the (1.6 million barrel a day) pipeline to Daqing and then extend it to Nakhodka."

Extending the network eastward is by no means the consensus. Prime Minister Mikhail Kasyanov opened a cabinet meeting last month with the confident - but speculative - declaration that there is enough oil in Siberia to justify a pipeline. Russia's Energy Minister, Igor Yusufov, observed correctly that, in the absence of sufficient exploration, oil and gas reserves in Siberia and the Far East, pegged at 1 billion tons, are, at best, guesstimates. If these are smaller than projected, the eastern thrust would prove to be a costly error.

More than $12 billion are needed in order to explore the vast swathe and to develop it to a profitable level of production - about 100 million tons a year by 2020. The pipelines will funnel 70-80 million tons of crude and 30 billion cubic meters of natural gas a year to Asian buyers.

Still, Russia cannot ignore the Asian markets, nor can it wait a decade or two to avoid commercial risks. Last week, Russia's Energy Ministry concluded the negotiation of a 10-year collaborative effort with Japan involving the construction of oil and gas pipelines, the development of hydrocarbon fuel reserves in Siberia and other projects.

Yesterday, Russian Ambassador to China, Igor Rogachev, told Interfax, the Russian news agency, that "in the past three years, the dynamic growth of merchandise turnover (between Russia and China led to a) volume (of) close to $12 billion last year. This year the volume of bilateral trade grew 37 percent for the first two months and exceeded $2 billion."

Russian exports to China since the beginning of the year soared by 27 percent and Russian imports by 62 percent. China is an avid consumer of Russian electricity generation, aviation, space, laser, and nuclear technologies. Russian firms made inroads into the construction of Chinese hydroelectric plants and railways.

The two countries have "plans for the construction of the Russia-China oil pipeline, and delivering up to 30 million tons of oil a year in it, and a gas pipeline from eastern Siberia to the northeast of (North Korea), and to consumers in third countries". Russia is constructing "a number of major, modern facilities ... in China, (including) the first and second (generating) units at the Tianwan nuclear power plant". China has also signed a contract to buy Russian Tu-204 civil aircraft.

Nor is the cooperation limited to heavy or military industry, explained the Ambassador:

"Agreements between Chinese and Russian companies that provide for the assembly in Russia color televisions and household air conditioners are being successfully implemented."

Twelve years after the demise of communism, Russia is regrouping. It is patching the torn fabric of its diplomacy. In the best American tradition, it is leveraging its growing pecuniary clout - now that it is poised to become the world's leading energy producer. It is reorienting itself -

emphasizing Asia over Europe. It is building new bridges and forming new alliances, both commercial and strategic.

As long as these serve the interests of the sole superpower - as may be the case with North Korea - Russia's revival as an important regional player is tolerated. But, following its sudden swing to the Franco-German camp in the run-up to the Iraqi campaign, it is on probation. Should it engage in anti-American activities, it may find that American patience and tolerance are rather strained.

Correspondence with Antonia Colibasanu, Strafor Strategic Forecasting, April 2007

Russia' interest in North Korea as a potential energy market is limited. It views the North as China's soft belly. Russia regards the USA as a superpower on the decline. American gains in Central Asia are being slowly rolled back through a combination of Russian soft power incentives and interventions, either directly or by proxy. America's standing in Europe is shaky owing to the Iraq War and to Russia's growing role as energy supplier. Granted, the USA is still dominant and will likely remain so in the next 20-30 years. But, the writing is on the geopolitical wall.

Russia will soon face one formidable historic foe: China. It must confront and contain China both in Asia and in Africa. Russia will seek to destabilize both regions by competing with China through the provision of foreign aid, military assistance, political support, clandestine activities, and even open confrontation.

North Korea is an important arena because it is one of three places where there is a confluence of interests:

America's, Russia's, and China's. Iran is another. Russia would seek to lend its support to the highest bidder (which, at the moment, is the USA).

Russia naturally leverages its mineral wealth to achieve its geopolitical goals. Hence the seeming interest in energy projects in that part of the peninsula. Russia simply has nothing else to offer (except arms).

YukosSibneft Oil - the outcome of the announced merger of Yukos Oil and Sibneft, two of Russia's prominent energy behemoths - will pump 2.06 to 2.3 million barrels of crude a day. This is more than Kuwait, Canada, or Iraq do.

With 19.3 to 20.7 billion barrels in known reserves (excluding Slavneft's), 150,000 workers, $15 billion in annual revenues and a market valuation of c. $36 billion - YukosSibneft is, by some measures, the fourth largest oil company in the world behind only ExxonMobil, Royal Dutch/Shell and British Petroleum. Its production cost - around $1.70 per barrel - is half the average outlay of its competitors. The merger offers no synergies - but, in oil, size does matter.

The listing of Yukos stock on the New York State Exchange, slated for the end of this year, will have to be postponed. Still, its American Depository Receipts shot up by 10 percent on the news. In contrast, Sibneft's barely budged, up 3 percent.

Having been shelved in 1998, the annus horribilis of the Russian economy, the deal was successfully struck two days ago. Yukos will pay $3 billion and dole out 26 percent of the combined group to Sibneft's "core" shareholders - namely the oligarchs Roman Abramovich and Boris Berezovsky. Minority stock owners are to be made a "fair offer" backed by a valuation produced by "an internationally recognized bank".

This would be Citigroup. Citibank placed $900 million of Sibneft's corporate debt in the past 5 quarters. It also advised Sibneft in its controversial acquisition, with Tyumen, of the government's stake in Slavneft. The purchase of Lithuanian oil company Mazeiku Nafta by Yukos was virtually designed by Citibank.

Yukos, owned 36 percent by Khodorkovsky, may also distribute a chunk of its $4 billion cash trove either in the form of a dividend or through a share buyback. Whatever the future of this merger, the magnate-shareholders seem to be eager to cash in prior to the expected plunge in oil prices.

Such mergers have become a staple of the sector in recent years. Spurred to consolidate by dropping oil prices and wild competition from Latin America, Central Asia and the Middle East - the giants of the industry mate fervently. Mikhail Khodorkovsky, the chief executive officer of YukosSibneft, is already eyeing acquisition targets to expand retail operations abroad.

Yukos has recently acquired refineries and pipelines in Lithuania and the Czech Republic, for instance. The combined outfit owns, in Lithuania, Belarus and Russia, ten refineries with a total capacity of c. 2 million bpd and more than 2500 filling stations.

The merger - coupled with British Petroleum's takeover of Tyumen Oil in February - depletes the pool of investments available to Western corporate suitors. It also cements Russia's dependence on energy. Oil accounts for close to one third of the vast country's gross domestic product and one half of its exports.

Production in the oil segment has been growing by annual leaps of 20 to 30 percent - compared to a standstill in the rest of Russian industry excluding energy. Reflecting this disparity, YukosSibneft's market value amounts to one half that of all other listed Russian firms combined.

Contrary to congratulatory noises made by self-interested Western bankers and securities analysts, the merger is not good news. It rewards rapacious oligarchs for the unabashed robbery of state assets in the 1990s, keeps much-needed foreign competition, management and capital out and reinforces Russia's addiction to extracted wealth. It spells another orgy of asset stripping and colossal self-enrichment by the junta of former spooks and their business allies.

This is the first time that the Putin administration approves of cooperation between oligarchs. The Kremlin also permitted Yukos to build the first private pipeline to the northern port of Murmansk, the export gateway to the lucrative American market. The avaricious elite sees no reason to share this bonanza with foreigners.

Vladimir Katrenko, the Chairman of the State Duma's Committee on Energy, Transport and Communications confirmed that "by uniting their capital, leading Russian oil and energy companies are trying to stand up to international corporations which exploit every opportunity to squeeze out competitors".

Furthermore, with a parliamentary vote by yearend and presidential elections looming next March, Putin, like president Boris Yeltsin before him, may be discovering the charms of abundant campaign finance and mogul sponsorship in the provinces. Yukos contributes heavily to political outfits, such as the Communist Party, the Union of the Right Forces (SPS), and the Apple (Yabloko) party.

Kohodorkovsky even announced his presidential ambitions in the 2008 campaign. Should he team up with the Family - the inner core of the Yeltsin-era crony machine - The Kremlin would justly feel besieged.

In a thinly-veiled allusion to Khodorkovsky's political aspirations, Deputy Chairman of the State Duma Budget Committee, Sergei Shtogrin, mused that "certain people in Russia have a great deal of influence in national politics and economics. At the moment it is still unclear what the policy of the new management will be and whether or not it will support the government in developing the economy or not."

Not surprisingly, therefore, Kremlin involvement is ubiquitous. It virtually micro-manages the oil sector. Putin leaned heavily on Sibneft not to conclude a deal with foreign suitors such as TotalFinaElf, ExxonMobil and Shell and to favor Yukos. Abramovich is said to be impotently seething at the loss of control over Sibneft. The merger was also a way to denude the outspoken Berezovsky, much-hated by the Kremlin, of his last assets in Russia.

The disgraced tycoon - whose extradition from the United Kingdom on fraud charges has been officially requested by Russian authorities last month - bought Sibneft for a mere $100 million in the heyday of Yeltsin the corrupt, in 1995-6. Asia Times reported, based on Moscow "banking sources", that Yukos has hitherto refrained from going public in New York due to Kremlin pressure. The firms have been hitherto closely held with the free floats of Yukos and Sibneft equal to less than one quarter and one seventh of their capital, respectively.

While it maintained Yukos' rating as is, Moody's Investors Service kept Sibneft under review for a possible downgrade:

"Moody's sees significant benefits of the transaction in terms of scale, the limited cash financing of the merger, and the good underlying reserve quality and operational efficiency of the two companies ... The enlarged group's intention (is) to maintain a moderate level of leverage and a strong working capital position. (But) the new entity's activities will remain wholly concentrated in Russia ... (and) while positive changes are being promised, corporate governance is also likely to persist as a constraining rating issue. This reflects the ongoing discussions with TNK regarding the split of the assets of Slavneft acquired in late 2002 by the two companies and Sibneft's practice of making high dividend payments."

These civil understatements disguise an unsettling opaqueness as to who exactly owns Sibneft. Nor are its frequent dealings more transparent. It recently sold its stakes in oil company Onaco and its chief production subsidiary, Orenburgneft, to Tyumen Oil - yet, no one knows for how much. Another imponderable is Gazprom, now a formidable and superbly connected direct competitor - with state-owned partner Rosneft - for energy reserves in eastern Siberia.

The YukosSibneft merger is in the worst of Russian traditions: self-dealing, self-serving and murky. This offspring of political meddling, egregious profit taking, insider trading, backstabbing and xenophobia it is unlikely to produce another Shell or BP. It is the venomous fruit of a poisoned tree.

Russia, State Security Sector of

Shabtai Kalmanovich vanished from London in late 1980's. He resurfaced in Israel to face trial for espionage. He was convicted and spent years in an Israeli jail before being repatriated to Russia. He was described by his captors as a mastermind, in charge of an African KGB station.

In the early 1970's he even served as advisor (on Russian immigration) to Israel's Iron Lady, Golda Meir. He then moved to do flourishing business in Africa, in Botswana and then in Sierra Leone, where his company, LIAT, owned the only bus operator in Freetown. He traded diamonds, globetrotted flamboyantly with an entourage of dozens of African chieftains and their mistresses, and fraternized with the corrupt elite, President Momoh included. In 1986-7 he even collaborated with IPE, a London based outfit, rumored to have been owned by former members of the Mossad and other paragons of the Israeli defense establishment (including virtually all the Israelis implicated in the ill-fated Iran-Contras affair).

Being a KGB officer was always a lucrative and liberating proposition. Access to Western goods, travel to exotic destinations, making new (and influential) friends, mastering foreign languages, and doing some business on the side (often with one's official "enemies" and unsupervised slush funds) - were all standard perks even in the 1970's and 1980's. Thus, when communism was replaced by criminal anarchy, KGB personnel (as well as mobsters) were the best suited to act as entrepreneurs in the new environment. They were well traveled, well connected, well capitalized, polyglot, possessed of management skills, disciplined, armed to the teeth, and ruthless. Far from being sidetracked, the security services rode the gravy train. But never more so than now.

January 2002. Putin's dour gaze pierces from every wall in every office. His obese ministers often discover a sudden sycophantic propensity for skiing (a favorite pastime of the athletic President). The praise heaped on him by the servile media (Putin made sure that no other kind of media survives) comes uncomfortably close to a Central Asian personality cult. Yet, Putin is not in control of the machinery that brought him to the pinnacle of power, under-qualified as he was. This penumbral apparatus revolves around two pivots: the increasingly fractured and warlord controlled military and, ever more importantly, the KGB's successors, mainly the FSB.

A. The Military

Two weeks ago, Russia announced yet another plan to reform its bloated, inefficient, impoverished, demoralized and corrupt military. Close to 200,000 troops are to go immediately and the same number in the next 3 years. The draft is to be abolished and the army professionalized. At its current size (officially, 1.2 million servicemen), the armed forces are severely under-funded. Cases of hunger are not uncommon. Ill (and late) paid soldiers sometimes beg for cigarettes, or food.

Conscripts, in what resembles slave labour, are "rented out" by their commanders to economic enterprises (especially in the provinces). A host of such "trading" companies owned by bureaucrats in the Ministry of Defense was shut down last June by the incoming Minister of Defense (Sergei Ivanov), a close pal of Putin. But if restructuring is to proceed apace, the successful absorption of former soldiers in the economy (requiring pensions, housing, start up capital, employment) - if necessary with the help of foreign capital - is bound to become a priority sooner or later.

But this may be too late and too little - the much truncated and disorientated armed forces have been "privatized" and commandeered for personal gain by regional bosses in cahoots with the command structure and with organized crime. Ex-soldiers feature prominently in extortion, protection, and other anti-private sector rackets.

The war in Chechnya is another long standing pecuniary bonanza - and a vested interest of many generals. Senior Russian Interior Ministry field commanders trade (often in partnership with Chechen "rebels") in stolen petroleum products, food, and munitions.

Putin is trying to reverse these pernicious trends by enlisting the (rank and file) army (one of his natural constituencies) in his battles against secessionist Chechens, influential oligarchs, venal governors, and bureaucrats beyond redemption.

As well as the army, the defense industry - with its 2 million employees - is also being brutally disabused of its centralist-nationalistic ideals.

Orders placed with Russia's defense manufacturers by the destitute Russian armed forces are down to a trickle. Though the procurement budget was increased by 50% last year, to c. $2.2 billion (or 4% of the USA's) and further increased this year to 79 billion rubles ($2.7 billion) - whatever money is available goes towards R&D, arms modernization, and maintaining the inflated nuclear arsenal and the personal gear of front line soldiers in the interminable Chechen war. The Russian daily "Kommersant" quotes Former Armed Forces weapons chief, General Anatoly Sitnov, as claiming that $16 billion should be allocated for arms purchases if all the existing needs are to be satisfied.

Having lost their major domestic client (defense constituted 75% of Russian industrial production at one time) - exports of Russian arms have soared to more than $4.4 billion annually (not including "sensitive" materiel). Old markets in the likes of Iran, Iraq, Syria, Algeria, Eritrea, Ethiopia, China, India, and Libya have revived. Decision makers in Latin America and East Asia (including Malaysia and Vietnam) are being avidly courted. Bribes change hands, off-shore accounts are open and shut, export proceeds mysteriously evaporate. Many a Russian are wealthier due to this export cornucopia.

The reputation of Russia's weapons manufacturers is dismal (no spare parts, after sales service, maintenance, or quality control). But Russian weapons (often Cold War surplus) come cheap and the list of Russian firms and institutions blacklisted by the USA for selling weapons (from handguns to missile equipped destroyers) to "rogue states" grows by the day. Less than one quarter of 2500 defense-related firms are subject to (the amorphous and inapt) Russian Federal supervision. Gradually, Russia's most advanced weaponry is being made available through these outfits.

Close to 4000 R&D programs and defense conversion projects (many financed by the West) have failed abysmally to transform Russia's "military-industrial complex". Following a much derided "privatization" (in which the state lost control over hundreds of defense firms to assorted autochthonous tycoons and foreign manufacturers) - the enterprises are still being abused and looted by politicians on all levels, including the regional and provincial ones. The Russian Federation, for instance, has controlling stakes in only 7 of c. 250 privatized air defense contractors. Manufacturing and R&D co-operation with Ukraine and other former Soviet republics is on the ascendant, often flying in the face of official policies and national security.

Despite the surge in exports, overproduction of unwanted goods leads to persistent accumulation of inventory. Even so, capacity utilization is said to be 25% in many factories. Lack of maintenance renders many plant facilities obsolete and non-competitive. The Russian government's new emphasis on R&D is wise - Russia must replenish its catalog with hi-tech gadgets if it wishes to continue to export to prime clients. Still, the Russian Duma's prescription of a return to state ownership, central planning, and subsidies, if implemented, is likely to prove to be the coup de grace rather than a graceful coup.

B. The FSB (the main successor to the KGB)

NOTE:

The KGB was succeeded by a host of agencies. The FSB inherited its internal security directorates. The SVR inherited the KGB's foreign intelligence directorates.

With the ascendance of the Vladimir Putin and his coterie (all former KGB or FSB officers), the security services revealed their hand - they are in control of Russia and always have been. They number now twice as many as the KGB at its apex. Only a few days ago, the FSB had indirectly made known its enduring objections to a long mooted (and government approved) railway reform (a purely economic matter). President Putin made December 20 (the day the murderous Checka, the KGB's ancestor, was established in 1917) a national holiday.

But the most significant tectonic shift has been the implosion of the unholy alliance between Russian organized crime and its security forces. The Russian mob served as the KGB's long arm until 1998. The KGB often recruited and trained criminals (a task it took over from the Interior Ministry, the MVD). "Former" (reserve) and active agents joined international or domestic racketeering gangs, sometimes as their leaders.

After 1986 (and more so after 1991), many KGB members were moved from its bloated First (SVR) and Third Directorates to its Economic Department. They were instructed to dabble in business and banking (sometimes in joint ventures with foreigners). Inevitably, they crossed paths - and then collaborated - with the Russian mafia which, like the FSB, owns shares in privatized firms, residential property, banks, and money laundering facilities.

The co-operation with crime lords against corrupt (read: unco-operative) bureaucrats became institutional and all-pervasive under Yeltsin. The KGB is alleged to have spun off a series of "ghost" departments to deal with global drug dealing, weapons smuggling and sales, white slavery, money counterfeiting, and nuclear material.

In a desperate effort at self-preservation, other KGB departments are said to have conducted the illicit sales of raw materials (including tons of precious metals) for hard currency, and the laundering of the proceeds through financial institutions in the West (in Cyprus, Israel, Greece, the USA, Switzerland, and Austria). Specially established corporate shells and "banks" were used to launder money, mainly on behalf of the party nomenklatura. All said, the emerging KGB-crime cartel has been estimated to own or control c. 40% of Russian GDP as early as 1994, having absconded with c. $100 billion of state assets.

Under the dual pretexts of "crime busting" and "fighting terrorism", the Interior Ministry and FSB used this period to construct massive, parallel, armies - better equipped and better trained than the official one.

Many genuinely retired KGB personnel found work as programmers, entrepreneurs, and computer engineers in the Russian private sector (and, later, in the West) - often financed by the KGB itself. The KGB thus came to spawn and dominate the nascent Information Technology and telecommunications industries in Russia. Add to this former (but on reserve duty) KGB personnel in banks, hi-tech corporations, security firms, consultancies, and media in the West as well as in joint ventures with foreign firms in Russia - and the security services' latter day role (and next big fount of revenue) becomes clear: industrial and economic espionage. Russian scholars are already ordered (as of last May) to submit written reports about all their encounters with foreign colleagues.

This is where the FSB began to part ways with crime, albeit hitherto only haltingly.

The FSB has established itself both within Russian power structures and in business. What it needs now more than money and clout - are respectability and the access it brings to Western capital markets, intellectual property (proprietary technology), and management. Having co-opted criminal organizations for its own purposes (and having acted criminally themselves) - the alphabet soup of security agencies now wish to consolidate their gains and transform themselves into legitimate, globe-spanning, business concerns. The robbers' most fervent wish is to become barons. Their erstwhile, less exalted, criminal friends are on the way. Expect a bloodbath, a genuine mafia gangland war over territory and spoils. The result is by no means guaranteed.

S

Scams

The syntax is tortured, the grammar mutilated, but the message - sent by snail mail, telex, fax, or e-mail - is coherent: an African bigwig or his heirs wish to transfer funds amassed in years of graft and venality to a safe bank account in the West. They seek the recipient's permission to make use of his or her inconspicuous services for a percentage of the loot - usually many millions of dollars. A fee is required to expedite the proceedings, or to pay taxes, or to bribe officials - they plausibly explain. A recent (2005) variant involves payment with expertly forged postal money orders for goods exported to a transit address.

It is a scam two decades old - and it still works. In September 2002, a bookkeeper for a Berkley, Michigan law firm embezzled $2.1 million and wired it to various bank accounts in South Africa and Taiwan. Other victims were kidnapped for ransom as they traveled abroad to collect their "share". Some never made it back. Every year, there are 5 such murders as well as 8-10 snatchings of American citizens alone. The usual ransom demanded is half a million to a million dollars.

The scam is so widespread that the Nigerians saw fit to explicitly ban it in article 419 of their penal code. The Nigerian President, Olusegun Obasanjo castigated the fraudsters for inflicting "incalculable damage to Nigerian businesses" and for "placing the entire country under suspicion".

"Wired" quotes statistics presented at the International Conference on Advance Fee (419) Frauds in New York on Sept. 17, 2002:

"Roughly 1 percent of the millions of people who receive 419 e-mails and faxes are successfully scammed. Annual losses to the scam in the United States total more than $100 million, and law enforcement officials believe global losses may total over $1.5 billion."

According to the "IFCC 2001 Internet Fraud Report", published by the FBI and the National White Collar Crime Center, Nigerian letter fraud cases amount to 15.5 percent of all grievances. The Internet Fraud Complaint Center (renamed the Internet Crime Complaint Center, or IC3) refers such rip-offs to the US Secret Service. While the median loss in all manner of Internet fraud was $435 - in the Nigerian scam it was a staggering $5575. But only one in ten successful crimes is reported, says the FBI's report.

The IFCC provides this advisory to potential targets:

- Be skeptical of individuals representing themselves as Nigerian or other foreign government officials asking for your help in placing large sums of money in overseas bank accounts.
- Do not believe the promise of large sums of money for your cooperation.
- Do not give out any personal information regarding your savings, checking, credit, or other financial accounts.
- If you are solicited, do not respond and quickly notify the appropriate authorities.

The "419 Coalition" is more succinct and a lot more pessimistic:

1. "NEVER pay anything up front for ANY reason.
2. NEVER extend credit for ANY reason.
3. NEVER do ANYTHING until their check clears.
4. NEVER expect ANY help from the Nigerian Government.
5. NEVER rely on YOUR Government to bail you out."

The State Department's Bureau of International Narcotics and Law Enforcement Affairs published a brochure titled "Nigerian Advance Fee Fraud". It describes the history of this particular type of swindle:

"AFF criminals include university-educated professionals who are the best in the world for nonviolent spectacular crimes. AFF letters first surfaced in the mid-1980s around the time of the collapse of world oil prices, which is Nigeria's main foreign exchange earner. Some Nigerians turned to crime in order to survive. Fraudulent schemes such as AFF succeeded in Nigeria, because Nigerian criminals took advantage of the fact that Nigerians speak English, the international language of business, and the country's vast oil wealth and natural gas reserves - ranked 13th in the world - offer lucrative business opportunities that attract many foreign companies and individuals."

According to London's Metropolitan Police Company Fraud Department, potential targets in the UK and the USA alone receive c. 1500 solicitations a week. The US Secret Service Financial Crime Division takes in 100 calls a day from Americans approach by the con-men. It now acknowledges that "Nigerian organized crime rings running fraud schemes through the mail and phone lines are now so large, they represent a serious financial threat to the country".

Sometimes even the stamps affixed to such letters are forged. Nigerian postal workers are known to be in cahoots with the fraudsters. Names and addresses are obtained from "trade journals, business directories, magazine and newspaper advertisements, chambers of commerce, and the Internet".

Victims are either too intimidated to complain or else reluctant to admit their collusion in money laundering and fraud. Others try in vain to recoup their losses by ploughing more money into the scheme.

Contrary to popular image, the scammers are often violent and involved in other criminal pursuits, such as drug trafficking, According to Nigeria's Drug Law Enforcement Agency. The blight has spread to other countries. Letters from Sierra Leone, Ghana, Congo, Liberia, Togo, Ivory Coast, Benin, Burkina Faso, South Africa, Taiwan, or even Canada, the United Kingdom, Oman, and Vietnam are not uncommon.

The dodges fall into a few categories.

Over-invoiced contract scams involve the ostensible transfer of amounts obtained through inflated invoices to the bank account of an unrelated foreign firm. Contract fraud or "trade default" is simply a bogus order accompanied by a fraudulent bank draft (or fake postal or other money order) for the products of an export company accompanied by demand for "samples" and various transaction "fees and charges".

Some of the rackets are plain outlandish. In the "wash-wash" confidence trick people have been known to pay up to $200,000 for a special solution to remove stains from millions in defaced dollar notes. Others "bought" heavily "discounted" crude oil stored in "secret" locations - or real estate in rezoned locales. "Clearing houses" or "venture capital organizations" claiming to act on behalf of the Central Bank of Nigeria launder the proceeds of the scams.

In another twist, charities, academic institutions, nonprofit organizations, and religious groups are asked to pay the inheritances tax on a "donation". Some "dignitaries" and their relatives may seek to flee the country and ask the victims to advance the bribe money in return for a generous cut of the wealth they have stashed abroad.

"Bankers" may find inactive accounts with millions of dollars - often in lottery winnings - waiting to be transferred to a safe off-shore haven. Bogus jobs with inflated wages are another ostensible way to defraud state-owned companies - as is the sale of the target's used vehicle to them for an extravagant price. There seems to be no end to criminal ingenuity.

Lately, the correspondence purports to be coming from - often white - disinterested professional third parties. Accountants, lawyers, directors, trustees, security personnel, or bankers pretend to be acting as fiduciaries for the real dignitary in need of help. Less gullible victims are subjected to plain old extortion with verbal intimidation and stalking.

The more heightened public awareness grows with over-exposure and the tighter the net of international cooperation against the scam, the wilder the stories it spawns. Letters have surfaced recently signed by dying refugees, tsunami victims, survivors of the September 11 attacks, and serendipitous US commandos on mission in Afghanistan.

Governments throughout the world have geared up to protect their businessmen. The US Department of Commerce, for instance, publishes the "World Traders data Report", compiled by US embassy in Nigeria. It "provides the following types of information: types of organizations, year established, principal owners, size, product line, and financial and trade references".

Unilateral US activity, inefficacious collaboration with the Nigerian government some of whose officials are rumored to be in on the deals, multilateral efforts in the framework of the OECD and the Interpol, education and information campaigns - nothing seems to be working.

The treatment of 419 fraudsters in Nigeria is so lenient that, according to the "Nigeria Tribune", the United States threatened the country with sanctions if it does not considerably improve its record on financial crime by November 2002. Both the US Treasury's Financial Crime Enforcement Network (FINCEN) and the OECD's Financial Action Task Force (FATF) had characterized the country as "one of the worst perpetrators of financial crimes in the world". The Nigerian central bank promises to get to grips with this debilitating problem.

Nigerian themselves - though often victims of the scams - take the phenomenon in stride. The Nigerian "Daily

Champion", proffered this insightful apologia on behalf of the ruthless and merciless 419 gangs. It is worth quoting at length:

"To eradicate the 419 scourge, leaders at all levels should work assiduously to create employment opportunities and people perception of the leaders as role models. The country's very high unemployment figure has made nonsense of the so-called democracy dividends. Great majority of Nigerian youthful school leaver's including University graduates, are without visible means of livelihood... The fact remains that most of these teeming youths cannot just watch our so-called leaders siphon their God-given wealthy. So, they resorted to alternative fraudulent means of livelihood called 419, at least to be seen as have arrived... Some of these 419ers are in the National Assembly and the State Houses of Assembly while some surround the President and governors across the country."

Some swindlers seek to glorify their criminal activities with a political and historical context. The Web site of the "419 Coalition" contains letters casting the scam as a form of forced reparation for slavery, akin to the compensation paid by Germany to survivors of the holocaust. The confidence tricksters boast of defrauding the "white civilization" and unmasking the falsity of its claims for superiority. But a few delusional individuals aside, this is nothing but a smokescreen.

Greed outweighs fear and avarice enmeshes people in clearly criminal enterprises. The "victims" of advance fee scams are rarely incognizant of their alleged role. They knowingly and intentionally collude with self-professed criminals to fleece governments and institutions. This is one of the rare crimes where prey and perpetrator may well deserve each other.

Strange, penumbral, characters roam the boardrooms of banks in the countries in transition. Some of them pop apparently from nowhere, others are very well connected and equipped with the most excellent introductions. They all peddle financial transactions which are too good to be true and often are. In the unctuously perfumed propinquity of their Mercedesed, Rolex waving entourage - the polydipsic natives dissolve in their irresistible charm and the temptations of the cash: mountainous returns on capital, effulgent profits, no collaterals, track record, or business plan required. Total security is cloyingly assured.

These Fausts roughly belong to four tribes:

The Shoppers

These are the shabby operators of the marginal shadows of the world of finance. They broker financial deals with meretricious sweat only to be rewarded their meagre, humiliated fees. Most of their deals do not materialize. The principle is very simple:

They approach a bank, a financial institution, or a borrower and say: "We are connected to banks or financial institutions in the West. We can bring you money in the form of credits. But to do that - you must first express interest in getting this money. You must furnish us with a bank guarantee / promissory note / letter of intent that indicates that you desire the credit and that you are willing to provide a liquid financial instrument to back it up.". Having obtained such instruments, the shoppers begin to "shop around". They approach banks and financial institutions (usually, in the West). This time, they reverse their text: "We have an excellent client, a good borrower. Are you willing to lend to it?" An informal process of tendering ensues. Sometimes it ends in a transaction and the shopper collects a small commission (between one quarter of a percentage point and two percentage points - depending on the amount). Mostly it doesn't -and the Flying Dutchman resumes his wanderings looking for more venal gulosity and less legal probity.

The Con-Men

These are crooks who set up elaborate schemes ("sting operations") to extract money from unsuspecting people and financial institutions. They establish "front" or "phantom" firms and offices throughout the world. They tempt the gullible by offering them enormous, immediate, tax-free, effort-free, profits. They let the victims profit in the first round or two of the scam. Then, they sting: the victims invest money and it evaporates together with the dishonest operators. The "offices" are deserted, the fake identities, the forged bank references, the falsified guarantees are all exposed (often with the help of an inside informant).

Probably the most famous and enduring scam is the "Nigerian-type Connection". Letters - allegedly composed by very influential and highly placed officials - are sent out to unsuspecting businessmen. The latter are asked to make their bank accounts available to the former, who profess to need the third party bank accounts through which to funnel the sweet fruits of corruption. The account owners are promised huge financial rewards if they collaborate and if they bear some minor-by-comparison upfront costs. The con-men pocket these "expenses" and vanish. Sometimes, they even empty the accounts of their entire balance as they evaporate.

The Launderers

A lot of cash goes undeclared to tax authorities in countries in transition. The informal economy (the daughter of both criminal and legitimate parents) comprises between 15% (Slovenia) and 50% (Russia, Macedonia) of the official one. Some say these figures are a deliberate and ferocious understatement. These are mind boggling amounts, which circulate between financial centres and off shore havens in the world: Cyprus, the Cayman Islands, Liechtenstein (Vaduz), Panama and dozens of aspiring laundrettes.

The money thus smuggled is kept in low-yielding cash deposits. To escape the cruel fate of inflationary corrosion, it has to be reinvested. It is stealthily re-introduced to the very economy that it so sought to evade, in the form of investment capital or other financial assets (loans and credits). Its anxious owners are preoccupied with legitimising their stillborn cash through the conduit of tax-fearing enterprises, or with lending it to same. The emphasis is on the word: "legitimate". The money surges in through mysterious and anonymous foreign corporations, via off-shore banking centres, even through respectable financial institutions (the Bank of New York we mentioned?). It is easy to recognize a laundering operation. Its hallmark is a pronounced lack of selectivity. The money is invested in anything and everything, as long as it appears legitimate. Diversification is not sought by these nouveau tycoons and they have no core investment strategy. They spread their illicit funds among dozens of disparate economic activities and show not the slightest interest in the putative yields on their investments, the maturity of their assets, the quality of their newly acquired businesses, their history, or real value. Never the sedulous, they pay exorbitantly for all manner of prestidigital endeavours. The future prospects and other normal investment criteria are beyond them. All they are after is a mirage of lapidarity.

The Investors

This is the most intriguing group. Normative, law abiding, businessmen, who stumbled across methods to secure excessive yields on their capital and are looking to borrow their way into increasing it. By cleverly participating in bond tenders, by devising ingenious option strategies, or by arbitraging - yields of up to 300% can be collected in the immature markets of transition without the normally associated risks. This sub-species can be found mainly in Russia and in the Balkans.

Its members often buy sovereign bonds and notes at discounts of up to 80% of their face value. Russian obligations could be had for less in August 1998 and Macedonian ones during the Kosovo crisis. In cahoots with the issuing country's central bank, they then convert the obligations to local currency at par (=for 100% of their face value). The difference makes, needless to add, for an immediate and hefty profit, yet it is in (often worthless and vicissitudinal) local currency. The latter is then hurriedly disposed of (at a discount) and sold to multinationals with operations in the country of issue, which are in need of local tender. This fast becomes an almost addictive avocation.

Intoxicated by this pecuniary nectar, the fortunate, those privy to the secret, try to raise more capital by hunting for financial instruments they can convert to cash in Western banks. A bank guarantee, a promissory note, a confirmed letter of credit, a note or a bond guaranteed by the Central Bank - all will do as deposited collateral against which a credit line is established and cash is drawn. The cash is then invested in a new cycle of inebriation to yield fantastic profits.

It is easy to identify these "investors". They eagerly seek financial instruments from almost any local bank, no matter how suspect. They offer to pay for these coveted documents (bank guarantees, bankers' acceptances, letters of credit) either in cash or by lending to the bank's clients and this within a month or more from the date of their issuance. They agree to "cancel" the locally issued financial instruments by offering a "counter-financial-instrument" (safe keeping receipt, contra-guarantee, counter promissory note, etc.). This "counter-instrument" is issued by the very Prime World or European Bank in which the locally issued financial instruments are deposited as collateral.

The Investors invariably confidently claim that the financial instrument issued by the local bank will never be presented or used (which is true) and that this is a risk free transaction (which is not entirely so). If they are forced to lend to the bank's clients, they often ignore the quality of the credit takers, the yields, the maturities and other considerations which normally tend to interest lenders very much.

Whether a financial instrument cancelled by another is still valid, presentable and should be honoured by its issuer is still debated. In some cases it is clearly so. If something goes horribly (and rarely, admittedly) wrong with these transactions - the local bank stands to suffer, too.

It all boils down to a terrible hunger, the kind of thirst that can be quelled only by the denominated liquidity of lucre. In the post nuclear landscape of this part of the world, a fantasy is shared by both predators and prey. Circling each other in marble temples, they switch their roles in dizzying progression. Tycoons and politicians, industrialists and bureaucrats all vie for the attention of Mammon. The shifting coalitions of well groomed man in back stabbed suits, an hallucinatory carousel of avarice and guile. But every circus folds and every luna park is destined to shut down. The dying music, the frozen accounts of the deceived, the bankrupt banks, the Jurassic Park of skeletal industrial beasts - a muted testimony to a wild age of mutual assured destruction and self deceit. The future of Eastern and South Europe. The present of Russia, Albania and Yugoslavia.

Scandals, Financial

Tulipmania - this is the name coined for the first pyramid investment scheme in history.

In 1634, tulip bulbs were traded in a special exchange in Amsterdam. People used these bulbs as means of exchange and value store. They traded them and speculated in them. The rare black tulip bulbs were as valuable as a big mansion house. The craze lasted four years and it seemed that it would last forever. But this was not to be.

The bubble burst in 1637. In a matter of a few days, the price of tulip bulbs was slashed by 96%!

This specific pyramid investment scheme (also known as "Ponzi scheme", after a notorious swindler) was somewhat different from the ones which were to follow it in human financial history elsewhere in the world. It had no "organizing committee", no identifiable group of movers and shakers, which controlled and directed it. Also, no explicit promises were ever made concerning the profits which the investors could expect from participating in the scheme - or even that profits were forthcoming to them.

Since then, pyramid (Ponzi) schemes have evolved into intricate psychological ploys.

Modern ones have a few characteristics in common:

First, they involve ever growing numbers of people. They mushroom exponentially into proportions that usually threaten the national economy and the very fabric of society. All of them have grave political and social implications.

Hundreds of thousands of investors (in a population of less than 3.5 million souls) were deeply enmeshed in the 1983 banking crisis in Israel.

This was a classic pyramid scheme: the banks offered their own shares for sale, promising investors that the price of the shares will only go up (sometimes by 2% daily). The banks used depositors' money, their capital, their profits and money that they borrowed abroad to keep this impossible and unhealthy promise. Everyone knew what was going on and everyone was involved.

The Ministers of Finance, the Governors of the Central Bank assisted the banks in these criminal pursuits. This specific pyramid scheme - arguably, the longest in history - lasted 7 years.

On one day in October 1983, ALL the banks in Israel collapsed. The government faced such civil unrest that it was forced to compensate shareholders through an elaborate share buyback plan which lasted 9 years. The total indirect damage is hard to evaluate, but the direct damage amounted to 6 billion USD.

This specific incident highlights another important attribute of pyramid schemes: investors are promised impossibly high yields, either by way of profits or by way of interest paid. Such yields cannot be derived from the proper investment of the funds - so, the organizers resort to dirty tricks.

They use new money, invested by new investors - to pay off the old investors.

The religion of Islam forbids lenders to charge interest on the credits that they provide. This prohibition is problematic in modern day life and could bring modern finance to a complete halt.

It was against this backdrop, that a few entrepreneurs and religious figures in Egypt and in Pakistan established what they called: "Islamic banks". These banks refrained from either paying interest to depositors - or from charging their clients interest on the loans that they doled out.

Instead, they have made their depositors partners in fictitious profits - and have charged their clients for fictitious losses. All would have been well had the Islamic banks stuck to healthier business practices.

But they offer impossibly high "profits" and ended the way every pyramid ends: they collapsed and dragged economies and political establishments with them.

The latest example of the price paid by whole nations due to failed pyramid schemes is, of course, Albania 1997. One third of the population was heavily involved in a series of heavily leveraged investment plans which collapsed almost simultaneously. Inept political and financial crisis management led Albania to the verge of disintegration into civil war.

But why must pyramid schemes fail? Why can't they continue forever, riding on the back of new money and keeping every investor happy, new and old?

The reason is that the number of new investors - and, therefore, the amount of new money available to the pyramid's organizers - is limited. There are just so many risk takers. The day of judgement is heralded by an ominous mismatch between overblown obligations and the trickling down of new money. When there is no more money available to pay off the old investors, panic ensues. Everyone wants to draw money at the same time. This, evidently, is never possible - some of the money is usually invested in real estate or was provided as a loan. Even the most stable and healthiest financial institutions never put aside more than 10% of the money deposited with them.

Thus, pyramids are doomed to collapse.

But, then, most of the investors in pyramids know that pyramids are scams, not schemes. They stand warned by the collapse of other pyramid schemes, sometimes in the same place and at the same time. Still, they are attracted again and again as butterflies are to the fire and with the same results.

The reason is as old as human psychology: greed, avarice. The organizers promise the investors two things:

1. That they could draw their money anytime that they want to, and
2. That in the meantime, they will be able to continue to receive high returns on their money.

People know that this is highly improbable and that the likelihood that they will lose all or part of their money grows with time. But they convince themselves that the high profits or interest payments that they will be able to collect before the pyramid collapses - will more than amply compensate them for the loss of their money. Some of them, hope to succeed in drawing the money before the imminent collapse, based on "warning signs". In other words, the investors believe that they can outwit the organizers of the pyramid. The investors collaborate with the organizers on the psychological level: cheated and deceiver engage in a delicate ballet leading to their mutual downfall.

This is undeniably the most dangerous of all types of financial scandals. It insidiously pervades the very fabric of human interactions. It distorts economic decisions and it ends in misery on a national scale. It is the scourge of societies in transition.

The second type of financial scandals is normally connected to the laundering of money generated in the "black economy", namely: the income not reported to the tax authorities. Such capital passes through banking channels, changes ownership a few times, so that its track is covered and the identities of the owners of the money are concealed. Money generated by drug dealings, illicit arm trade and the less exotic form of tax evasion is thus "laundered".

The financial institutions which participate in laundering operations, maintain double accounting books. One book is for the purposes of the official authorities. Those agencies and authorities that deal with taxation, bank supervision, deposit insurance and financial liquidity are given access to this set of "engineered" books. The true record is kept hidden in another set of books. These accounts reflect the real situation of the financial institution: who deposited how much, when and under which conditions - and who borrowed what, when and under which conditions.

This double standard blurs the true situation of the institution to the point of no return. Even the owners of the institution begin to lose track of its activities and misapprehend its real standing.

Is it stable? Is it liquid? Is the asset portfolio diversified enough? No one knows. The fog enshrouds even those who created it in the first place. No proper financial control and audit is possible under such circumstances.

Less scrupulous members of the management and the staff of such financial bodies usually take advantage of the situation. Embezzlements are very widespread, abuse of authority, misuse or misplacement of funds. Where no light shines, a lot of creepy creatures tend to develop.

The most famous - and biggest - financial scandal of this type in human history was the collapse of the Bank for Credit and Commerce International LTD. (BCCI) in London in 1991. For almost a decade, the management and employees of this shady bank engaged in stealing and misappropriating 10 billion (!!!) USD. The supervision department of the Bank of England, under whose scrutinizing eyes this bank was supposed to have been - was proven to be impotent and incompetent. The owners of the bank - some Arab Sheikhs - had to invest billions of dollars in compensating its depositors.

The combination of black money, shoddy financial controls, shady bank accounts and shredded documents proves to be quite elusive. It is impossible to evaluate the total damage in such cases.

The third type is the most elusive, the hardest to discover. It is very common and scandal may erupt - or never occur, depending on chance, cash flows and the intellects of those involved.

Financial institutions are subject to political pressures, forcing them to give credits to the unworthy - or to forgo diversification (to give too much credit to a single borrower). Only lately in South Korea, such politically motivated loans were discovered to have been given to the failing Hanbo conglomerate by virtually every bank in the country. The same may safely be said about banks in Japan and almost everywhere else. Very few banks would dare to refuse the Finance Minister's cronies, for instance.

Some banks would subject the review of credit applications to social considerations. They would lend to certain sectors of the economy, regardless of their financial viability. They would lend to the needy, to the affluent, to urban renewal programs, to small businesses - and all in the name of social causes which, however justified - cannot justify giving loans.

This is a private case in a more widespread phenomenon: the assets (=loan portfolios) of many a financial institution are not diversified enough. Their loans are concentrated in a single sector of the economy (agriculture, industry, construction), in a given country, or geographical region. Such exposure is detrimental to the financial health of the lending institution. Economic trends tend to develop in unison in the same sector, country, or region. When real estate in the West Coast of the USA plummets - it does so indiscriminately. A bank whose total portfolio is composed of mortgages to West Coast Realtors, would be demolished.

In 1982, Mexico defaulted on the interest payments of its international debts. Its arrears grew enormously and threatened the stability of the entire Western financial system. USA banks - which were the most exposed to the Latin American debt crisis - had to foot the bulk of the bill which amounted to tens of billions of USD. They had almost all their capital tied up in loans to Latin American countries. Financial institutions bow to fads and fashions. They are amenable to "lending trends" and display a herd-like mentality. They tend to concentrate their assets where they believe that they could get the highest yields in the shortest possible periods of time. In this sense, they are not very different from investors in pyramid investment schemes.

Financial mismanagement can also be the result of lax or flawed financial controls. The internal audit department in every financing institution - and the external audit exercised by the appropriate supervision authorities are responsible to counter the natural human propensity for gambling. The must help the financial organization re-orient itself in accordance with objective and objectively analysed data. If they fail to do this - the financial institution would tend to behave like a ship without navigation tools. Financial audit regulations (the most famous of which are the American FASBs) trail way behind the development of the modern financial marketplace. Still, their judicious and careful implementation could be of invaluable assistance in steering away from financial scandals.

Taking human psychology into account - coupled with the complexity of the modern world of finances - it is nothing less than a miracle that financial scandals are as few and far between as they are.

Scarcity

My love as deep; the more I give to thee,
The more I have, for both are infinite.

(William Shakespeare, Romeo and Juliet, Act 2, Scene 2)

Are we confronted merely with a bear market in stocks - or is it the first phase of a global contraction of the magnitude of the Great Depression? The answer overwhelmingly depends on how we understand scarcity.

It will be only a mild overstatement to say that the science of economics, such as it is, revolves around the

Malthusian concept of scarcity. Our infinite wants, the finiteness of our resources and the bad job we too often make of allocating them efficiently and optimally - lead to mismatches between supply and demand. We are forever forced to choose between opportunities, between alternative uses of resources, painfully mindful of their costs.

This is how the perennial textbook "Economics" (seventeenth edition), authored by Nobel prizewinner Paul Samuelson and William Nordhaus, defines the dismal science:

"Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people."

The classical concept of scarcity - unlimited wants vs. limited resources - is lacking. Anticipating much-feared scarcity encourages hoarding which engenders the very evil it was meant to fend off. Ideas and knowledge - inputs as important as land and water - are not subject to scarcity, as work done by Nobel laureate Robert Solow and, more importantly, by Paul Romer, an economist from the University of California at Berkeley, clearly demonstrates. Additionally, it is useful to distinguish natural from synthetic resources.

The scarcity of most natural resources (a type of "external scarcity") is only theoretical at present. Granted, many resources are unevenly distributed and badly managed. But this is man-made ("internal") scarcity and can be undone by Man. It is truer to assume, for practical purposes, that most natural resources - when not egregiously abused and when freely priced - are infinite rather than scarce. The anthropologist Marshall Sahlins discovered that primitive peoples he has studied had no concept of "scarcity" - only of "satiety". He called them the first "affluent societies".

This is because, fortunately, the number of people on Earth is finite - and manageable - while most resources can either be replenished or substituted. Alarmist claims to the contrary by environmentalists have been convincingly debunked by the likes of Bjorn Lomborg, author of "The Skeptical Environmentalist".

Equally, it is true that manufactured goods, agricultural produce, money, and services are scarce. The number of industrialists, service providers, or farmers is limited - as is their life span. The quantities of raw materials, machinery and plant are constrained. Contrary to classic economic teaching, human wants are limited - only so many people exist at any given time and not all them desire everything all the time. But, even so, the demand for man-made goods and services far exceeds the supply.

Scarcity is the attribute of a "closed" economic universe. But it can be alleviated either by increasing the supply of goods and services (and human beings) - or by improving the efficiency of the allocation of economic resources. Technology and innovation are supposed to achieve the former - rational governance, free trade, and free markets the latter.

The telegraph, the telephone, electricity, the train, the car, the agricultural revolution, information technology and, now, biotechnology have all increased our resources, seemingly ex nihilo. This multiplication of wherewithal falsified all apocalyptic Malthusian scenarios hitherto.

Operations research, mathematical modeling, transparent decision making, free trade, and professional management - help better allocate these increased resources to yield optimal results.

Markets are supposed to regulate scarcity by storing information about our wants and needs. Markets harmonize supply and demand. They do so through the price mechanism. Money is, thus, a unit of information and a conveyor or conduit of the price signal - as well as a store of value and a means of exchange.

Markets and scarcity are intimately related. The former would be rendered irrelevant and unnecessary in the absence of the latter. Assets increase in value in line with their scarcity - i.e., in line with either increasing demand or decreasing supply. When scarcity decreases - i.e., when demand drops or supply surges - asset prices collapse. When a resource is thought to be infinitely abundant (e.g., air) - its price is zero.

Armed with these simple and intuitive observations, we can now survey the dismal economic landscape.

The abolition of scarcity was a pillar of the paradigm shift to the "new economy". The marginal costs of producing and distributing intangible goods, such as intellectual property, are negligible. Returns increase - rather than decrease - with each additional copy. An original software retains its quality even if copied numerous times. The very distinction between "original" and "copy" becomes obsolete and meaningless. Knowledge products are "non-rival goods" (i.e., can be used by everyone simultaneously).

Such ease of replication gives rise to network effects and awards first movers with a monopolistic or oligopolistic position. Oligopolies are better placed to invest excess profits in expensive research and development in order to achieve product differentiation. Indeed, such firms justify charging money for their "new economy" products with the huge sunken costs they incur - the initial expenditures and investments in research and development, machine tools, plant, and branding.

To sum, though financial and human resources as well as content may have remained scarce - the quantity of intellectual property goods is potentially infinite because they are essentially cost-free to reproduce. Plummeting production costs also translate to enhanced productivity and wealth formation. It looked like a virtuous cycle.

But the abolition of scarcity implied the abolition of value. Value and scarcity are two sides of the same coin. Prices reflect scarcity. Abundant products are cheap. Infinitely abundant products - however useful - are complimentary. Consider money. Abundant money - an intangible commodity - leads to depreciation against other currencies and inflation at home. This is why central banks intentionally foster money scarcity.

But if intellectual property goods are so abundant and cost-free - why were distributors of intellectual property so valued, not least by investors in the stock exchange? Was it gullibility or ignorance of basic economic rules?

Not so. Even "new economists" admitted to temporary shortages and "bottlenecks" on the way to their utopian paradise of cost-free abundance. Demand always initially exceeds supply. Internet backbone capacity, software programmers, servers are all scarce to start with - in the old economy sense.

This scarcity accounts for the stratospheric erstwhile valuations of dotcoms and telecoms. Stock prices were driven by projected ever-growing demand and not by projected ever-growing supply of asymptotically-free goods and services. "The Economist" describes how WorldCom executives flaunted the cornucopian doubling of Internet traffic every 100 days. Telecoms predicted a tsunami of clients clamoring for G3 wireless Internet services. Electronic publishers gleefully foresaw the replacement of the print book with the much heralded e-book.

The irony is that the new economy self-destructed because most of its assumptions were spot on. The bottlenecks were, indeed, temporary. Technology, indeed, delivered near-cost-free products in endless quantities. Scarcity was, indeed, vanquished.

Per the same cost, the amount of information one can transfer through a single fiber optic swelled 100 times. Computer storage catapulted 80,000 times. Broadband and cable modems let computers communicate at 300 times their speed only 5 years ago. Scarcity turned to glut. Demand failed to catch up with supply. In the absence of clear price signals - the outcomes of scarcity - the match between the two went awry.

One innovation the "new economy" has wrought is "inverse scarcity" - unlimited resources (or products) vs. limited wants. Asset exchanges the world over are now adjusting to this harrowing realization - that cost free goods are worth little in terms of revenues and that people are badly disposed to react to zero marginal costs.

The new economy caused a massive disorientation and dislocation of the market and the price mechanism. Hence the asset bubble. Reverting to an economy of scarcity is our only hope. If we don't do so deliberately - the markets will do it for us, mercilessly.

A Comment on "Manufactured Scarcity"

Conspiracy theorists have long alleged that manufacturers foster scarcity by building into their products mechanisms of programmed obsolescence and apopstosis (self-destruction). But scarcity is artificially manufactured in less obvious (and far less criminal) ways.

Technological advances, product revisions, new features, and novel editions render successive generations of products obsolete. Consumerism encourages owners to rid themselves of their possessions and replace them with newer, more gleaming, status-enhancing substitutes offered by design departments and engineering workshops worldwide. Cherished values of narcissistic competitiveness and malignant individualism play an important socio-cultural role in this semipternal game of musical chairs.

Many products have a limited shelf life or an expiry date (rarely supported by solid and rigorous research). They are to be promptly disposed of and, presumably, instantaneously replaced with new ones.

Finally, manufacturers often knowingly produce scarcity by limiting their output or by restricting access to their goods. "Limited editions" of works of art and books are prime examples of this stratagem.

Science, Financing of

In the United States, Congress approved, In February 2003, increases in the 2003 budgets of both the National Institutes of Health and National Science Foundation. America is not alone in - vainly - trying to compensate for imploding capital markets and risk-averse financiers.

In 1999, chancellor Gordon Brown inaugurated a $1.6 billion program of "upgrading British science" and commercializing its products. This was on top of $1 billion invested between 1998-2002. The budgets of the Medical Research Council and the Biotechnology and Biological Sciences Research Council were quadrupled overnight.

The University Challenge Fund was set to provide $100 million in seed money to cover costs related to the hiring of managerial skills, securing intellectual property, constructing a prototype or preparing a business plan. Another $30 million went to start-up funding of high-tech, high-risk companies in the UK.

According to the United Nations Development Programme (UNDP), the top 29 industrialized nations invest in R&D more than $600 billion a year. The bulk of this capital is provided by the private sector. In the United Kingdom, for instance, government funds are dwarfed by private financing, according to the British Venture Capital Association. More than $80 billion have been ploughed into 23,000 companies since 1983, about half of them in the hi-tech sector. Three million people are employed in these firms. Investments surged by 36 percent in 2001 to $18 billion.

But this British exuberance is a global exception.

Even the - white hot - life sciences field suffered an 11 percent drop in venture capital investments in 2002, reports the MoneyTree Survey. According to the Ernst & Young 2002 Alberta Technology Report released in March 2003, the Canadian hi-tech sector is languishing with less than $3 billion invested in 2002 in seed capital - this despite generous matching funds and tax credits proffered by many of the provinces as well as the federal government.

In Israel, venture capital plunged to $600 million in 2002 - one fifth its level in 2000. Aware of this cataclysmic reversal in investor sentiment, the Israeli government set up 24 hi-tech incubators. But these are able merely to partly cater to the pecuniary needs of less than 20 percent of the projects submitted.

As governments pick up the monumental slack created by the withdrawal of private funding, they attempt to rationalize and economize.

The New Jersey Commission of Health Science Education and Training recently proposed to merge the state's three public research universities. Soaring federal and state budget deficits are likely to exert added pressure on the already strained relationship between academe and state - especially with regards to research priorities and the allocation of ever-scarcer resources.

This friction is inevitable because the interaction between technology and science is complex and ill-understood. Some technological advances spawn new scientific fields - the steel industry gave birth to metallurgy, computers to computer science and the transistor to solid state physics. The discoveries of science also lead, though usually circuitously, to technological breakthroughs - consider the examples of semiconductors and biotechnology.

Thus, it is safe to generalize and say that the technology sector is only the more visible and alluring tip of the drabber iceberg of research and development. The military, universities, institutes and industry all over the world plough hundreds of billions annually into both basic and applied studies. But governments are the most important sponsors of pure scientific pursuits by a long shot.

Science is widely perceived as a public good - its benefits are shared. Rational individuals would do well to sit back and copy the outcomes of research - rather than produce widely replicated discoveries themselves. The government has to step in to provide them with incentives to innovate.

Thus, in the minds of most laymen and many economists, science is associated exclusively with publicly-funded universities and the defense establishment. Inventions such as the jet aircraft and the Internet are often touted as examples of the civilian benefits of publicly funded military research. The pharmaceutical, biomedical, information technology and space industries, for instance - though largely private - rely heavily on the fruits of nonrivalrous (i.e. public domain) science sponsored by the state.

The majority of 501 corporations surveyed by the Department of Finance and Revenue Canada in 1995-6 reported that government funding improved their internal cash flow - an important consideration in the decision to undertake research and development. Most beneficiaries claimed the tax incentives for seven years and recorded employment growth.

In the absence of efficient capital markets and adventuresome capitalists, some developing countries have taken this propensity to extremes. In the Philippines, close to 100 percent of all R&D is government-financed. The meltdown of foreign direct investment flows - they declined by nearly three fifths since 2000 - only rendered state involvement more indispensable.

But this is not a universal trend. South Korea, for instance, effected a successful transition to private venture capital which now - even after the Asian turmoil of 1997 and the global downturn of 2001 - amounts to four fifths of all spending on R&D.

Thus, supporting ubiquitous government entanglement in science is overdoing it. Most applied R&D is still conducted by privately owned industrial outfits. Even "pure" science - unadulterated by greed and commerce - is sometimes bankrolled by private endowments and foundations.

Moreover, the conduits of government involvement in research, the universities, are only weakly correlated with growing prosperity. As Alison Wolf, professor of education at the University of London elucidates in her seminal tome "Does Education Matter? Myths about Education and Economic Growth", published in 2002, extra years of schooling and wider access to university do not necessarily translate to enhanced growth (though technological innovation clearly does).

Terence Kealey, a clinical biochemist, vice-chancellor of the University of Buckingham in England and author of "The Economic Laws of Scientific Research", is one of a growing band of scholars who dispute the intuitive linkage between state-propped science and economic progress. In an interview published in March 2003 by Scientific American, he recounted how he discovered that:

"Of all the lead industrial countries, Japan - the country investing least in science - was growing fastest. Japanese science grew spectacularly under laissez-faire. Its science was actually purer than that of the U.K. or the U.S. The countries with the next least investment were France and Germany, and were growing next fastest. And the countries with the maximum investment were the U.S., Canada and U.K., all of which were doing very badly at the time."

The Economist concurs: "it is hard for governments to pick winners in technology." Innovation and science sprout in - or migrate to - locations with tough laws regarding intellectual property rights, a functioning financial system, a culture of "thinking outside the box" and a tradition of excellence.

Government can only remove obstacles - especially red tape and trade tariffs - and nudge things in the right direction by investing in infrastructure and institutions. Tax incentives are essential initially. But if the authorities meddle, they are bound to ruin science and be rued by scientists.

Still, all forms of science funding - both public and private - are lacking.

State largesse is ideologically constrained, oft-misallocated, inefficient and erratic (the recent examples being stem-cell and cloning research in the USA). In the United States, mega projects, such as the Superconducting Super Collider, with billions already sunk in, have been abruptly discontinued as were numerous other defense-related schemes. Additionally, some knowledge gleaned in government-funded research is barred from the public domain.

But industrial money can be worse. It comes with strings attached. The commercially detrimental results of drug studies have been suppressed by corporate donors on more than one occasion, for instance. Commercial entities are unlikely to support basic research as a public good, ultimately made available to their competitors as a "spillover benefit". This understandable reluctance stifles innovation.

There is no lack of suggestions on how to square this circle.

Quoted in the Philadelphia Business Journal, Donald Drakeman, CEO of the Princeton biotech company Medarex, proposed In February 2003 to encourage pharmaceutical companies to shed technologies they have chosen to shelve: "Just like you see little companies coming out of the research being conducted at Harvard and MIT in Massachusetts and Stanford and Berkley in California, we could do it out of Johnson & Johnson and Merck."

This would be the corporate equivalent of the Bayh-Dole Act of 1980. The statute made both academic institutions and researchers the owners of inventions or discoveries financed by government agencies. This unleashed a wave of unprecedented self-financing entrepreneurship.

In the two decades that followed, the number of patents registered to universities increased tenfold and they spun off more than 2200 firms to commercialize the fruits of research. In the process, they generated $40 billion in gross national product and created 260,000 jobs.

None of this was government financed - though, according to The Economist's Technology Quarterly, $1 in research usually requires up to $10,000 in capital to get to market. This suggests a clear and mutually profitable division of labor - governments should picks up the tab for basic research, private capital should do the rest, stimulated by the transfer of intellectual property from state to entrepreneurs.

But this raises a host of contentious issues.

Such a scheme may condition industry to depend on the state for advances in pure science, as a kind of hidden subsidy. Research priorities are bound to be politicized and lead to massive misallocation of scarce economic resources through pork barrel politics and the imposition of "national goals". NASA, with its "let's put a man on the moon (before the Soviets do)" and the inane International Space Station is a sad manifestation of such dangers.

Science is the only public good that is produced by individuals rather than collectives. This inner conflict is difficult to resolve. On the one hand, why should the public purse enrich entrepreneurs? On the other hand, profit-driven investors seek temporary monopolies in the form of intellectual property rights. Why would they share this cornucopia with others, as pure scientists are compelled to do?

The partnership between basic research and applied science has always been an uneasy one. It has grown more so as monetary returns on scientific insight have soared and as capital available for commercialization multiplied. The future of science itself is at stake.

Were governments to exit the field, basic research would likely crumble. Were they to micromanage it - applied science and entrepreneurship would suffer. It is a fine balancing act and, judging by the state of both universities and startups, a precarious one as well.

Securities and Exchange Commission (SEC)

In June 2005, William H. Donaldson was forced to resign as Chairman of the Securities and Exchange Commission (SEC). The reason? As the New York Times put it: "criticism that his enforcement was too heavy-handed". President Bush chose California Rep. Christopher Cox, a Republican, to replace him.

Gary Langan Goodenow is an attorney licensed to practice in the State of Florida and the District of Columbia. The Webmaster of www.RealityAtTheSEC.com, he worked at the Miami office of the SEC for about six years, in the Division of Enforcement.

His experience is varied. As a staff attorney, he investigated and prosecuted cases enforcing the federal securities laws. As a branch chief, he supervised the work of several staff attorneys. As a Senior Trial Counsel, he was responsible for litigating about thirty enforcement cases at any one time in federal court. As Senior Counsel, he made the final recommendations on which cases the office would investigate and prosecute, or decline.

He describes an experience he had after he left the SEC.

"I represented an Internet financial writer with a Web site that touted stocks, Mr. Ted Melcher of SGA Whisper Stocks. The SEC sued Ted because as he was singing the praises of certain stocks in his articles, he was selling them into a rising market. He got his shares from the issuers in exchange for doing the promotional touting. Unfortunately for him, the SEC and the Department of Justice made an example of his case, and he went to jail."

Q. The SEC is often accused of lax and intermittent enforcement of the law. Is the problem with the enforcement division - or with the law? Can you describe a typical SEC investigation from start to finish?

A. The problem lies with both.

At the SEC, the best argument in support of a proposed course of action is "that's what we did last time". That will inevitably please the staff attorney's superiors.

SEC rules and regulations remind me of an old farmhouse that has been altered and adapted, sometimes for convenience, other times for necessity. But it has never been just plain pulled down and rebuilt despite incredible changes around it. To the uninitiated, the house is rambling with hidden passages, dark corners, low ceilings, folklore and horror stories, and accumulations of tons of antique rubbish that sometimes no one – not even some SEC Commissioners – can wade through.

Wandering from room to room in this farmhouse are the SEC staff. Regretfully, I found that many are ignorant or indifferent to their mission, or scornful of investors' plight, too addicted to their petty specializations in their detailed job descriptions, and way too prone to follow only the well-trodden path.

They are stunned by the rapidity, multiplicity, immensity and intelligence behind the scams. Their tools of research, investigation and prosecution are confusingly changed periodically when Congress passes some new "reform" legislation, or a new Chairman or new Enforcement Director issues some memo edict on a "new approach".

Staff attorneys typically bring investors only bad news and are numbed by the latters' emotional reactions, in a kind of "shell shock". The SEC lost one quarter of its staff in the last two years. The turnover of its 1200 attorneys, at 14%, is nearly double the government's average.

One SEC official was quoted as saying "We are losing our future – the people who would have had the experience to move into the senior ranks". Those that stay behind and rise in the ranks are often the least inspired. At the SEC enforcement division, one is often confronted with the "evil of banality".

The SEC is empowered by the Securities Act of 1933 and the Securities Exchange Act of 1934 to seek injunctive relief where it appears that a person is engaged or about to engage in violations of the federal securities laws. This is a ***civil*** remedy, not a criminal law sanction. Under well-settled case law, the purpose of injunctive relief is deterrence, ***rather than punishment***, of those who commit violations. Investors do not know that, and are uniformly shocked when told.

The "likelihood requirement" means that, once the Commission demonstrates a violation, for injunctive relief it needs only show that there is some reasonable likelihood of future violations. "Positive proof' of likelihood, as one court demanded, is hard to provide. At the other extreme, I had one former Commissioner tell me that, as he understood the law, if the person is alive and breathing, the Commission enforcement staff can show likelihood of future violations.

The broad powers of the federal courts are used in actions brought by the Commission to prevent securities violators from enjoying the fruits of their misconduct. But because this is a ***civil*** and not a ***criminal*** remedy, the SEC has a unique rule where defendants can consent to an injunction without "admitting or denying the allegations of the complaint". This leads to what are called "waivers", and I submit that "waivers" are the fundamental flaw in U.S. securities laws enforcement.

In a nutshell, here is the problem. A "fraudster" commits a fraud. The Commission sues for an injunction. The fraudster consents to the injunction as per above. The Court then orders the fraudster to "disgorge" his "ill gotten gains" from the scam, usually within 30 days and with interest.

In most cases, the fraudster doesn't pay it all and the Commission moves to hold him in civil contempt for disobeying the Court's order. The fraudster claims to the Court that it is impossible for him to comply because the money is gone and he is "without the financial means to pay". The Commission then issues a ***"waiver"*** and that's the way many cases end. Thus both sides can put the case behind them. The fraudster agrees to the re-opening of the case if he turns out to have lied.

This procedure is problematic. The Commission typically alleges that these fraudsters have lied through their teeth in securities sales - but is forced to accept their word in an affidavit swearing that they have no money to pay the disgorgement. So the waivers are based on an assumption of credibility that has no basis in experience and possibly none in fact.

Moreover, the Division of Enforcement has no mechanism in place to check if the fraudster has, indeed, lied. After the waiver, the files of the case get stored. The case is closed. I don't know if there's even a central place where the records of waivers are kept.

In the six years I was at the Commission, I never heard of a case involving a breach of waiver affidavit. I doubt if one has ever been brought by the Commission - anywhere. UPI ought to do a Freedom Of Information Act Request on that.

Something similar happens with the Commission's much vaunted ability to levy civil penalties. The statute requires that a court trial be held to determine the egregiousness of the fraud. Based on its findings, the court can levy the fines. But, according to some earlier non-SEC case law, a fraudster can ask for a jury trial regarding the amount of the civil penalties because he or she lack the means to pay them. U.S. district courts being as busy as they are, there's no way the court is going to hold a jury trial.

Instead, the fraudster consents to a court order "noting the appropriateness of civil penalties for the case, but declining to set them based on a demonstrated inability to pay". Again, if the fraudster lied, the Commission can ask the Court to revisit the issue.

Q. Internet fraud, corporate malfeasance, derivatives, off-shore special purpose entities, multi-level marketing, scams, money laundering - is the SEC up to it? Isn't its staff overwhelmed and under-qualified?

A. The staff is overwhelmed. The longest serving are often the least qualified because the talented usually leave.

We've already got the criminal statutes on the books for criminal prosecution of securities fraud at the federal level. Congress should pass a law deputizing staff attorneys of the Commission Division of Enforcement, with at least one-year experience and high performance ratings, as Special Assistant United States Attorneys for the prosecution of securities fraud. In other words, make them part of the Department of Justice to make criminal, not just civil cases, against the fraudsters.

The US Department of Justice does not have the person power to pursue enough criminal securities cases in the Internet Age. Commission attorneys have the expertise, but not the legal right, to bring criminal prosecution. The afore-described waiver system only makes the fraudsters more confident that the potential gain from fraud outweighs the risk.

I'd keep the civil remedies. In an ongoing fraud, with no time to make out a criminal case, the Commission staff can seek a Temporary Restraining Order and an asset freeze. This more closely resembles the original intent of Congress in the 1930s. But after the dust settles, the investing public deserves to demand criminal accountability for the fraud, not just waivers.

Q. Is the SEC - or at least its current head - in hock to special interests, e.g., the accounting industry?

A. "In hock to special interests" is too explicit a statement about US practice. It makes a good slogan for a Marxist law school professor, but reality is far subtler.

By unwritten bipartisan agreement, the Chairman of the SEC is always a political figure. Two of the five SEC Commissioners are always Democrats, two Republicans, and the Chairman belongs to the political party of the President. I am curious to see if this same agreement will apply to the boards established under the Sarbannes-Oxley Act.

Thus, both parties typically choose a candidate for Chairman of impeccable partisan credentials and consistent adherence to the "party line". The less connected, the less partisan, and academicians serve as Commissioners, not Chairmen.

The Chairman's tenure normally overlaps with a specific President's term in office, even when, as with President Bush the elder following President Reagan, the same party remains in power. SEC jobs lend themselves to lucrative post-Commission employment. This explains the dearth of "loyal opposition". Alumni pride themselves on their connections following their departure.

The Chairman is no more and no less "in hock" than any leading member of a US political party. Still, I faulted Chairman Pitt, and became the first former member of SEC management to call for his resignation, in an Op/Ed item in the Miami Herald. In my view, he was impermissibly indulgent of his former law clients at the expense of SEC enforcement.

Q. What more could stock exchanges do to help the SEC?

A. At the risk of being flippant, enforce their own rules. The major enforcement action against the NASDAQ brokers a few years ago, for instance, was toothless. Presently, Merrill Lynch is being scrutinized by the State of New York, but there is not a word from the NYSE.

Q. Do you regard the recent changes to the law - especially the Sarbanes-Oxley Act - as toothless or an important enhancement to the arsenal of law enforcement agencies? Do you think that the SEC should have any input in professional self-regulating and regulatory bodies, such as the recently established accountants board?

A. It remains to be seen. The Act establishes a Public Accounting Oversight Board ("the Board"). It reflects one major aspect of SEC enforcement practice: unlike in many countries, the SEC does <u>not</u> recognize an accountant/client privilege, though it does recognize an attorney/client privilege.

Regrettably, in my experience, attorneys organize at least as much securities fraud as accountants. Yet in the US, one would never see an "attorneys oversight board". For one thing, Congress has more attorneys than accountants.

Section 3 of the Act, titled ***"Commission Rules and Enforcement"***, treats a violation of the Rules of the Public Company Accounting Oversight Board as a violation of the '34 Act, giving rise to the same penalties. It is unclear if this means ***waiver after waiver***, as in present SEC enforcement. Even if it does, the Rules may still be more effective because US state regulators can forfeit an accountant's license based on a waived injunction.

The Act's provision, in Section 101, for the membership of said Board has yet to be fleshed out. Appointed to five-year terms, two of the members must be - or have been - certified public accountants, and the remaining three must not be and ***cannot have been*** CPAs. Lawyers are the likeliest to be appointed to these other seats. The Chairmanship may be held by one of the CPA members, provided that he or she has not been engaged as a practicing CPA for five years, meaning, ab initio, that he or she will be behind the practice curb at a time when change is rapid.

No Board member may, during their service on the Board, "share in any of the profits of, or receive payments from, a public accounting firm," other than "fixed continuing payments," such as retirement payments. This mirrors

SEC practice with the securities industry, but does little to tackle "the revolving door".

The Board members are appointed by the SEC, "after consultation with" the Federal Reserve Board Chairman and the Treasury Secretary. Given the term lengths, it is safe to predict that every new presidential administration will bring with it a new Board.

The major powers granted to the Board will effectively change the accounting profession in the USA, at least with regards to public companies, from a self-regulatory body licensed by the states, into a national regulator.

Under Act Section 103, the Board shall: (1) register public accounting firms; (2) establish "auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers;" (3) inspect accounting firms; and (4) investigate and discipline firms to enforce compliance with the Act, the Rules, professional standards and the federal securities laws. This is a sea change in the US.

As to professional standards, the Board must "cooperate on an on-going basis" with certain accountants advisory groups. Yet, US federal government Boards do not "co-operate" - they dictate. The Board can "to the extent that it determines appropriate" adopt proposals by such groups.

More importantly, it has authority to reject any standards proffered by said groups. This will then be reviewed by the SEC, because the Board must report on its standards to the Commission every year. The SEC may – by rule – require the Board to cover additional ground. The Board, and the SEC through the Board, now run the US accounting profession.

The Board is also augments the US effort to establish hegemony over the global practice of accounting. Act Section 106, ***Foreign Public Accounting Firms***, subjects foreigners who audit U.S. companies - including foreign

firms that perform audit work that is used by the primary auditor on a foreign subsidiary of a U.S. company - to registration with the Board.
I am amazed that the EU was silent on this inroad to their sovereignty. This may prove more problematic in US operations in China. I do not think the US can force its accounting standards on China without negatively affecting our trade there.
Under Act Section 108, the SEC now decides what are "generally" accepted accounting principles. Registered public accounting firms are barred from providing certain non-audit services to an issuer they audit. Thus, the split, first proposed by the head of Arthur Anderson in 1974, is now the law.
Act Section 203, ***Audit Partner Rotation***, is a gift to the accounting profession. The lead audit or coordinating partner and the reviewing partner must rotate every 5 years. That means that by law, the work will be spread around. Note that the law says "partner", not "partnership". Thus, we are likely to continue to see institutional clients serviced by "juntas" at accounting firms, not by individuals. This will likely end forever the days when a single person controlled major amounts of business at an accounting firm. US law firms would never countenance such a change, as the competition for major clients is intense.
Act Section 209, ***Consideration by Appropriate State Regulatory Authorities***, "throws a bone" to the states. It requires state regulators to make an independent determination whether Board standards apply to small and mid-size non-registered accounting firms. No one can seriously doubt the outcome of these determinations. But we now pretend that we still have real state regulation of the accounting profession, just as we pretend that we have state regulation of the securities markets through "blue

sky laws". The reality is that the states will be confined hence to the initial admission of persons to the accounting profession. Like the "blue sky laws", it will be a revenue source, but the states will be completely junior to the Board and the SEC.

Act Section 302, ***Corporate Responsibility For Financial Reports***, mandates that the CEO and CFO of each issuer shall certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer". This may prove problematic with global companies. We have already seen resistance by Daimler-Benz of Germany.

Act Section 305: ***Officer And Director Bars And Penalties; Equitable Relief***, will be used by the SEC to counterattack arguments arising out of the Central Bank case. As I maintained in the American Journal of Trial Advocacy, the real significance of the Supreme Court decision in Central Bank was that the remedial sanctions of the federal securities laws should be narrowly construed.

Well, now the SEC has a Congressional mandate. Federal courts are authorized to "grant any equitable relief that may be appropriate or necessary for the benefit of investors". That is an incredibly broad delegation of rights, and is an end run around Central Bank. I was surprised that this received no publicity.

Lastly, Act Section 402, ***Prohibition on Personal Loans to Executives***, shows how low this generation of US leadership has sunk. President Bush has signed a law that makes illegal the type of loans from which he and his extended family have previously benefited.

Tacitly, the Act admits that some practices of Enron were not illegal ***inter se***. Act Section 401, ***Study and Report on***

Special Purpose Entities*,* provides that the SEC should study off-balance sheet disclosures to determine their extent and whether they are reported in a sufficiently transparent fashion. The answer will almost certainly be no, and the Board will change GAAP accordingly.

Q. Does the SEC collaborate with other financial regulators and law enforcement agencies internationally? Does it share information with other US law enforcement agencies? Is there interagency rivalry and does it hamper investigations? Can you give us an example?

A. The SEC and other regulators - as well as two House subcommittees - have only very recently begun considering information sharing between financial regulators.

This comes too late for the victims of Martin Frankel, who, having been barred for life from the securities industry by the SEC and NASD in 1992, simply moved over to the insurance industry to perpetrate a scam where investors have lost an estimated $200 million dollars.

Had the state insurance regulators known this person's background, he would have been unable to set up multiple insurance companies. Failure to share information is a genuine problem, but "turf" considerations generally trump any joint efforts.

Serbia and Montenegro, Economy of

Looking forward to a $260 million IMF loan, Serbia's current rulers can sigh in relief. A donor conference is scheduled for June 29th in Brussels. Serbia endured a decade of war, sanctions, civil wars, international pariah status, bombing, and refugees. Its infrastructure is decrepit, its industry obsolete, its agriculture shattered to inefficient smithereens, its international trade criminalized. It is destitute. The average monthly salary is

50-70 US dollars. The foreign exchange reserves are depleted by years of collapsing exports, customs evasion, and theft.

The last seven months witnessed a concerted and much applauded effort at reforming the economy. It is a sad testimony to the state of Serbia's finances that a projected rate of inflation of 35% for 2001 is considered to be a major achievement. Growth (from a basis equal to 40% of Serbia's 1989 GNP) is predicted to be c. 5% this year and even higher in 2002. But such a rebound is technical. The fundamental issues of a crime-laden and dysfunctional financial sector, sagging privatization, and a private sector crowded out and bullied by the state and its reams of venal red tape - are far from being tackled. An entrenched old boys nertwork of managers, secret service operators, politicians, and downright criminals sees to that. At the other extreme, revanchism against the Milosevic era cadre is rife and creates instability and uncertainty.

No amount of international aid - multilateral and bilateral pledges now amount to more than $1 billion - will suffice if these social ailments are not tackled. Serbia's physical infrastructure alone sustained damage estimated at $4 billion. And although puny in relation to the Serb economy, Montenegro's looming secession and its autonomous currency pose almost insurmountable legalistic problems as to who gets the funds alotted, how, and how much. Still, compared to the expenditures of waging war and maintainig peace, the aid pledged is small money. The USA alone has spent in excess of $21 billion in the Balkan in the 1990's. This is more than Yugoslavia's whole GDP.

Some elementary reforms have surprisingly been neglected hitherto:

As a result of a multi-annual spiral of mega devaluations followed by hyperinflation, Serbia's currency, the dinar, is distrusted by everyone. The DEM and Euro are widely used. Influential economic think tanks suggest to implement a currency board (as in Bulgaria) or to fully replace the dinar with the DEM or the Euro. The antiquated, centralized, and corrupt payment system needs to be wiped out. The insurance and banking markets should be thrown wide open to foreign ownership. The national accounts need to be made transparent - everything, from money supply aggreggates to levels of foreign exchange reserves, should be published regularly.

The Serbs do not trust their "banks", these instruments of official corruption, cronyism, and outright theft. Introducing foreign owners and foreign management is only half the equation. The other half is injecting competition to this staid marketplace by allowing credit co-operatives and other forms of non-bank lending to operate freely.

The second phase must involve a simplification of the tax code, strict enforcement and a shift from income and profit taxes to simple and easily collected consumption taxes. Whether monetary and fiscal policies should be lax to encourage growth - or strict to reduce the twin (budget and current account) deficits is now hotly debated in Serbia. Other raging debates are: which sector of the economy should most benefit from credit available to SMEs - agriculture or industry? And should state owned firms be privatized or shut down?

Economic co-operation with neighbouring countries (such as Greece) and historical strategic partners (such as Russia and even Italy) is the key to the resuscitation of Serbia'a flagging economic fortunes. West - from Australia, through Israel and Sweden to the USA - and East - China, Japan - are already expressing interest and signing deals. Serbia is strategically located, a large market, with a history of capitalism, an educated workforce, and a rich export culture and history. Inevitably, Serbia's immediate neighbours (Croatia, Macedonia, Bosnia, even Slovenia) regard these developments with cautious pessimism. International aid is considered to be a zero sum game - if Serbia gains, someone must lose.

Still, in the long run, the solution to Serbia's economic quagmire is in the hands of the European Union. Serbia needs unilateral transfers by Serbian workers in the European Union, open markets to its goods and services, and an actual and effective integration of Serbia into the continent's free trade zone. What Serbia has instead is a protectionist European Union which adamantly refuses to open its borders to labor and goods from the Balkans. This is not a good omen.

"Turn to High Return" is the title of a glitzy campaign launched by the Economy and Privatization Ministry to get the public acquainted with the benefits of rapid privatization of state assets. The risks are clear to everyone: mass layoffs, closure of inefficient economic sectors, social tensions, and poverty. The benefits are in the long term and are likely to mainly accrue to the few members of the well-educated elite. When Zastava (in Kragujevac) was prepared for privatization, half its workforce (14,000 workers) were made redundant. Of these, 9000 joined a bogus retraining scheme, a form of covert unemployment insurance plan. Getting the citizens of Yugoslavia to willingly give up their insular, protective, and self-delusional economy is an uphill struggle.

Still, at least Serbia, the regional power, is back, abuzz with business dealings, construction, and trading. Foreign investments are expected to restore Yugoslavia's devastated environment and Serb infrastructure (especially its decrepit roads, railways, and electricity grid) to their former, pre-Milosevic, glory. An Israeli group (Merhav) will irrigate 20,000 ha. in relatively prosperous Vojvodina. Serb ministers - energetically led by the Minister of Finance, Bozidar Djelic - enthuse in public about Yugoslavia's imminent (and implausible) accession into the EU and (more probable) membership in the OECD. Foreign dignitaries (the last one being the Czech Prime Minister) pile up to show their unmitigated support for Serb renewal. Yugoslavia has concluded bilateral agreements with Croatia and, in the near future, with Bosnia Hercegovina. The foreigners all promise to encourage their firms to invest in Serbia. But everyone diligently skirts the delicate issue of what is "Yugoslavia", which are its constituent components, when will it settle on a constitution, and is it really the sole successor to former Yugoslavia.

Yet, the first instinct of both government and private sector is to capitalize on the renewed influx of international aid and credits - rather than develop a healthy, independent, self-sustaining economy. Virtually bankrupt state companies (such as Yugoslav Airlines) are still being subsidized and shielded from the vagaries of the free market. Salaries in the public sector are frozen by decree, heavily politicized boards of directors are appointed from high up (e.g., recently in the Oil Industry of Serbia), the media is subservient, agricultural crops (such as the sunflower harvest) are purchased by the state (subject to antiquated and harmful dual pricing), turf wars cyclically erupt between Kostunica and Djindjic and among their cronies - the more it changes, the more it stays the same. In the "new" Serbia, the Prime Minister felt free to instruct (private!) meat producers to reduce their retail prices by 10-15%. All of them promptly (and very publicly) "agreed" with him. And this, from the same people who started off by eliminating artificial price disparities (a strategy dubbed "shock therapy" by its opponents).

A year after Milosevic is gone and many months after the old, cronyist, and corrupt managements of state companies and utilities were booted out - not one major industry or firm were privatized or opened to competition. Electricity prices were increased by a meager 10-15% this month only as a result of unrelenting pressure by the IMF. This week, Yugoslavia published the announcement seeking financial advisors to the privatization of 11 (out of hundreds) state companies. Yugoslavia may have missed the boat. Investors after September 11 are risk averse. Global FDI has plunged by 40% and dried up completely in emerging economies (especially in crisis regions, such as the Balkan).

The only ray of hope is the financial services sector, the only one to be liberalized systematically, mainly under the influence of competent and technocratic Ministry of Finance and National Bank (led by Mladjan Dinkic). Most taxes on financial transactions are expected to be abolished soon. The currency (the dinar) has stabilized and foreign currency reserves - though still frighteningly inadequate - climbed to 1 billion US dollars by mid year. For the first time in a decade, people trust their government sufficiently to save in foreign exchange accounts. Real wages increased by 20% in the year to July (and real income by 11%), albeit from a much reduced base. The bulk of this impressive rise is attributed to climbing productivity.

Thus, the failure to subdue inflation - it will exceed 40%, official proclamations to the contrary notwithstanding - is a result of fiscal, rather than monetary, dysfunction.

On the budget front, tax collection is suffering due to what amounts to a civil disobedience campaign. More than 80% of taxpayers refused to pay the income tax surcharge recently imposed. Corporate taxes were reduced by an average of 10%, creating a shortfall. Social welfare benefits have been cut and some pension payments are late. The government has wisely focused its attention on reforming the customs service, preventing the smuggling of oil (down by 90%, according to official figures) and cigarettes (down by 60%), and expanding the tax base. Thousands of "financial auditors" monitor the borders and dismantle points of sale of illicit goods. The budget also benefits from foreign handouts. The French government contributed 50 million FF this year. External debts (mainly to multilateral financial institutions) have been (and are being) rescheduled. Yugoslavia should be able to make it.

Economic transition takes place primarily in public opinion and in private awareness. It is here that the Yugoslav October 2000 revolution failed. No consensus in favour of free markets, privatization, and free trade has emerged. Old Milosevic-era hands are staging a comeback and gaining in popularity, although almost imperceptibly. The window of opportunity has already shut abroad and may be doing so domestically as well.

Short Selling

Short selling involves the sale of securities borrowed from brokers who, in turn, usually borrow them from third party investors. The short seller pays a negotiated fee for the privilege and has to "cover" her position: to re-acquire the securities she had sold and return them to the lender (again via the broker). This allows her to bet on the decline of stocks she deems overvalued and to benefit if she is proven right: she sells the securities at a high price and re-acquires them once their prices have, indeed, tanked.

A study titled ***"A Close Look at Short Selling on NASDAQ"***, authored by James Angel of Georgetown University - Department of Finance and Stephen E. Christophe and Michael G. Ferri of George Mason University - School of Management, and published in the Financial Analysts Journal, Vol. 59, No. 6, pp. 66-74, November/December 2003, yielded some surprising findings:

"(1) overall, 1 of every 42 trades involves a short sale; (2) short selling is more common among stocks with high returns than stocks with weaker performance; (3) actively traded stocks experience more short sales than stocks of limited trading volume; (4) short selling varies directly with share price volatility; (5) short selling does not appear to be systematically different on various days of the week; and (6) days of high short selling precede days of unusually low returns."

Many economists insist that short selling is a mechanism which stabilizes stock markets, reduces volatility, and creates
incentives to correctly price securities. This sentiment is increasingly more common even among hitherto skeptical economists in developing countries.

In an interview he granted to Financialexpress.com in January 2007, Marti G Subrahmanyam, the Indian-born Charles E Merrill professor of Finance and Economics in the Stern School of Business at New York University had this to say:

"Q: Should short-selling be allowed?

A: Such kind of restrictions would only magnify the volatility and crisis. If a person who is bearish on the market and is not allowed to short sell, the market cannot discount the true sentiment and when more and more negative information pour in, the market suddenly slips down heavily."

But not everyone agrees. In a paper titled ***"The Impact of Short Selling on the Price-Volume Relationship: Evidence from Hong Kong"***, the authors, Michael D. McKenzie or RMIT University - School of Economics and Finance and Olan T. Henry of the University of Melbourne - Department of Economics, unequivocally state:

"The results suggest (i) that the market displays greater volatility following a period of short selling and (ii) that asymmetric responses to positive and negative innovations to returns appear to be exacerbated by short selling."

Similar evidence emerged from Australia. In a paper titled ***"Short Sales Are Almost Instantaneously Bad News: Evidence from the Australian Stock Exchange"***, the authors, Michael J. Aitken, Alex Frino, Michael S. McCorry, and Peter L. Swan of the University of Sydney and Barclays Global Investors, investigated ***"the market reaction to short sales on an intraday basis in a market setting where short sales are transparent immediately following execution."***

They found ***"a mean reassessment of stock value following short sales of up to −0.20 percent with adverse information impounded within fifteen minutes or twenty trades. Short sales executed near the end of the financial year and those related to arbitrage and hedging activities are associated with a smaller price reaction; trades near information events precipitate larger price reactions. The evidence is generally weaker for short sales executed using limit orders relative to market orders."*** Transparent short sales, in other words, increase the volatility of shorted stocks.

Studies of the German DAX, conducted in 1996-8 by Alexander Kempf, Chairman of the Departments of Finance in the University of Cologne and, subsequently, at the University of Mannheim, found that mispricing of stocks increases with the introduction of arbitrage trading techniques. ***"Overall, the empirical evidence suggests that short selling restrictions and early unwinding opportunities are very influential factors for the behavior of the mispricing."*** - Concluded the author.

Charles M. Jones and Owen A. Lamont, who studied the 1926-33 bubble in the USA, flatly state: ***"Stocks can be overpriced when short sale constraints bind." (NBER***

Working Paper No. 8494, issued in October 2001). Similarly, in a January 2006 study titled ***"The Effect of Short Sales Constraints on SEO Pricing",*** the authors, Charlie Charoenwong and David K. Ding of the Ping Wang Division of Banking and Finance at the Nanyang Business School of the Nanyang Technological University Singapore, summarized by saying:

"The (short selling) Rule's restrictions on informed trading appear to cause overpricing of stocks for which traders have access to private adverse information, which increases the pressure to sell on the offer day."

In a March 2004 paper titled ***"Options and the Bubble"***, Robert H. Battalio and Paul H. Schultz of University of Notre Dame - Department of Finance and Business Economics contradict earlier (2003) findings by Ofek and Richardson and correctly note:

"Many believe that a bubble was behind the high prices of Internet stocks in 1999-2000, and that short-sale restrictions prevented rational investors from driving Internet stock prices to reasonable levels. Using intraday options data from the peak of the Internet bubble, we find no evidence that short-sale restrictions affected Internet stock prices. Investors could also cheaply short synthetically using options. Option strategies could also permit investors to mitigate synchronization risk. During this time, information was discovered in the options market and transmitted to the stock market, suggesting that the bubble could have been burst by options trading."

But these findings, of course, would not apply to markets with non-efficient, illiquid, or non-existent options exchanges - in short, they are inapplicable to the vast majority of stock exchanges, even in the USA.

A much larger study, based on data from 111 countries with a stock exchange market was published in December 2003. Titled ***"The World Price of Short Selling"*** and written by Anchada Charoenrook of Vanderbilt University - Owen Graduate School of Management and Hazem Daouk of Cornell University - Department of Applied Economics and Management, its conclusions are equally emphatic:

"We find that there is no difference in the level of skewness and coskewness of returns, probability of a crash occurring, or the frequency of crashes, when short-selling is possible and when it is not. When short-selling is possible, volatility of aggregate stock returns is lower. When short-selling is possible, liquidity is higher consistent with predictions by Diamond and Verrecchia (1987). Lastly, we find that when countries change from a regime where short-selling is not possible to where it is possible, the stock price increases implying that the cost of capital is lower. Collectively, the empirical evidence suggests that short-sale constraints reduce market quality."

But the picture may not be as uniform as this study implies.

Within the framework of Regulation SHO, a revamp of short sales rules effected in 2004, the US Securities and Exchange Commission (SEC) lifted, in May 2005, all restrictions on the short selling of 1000 stocks. In September 2006, according to Associated Press, many of its economists (though not all of them) concluded that:

"Order routing, short-selling mechanics and intraday market volatility has been affected by the experiment, with volatility increasing for smaller stocks and declining for larger stocks. Market quality and liquidity don't appear to have been harmed."

Subsequently, the aforementioned conclusions notwithstanding, the SEC recommended to remove all restrictions on stocks of all sizes and to incorporate this mini-revolution in its July 2007 regulation NMS for broker-dealers. Short selling seems to have finally hit the mainstream.

Shuttle (Suitcase) Trade

They all sport the same shabby clothes, haggard looks, and bulging suitcases bound with frayed ropes. These are the shuttle traders. You can find them in Mongolia and Russia, China and Ukraine, Bulgaria and Kosovo, the West Bank and Turkey. They cross the border as "tourists", sometimes as often as 10 times a year, and come back with as much merchandise as they can carry in their enormous luggage. Some of them resort to freight forwarding their "personal belongings".

They distort trade figures, smuggle goods across ill-guarded borders, ignore international treaties and conventions and, in short, revive moribund economies. They are the life-blood and the only manifestation of true entrepreneurship in swathes of economic wastelands. They meet demands for consumer goods unmet by domestic manufacturers or by officially-sanctioned importers.

In recognition of their vital role, the worried Kyrgyz government held a round table discussion last summer about the precarious state of Kyrgyzstan's shuttle trade. Many former Soviet republics have tightened up their border controls. In May last year, Russian officials seized half a million dollars worth of shuttle goods belonging to 1500 traders. When two million dollars worth of goods were confiscated in a similar incident in fall 2001, eight Kyrgyz traders committed suicide.

The number of Kyrgyz shuttle traders dropped in 2002 to 300,000 (from 500,000 in 1996). The majority of those who remain are insolvent. Many of them emigrated to other countries. The shuttle traders asked the government to legalize and regulate their vanishing trade and thus to save them from avaricious and minacious customs officials.

Even prim international financial institutions recognize the survival-value of shuttle trade to the economies of developing and transition countries. It employs millions, boosts investments in transport and infrastructure, and encourages grassroots capitalism. The IMF - in the 11th meeting of its Committee on Balance of Payments Statistics in 1998 - officially recognized shuttle trade as a business activity to be recorded under "goods".

But there is a seedier and seamier side to shuttle trade where it interfaces with organized crime and official corruption. Shuttle trade also constitutes unfair competition to legitimate, tax and customs duties paying enterprises - the manufacturers of textiles, shoes, cigarettes, alcoholic drinks, and food products. Shuttled goods are not subject to health and safety inspections, or quality control.

According to the March 27th 2002 issue of East West Institute's "Russian Regional Report", the value of Chinese goods shuttled into the borderlands of the Russian Far East is a whopping $50 million a month. China benefits from the serendipitous proceeds of these informal exports - but is unhappy at the lost tax revenues.

EWI claims that Russian banks in the region (such as DalOVK, Primsotsbank, and Regiobank) are already offering money transfer services to China. DalOVK alone transfers $1 million a month - a fortune in local terms. But even these figures may be a serious under-estimate. The trade between Khabarovsk Territory in Russia and Heilongjiang Province in China - most of it in shuttle form - was $1.5 billion in 2001. The bulk of it was one way, from China to Russia.

Shuttle trade is even more prominent between Iraq and Turkey. The Anatolia News Agency expected it to increase to $2 billion in 2002. By comparison, the official exports of Turkey to Iraq amount to $800 million. The then prime minister Bulent Ecevit himself stated to the Ankara Anatolia news agency: "We have provided necessary support to increase shuttle trade".

"The Economist" reports about the flourishing "petty trade" between China and Vietnam. Western and counterfeit goods are smuggled to bazaars in Vietnam, owned and operated by Chinese nationals. The border between these two erstwhile enemies opened in 1990. This led to the rise of criminal networks which involve border guards and policemen.

Another hot spot is the Balkan. In a report dated July 2001, the Balkan Information Exchange describes the

"Tulip Market" in Istanbul. Vendors are fluent in Russian, Bulgarian and Romanian and most of the clients are East European. They buy wholesale and use special vans and buses to transport the goods - mainly textiles - northwards, frequently to destinations in the Balkan. This kind of trade is estimated to be worth $8 billion a year - more than one quarter of Turkey's official exports.

Bulgarian customs officials, border patrols, and policemen form part of these efficient rings - as do their Macedonian and, to a lesser extent, Greek counterparts. The Sofia-based Center for the Study of Democracy thinks that a third of the Bulgarian workforce (i.e., c. 1 million people) may be involved. Many of the traders maintain mom-and-pop establishments or stalls in public bazaars, where members of their family sell the goods.

Some of the merchandise ends up in Serbia, which was subjected to UN sanctions until lately. Fuel smuggling on bikes and other forms of sanctions busting have largely ended but they have been replaced by cigarettes, alcohol, firearms, stolen cars, and mobile phones.

The Serbian authorities often round up and deport Bulgarian shuttle traders, provoking furious resentment in Bulgaria. Headlines like "(Serbian) Policemen take away our countrymen's money" and "Serbs searching (Bulgarian) women's genitals for money" are pretty common. The Bulgarians are embittered. They used to smuggle medicines and fuel into embargoed Serbia - only to be abused by Serb officials now, that the embargo has been lifted.

East European buyers used to reach as far as India where they shopped wholesale in winter. Russians used to buy readymade clothes, leather goods, and cheap jewelry in New Delhi and elsewhere and sell the goods in the numerous flea markets back home.

To finance their purchases, they used to sell in India Russian cosmetics and consumer goods such as watches, cameras, or hair dryers. But the 1998 financial crisis and sub-standard wares offered by unscrupulous Indian traders put a stop to this particular venue.

Governments are trying to stem the shuttle trade. The Russian news agency, ITAR-TASS, reports that Sergei Stepashin, the dynamic chairman of the Russian Audit Chamber (and a former short-lived prime minister of Russia) is bent on tightening the cooperation between member states of the Shanghai Cooperation Organization.

The audit agencies of China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan will exchange information and strive to control the thriving shuttle trade across their porous borders. China and Russia are poised to sign a bilateral accord regarding these issues in October.

The WPS Monitoring Agency reported last November that the Economic Development and Trade Ministry of Russia intends to treat cargos of more than 50 kilos as a consignment of commercial goods, subject to import tariffs (on top of the current tax of 30 percent).

The Ministry claimed that shuttle trade accounts for up to 90 percent of all imported goods "in certain spheres" (e.g., furs). As late as 1994, Russians were allowed to import up to $5000 of duty-free goods in their accompanied baggage - a relic of communist days when only the privileged few were allowed to travel.

Up to 2 million Russian citizens may be engaged in shuttle trade and the value of "gray" goods may be as high as $10 billion annually. Goods from Turkey alone amounted in 2002 to $1.5-2 billion, according to then vice-premier Viktor Khristenko, but shuttle traders also operate in the United Arab Emirates, Syria, Israel, Pakistan, India, China, Poland, Hungary, and Italy.

A set of figures published for the first quarter of 2001 shows that shuttle trade amounted to $2.6 billion, or 8 percent of Russia's total foreign trade. Shuttle traded goods made up 1.5 percent of exports - but a full quarter of imports.

But the shuttle trade's coup de grace may well be EU enlargement. Already a new "iron curtain", comprised of visas and regulations, is rising between EU candidates and other East European and Balkan countries.

Consider the EU's eastern boundary. More than a million people cross the busy Ukrainian-Polish border every month. Enhanced regulation on the Polish side and new, IMF-inspired, tax laws on the Ukrainian side - led to a massive increase in corruption and smuggling. Truck owners now bribe customs officials to the tune of $300 per vehicle, according to a January 2001 report by CEPS.

The results are grave. Following the introduction of these new measures, cross border traffic fell by 50 percent and unemployment in the Polish border zones jumped by 40 percent in 2002 alone. It has since doubled. The IMF and the EU are much decried by the Polish minority now trapped in Western Ukraine.

The situation is likely to be further exacerbated with the introduction of a reciprocal visa regime between the two countries. Shuttle trade may be decimated by the resulting bureaucratic bottlenecks.

Still, it may no longer be needed now that Poland acceded to the EU. Shuttle trade thrives on poverty. It arbitrates between inefficient markets. It satisfies unrequited demand for goods. The single market ought to rid Europe of all these distortions - and, thus, most probably of this makeshift though resilient solution, the shuttle trader.

Skoda

Skoda Auto, the Czech-based carmaker, is completing its transformation from manufacturer of smoke-belching, low-budget, communist-era clunkers to producer of upscale, affordable, BMW-alikes. "Skoda" means in Czech pity or shame - an apt moniker for the company's erstwhile products.

No more. In the British International Motor Show a fortnight ago, Skoda hired supermodel and heir to a chocolate dynasty, Alicia Rowntree, to launch its new Octavia vRS Estate, a 4X4, replete with a turbo-charged 1.8 liter engine producing 180 brake horsepower and a top speed of 146 miles per hour. The hatchback's price tag? Less than $24,000.

Seventy percent of Skoda were purchased from the Czechoslovakian state by Volkswagen in a controversial $650 million privatization in 1991. According to The Economist, Skoda has since tripled its annual production to more than 500,000 vehicles. It now employs directly and indirectly c. 4 percent of the Czech workforce, some 150,000 people. Skoda and its suppliers generate more than $4 billion of combined yearly revenues. Skoda reinvested $2 billion of its cashflow in its manufacturing facilities.

The domestic market accounted for three quarters of Skoda's sales in 1989. It now exports 80 percent of its production to more than 70 countries and constitutes one seventh of all Czech exports. Skoda Auto is a true multinational, with assembly plants in Bosnia, Poland, and India. A deal negotiated by Volkswagen to establish yet another workshop in Macedonia fell through in 1997-8.

But last year was not kind to Skoda. Sales tumbled. According to Skoda's chief executive officer, Vratislav Kulhanek, quoted by the Prague Business Journal, the company will sell 16,000 fewer cars this year compared to last year. Skoda plans to slash 2000 foreign workers - Slovaks and Poles - in its plants in the Czech Republic. According to Ananova, Skoda employs nearly 3000 foreign workers and 21,700 full time Czech staff.

Skoda can expect little support from its German owners. Volkswagen's profits in the quarter to September plunged by 51 percent. A combination of ageing models and weak demand in its core markets - Europe and South America - has affected the bottom line. In north America - which account for 40 percent of sales - Volkswagen failed to respond effectively to zero interest financing offered by major American manufacturers, such as General Motors.

The launching of new models next year, the weakening dollar and writing-off some portfolio investments did the rest. According to Interfax, this year, Volkswagen's was the second worst performance among European automotive companies after ailing Fiat's.

Relationships were further complicated by the nagging and emotionally charged issue of the Benes decrees - a series of statutes which led to the expulsion of 3 million Germans from Czechoslovakia after the war. Germany and Austria demand their revocation. The Czech Republic refuses to discuss the issue.

A bigger problem is brand confusion. Volkswagen shares its platforms - in other words, it uses the same chassis to produced different models. Bernd Pischetsrieder, chairman of Volkswagen (VW), is quoted in The Economist as saying, when he was still at BMW, that Skoda's cheap brands often cannibalize Volkswagen's more profitable ones. The result, according to Keith Hayes, a motor industry analyst at Goldman Sachs, is a poor return on capital of less than 3 percent. BMW's, by comparison, is four times that.

Volkswagen is in a quandary. On the one hand, models like Skoda's Octavia - and even Fabia - cannibalize the sales of models such as the Audi A3 and the Volkswagen Golf. On the other hand, Volkswagen's ability to charge more for its products due to an image of German perfectionism and quality has been adversely affected by the acquisition of the downmarket, central European, Skoda. Hence Skoda's sudden conversion to swankier models such as the Octavia.

In a bizarre realignment of Volkswagen's brands last year, Skoda was grouped with Bentley in the "classic" brands. Audi, SEAT, and Lamborghini formed the "sporty brands" cluster. Risking its Audi posh marque, Volkswagen launched the upmarket loss leading Phaeton saloon car with the express intention of reviving the "halo effect" and "adding emotion to the brand".

Not all is doom. Even as Western markets wither, increasing purchasing power in central and eastern Europe presents luring opportunities. Volkswagen's sales in Russia, for instance, shot up by 24 percent this year. According to Prime-TASS, Skoda increased its Russian sales by 41 percent in the nine months to September 2002.

Proof of the rising importance of the central European car market is the interest Western automakers are showing in Zastava. The carpet-bombed and obsolete manufacturer of the much-derided Yugo, it currently produces at a mere 9 percent of its pre-1990 200,000 vehicles annual capacity. A $50 million reorganization effort resulted in mass layoffs. Zastava - previously a cradle to grave conglomerate - has now attractively reverted to its core competency: car assembly.

If Dacia - the decrepit Romanian car maker - enticed Renault as a buyer, Zastava is bound to end up foreign-owned. With all central and east European brands in Western ownership, the real bloodbath will begin. Skoda is well placed to emerge triumphant.

Slavery

Spanish settlements in the territory of the current-day USA owned slaves as early as 1526. Twenty one African chattel slaves were first brought to British North America (to Jamestown, Virginia) in 1619. They joined white indentured laborers (servants) from all over Europe as well as Indian (Native-American) and Caribbean slaves. All the colonies legalized race-based (black) slavery and introduced "slave codes" by 1670. In total, 10-13 million Africans were abducted (mainly by other Africans and Arabs) and sold as slaves (mostly in the Americas) between 1620 and 1880.

The slaves were transported across the ocean in especially fitted ships. They were kept lying on narrow ledges, chained, but were brought above deck in good weather. Women and children were not shackled. Even these harsh conditions did not prevent the would-be slaves from frequently attempting to rebel, though, usually, unsuccessfully.

Overcrowding, minimal and monotonous diet (two meals per day and a pint of water), poor hygiene, epidemics, and lack of physical activity decimated, on each and every 1-2 months long trip, a whopping one seventh to one fourth of the "cargo" and one sixth to one half of the crew. Another 10% of the slaves died during the process of "seasoning" - getting used to local conditions in their destinations.

Initially, all types of unfree workers, regardless of color, were treated the same way: bought, sold, and worked, sometimes to death. Gradually, starting in the 18th century, light-skinned slaves ("house negroes") and whites were tackled more leniently. Surprisingly, slave rebellions were rather rare - perhaps because cruel slave-owners were socially ostracized and miscegenation (white-black sexual liaisons) was frowned upon.

Most slave-owners regarded themselves as custodians of their slaves. They properly fed the working adults (though children usually went malnourished), allowed them to grow vegetables in their own garden plots, provided them with clothing (four suits) and housing (one wooden cabin per family). In wealthier and larger plantations, the slaves were cared for by qualified physicians. The master felt it his obligation and right to constantly intervene, interfere, and meddle in the lives of his inferiors.

Slave life was richer than portrayed in literature and cinema. Slaves belonged to churches and were ordained as ministers and preachers. A few learned to read and write. Music was a favorite pastime. Understandably, so was drinking. Slaves were allowed to moonlight or work on their own free time.

Actually, only a minority of the white population in the south were slave-owners (347,525 out of 6,000,000 in 1850). Only 1,800 people owned more than 100 slaves. There were 250,000 freed slaves in the south by 1860. The average cotton plantation had only 35 slaves, about 50-60% of them engaged in the production of the immensely profitable crop and its processing.

Still, slaves constituted more than half the population in some southern states (South Carolina, Mississippi) and two fifths of the total southern populace (compared to an average of 5% in the north and 10% in New-York). Of the first 12 Presidents of the USA, 8 were slave-owners. Some slave-owners were themselves black and former slaves.

The Law, even in the Deep South, recognized slaves as both chattel and human beings. Slaves were held responsible for criminal acts they had committed, for instance, and enjoyed many human rights (e.g., the right not to be killed, tortured, or beaten brutally, to be cared for in old age or sickness, to receive religious instruction, to bring suit and give evidence in some cases). Case law and non-binding custom endowed them with additional privileges: the right to marry, own private property (peculium), have free time, enter contracts, and (if female or child) be consigned to lighter labor.

Still, a minority of slave-owners ignored these legal protections and social censure and indulged their sadistic urges and sexual appetites. In some plantations, nutrition was so lopsided or deficient that slaves resorted to eating clay to supplement their diet. In others mutilation, branding, chaining, torture, murder, and rape - all criminal acts prohibited by Law - were common.

But while individual slaves were, at least theoretically, protected by law and social custom - not so the negro family. The owner had the right to sell his slaves separately, regardless of their familial ties. Some states, like Louisiana in 1829, passed legislation prohibiting the sale of children under the age of ten. Others (Alabama and Georgia) forbade the separation of inherited slave families. But these were the exceptions to the widespread practice.

Though not recognized or protected by Law, many slaves accumulated property. A few hundred slaves even purchased their freedom from their white masters. Slave-owners in the USA usually retained ownership of sick, disabled, or infirm slaves and took care of them. Suicide among slaves in the USA was a rarity. Many slaves (especially in the coastal areas of Georgia and South Carolina) were free to do as they chose once they had completed their daily assignments (the "task system").

On the eve of the American Revolution, c. 400,000 slaves amounted to one fifth of the population of the rebellious colonies. Slavery in the USA was abolished in stages and decades after it was eliminated in Britain. Rhode Island banned it as early as 1774. Pennsylvania, New-York, and New Jersey followed suit. In 1787, the Continental Congress prohibited the practice in the Midwest. The slave trade - or, more precisely, the importation of slaves into the USA - was banned altogether in 1808. Even so, between 1808 and 1865, traders smuggled 270,000 slaves into the USA.

But the major engine of growth of the slave population was reproduction. Twenty thousand slaves were born every year during the 1790s - and 70,000 annually in the 1840s. As a result, the ratio between the sexes was equal and the slave population skyrocketed from 1.2 million in 1810 to 4 million in 1860. Some slave-owners even established "breeding farms" and sold the off-spring in the markets of "deficit" states.

Gradually, all the states north of the Ohio River and the Mason-Dixon line became slave-free. Northerners resented the presence of fugitive slaves (about 1000 per year) who crossed the Ohio River in what was known as the Underground Railroad, but they often clashed with federal authorities when the latter tried to extend their jurisdiction to the escapees under the Fugitive Slave Laws.

Most abolitionists - as well as President Abraham Lincoln (who was never one) - wanted to repatriate the blacks (return them to Africa) and, in any case, expel all free blacks from northern and, later, southern territories. The African nation-state of Liberia was established specifically to accommodate former North American slaves.

It was widely acknowledged that slave-owners should be compensated for the loss of their property. Not a single abolitionist supported or even discussed reparations (compensating the slaves for their free labor, denial of freedom, brutal treatment, and hardships). It was accepted wisdom that blacks - both slaves and free - should never be allowed to carry arms.

Slaves in the South (the Confederacy) were finally emancipated in 1863, during the Civil War. But, even then, Lincoln's Emancipation Proclamation did not apply to some states within the Union. These other slaves remained in slavery until December 1865, when the Thirteenth Amendment to the US Constitution was adopted.

Slovakia, Economy of

Only four months ago, delirious Slovaks celebrated a gold medal, having thrashed the Russian team in the Ice Hockey World Championship. President Rudolph Schuster hastened to publicly draw some lessons: "You are a very good example for Slovakia because it's bad when people are dividing (into groups). We need to unite one with the other."

Yet, unity is no more than wishful thinking and Slovakia - a country of 5.5 million people and 50,000 sq. km. - is on ever thinner ice. This, in no small measure, is due to Schuster's blatant partisanship. Three months ago, quoted by the BBC, he exhorted his countrymen to vote for the ruling center-left coalition in a high turnout in today's and tomorrow's parliamentary elections. Slovakia gained in prestige during the current administration's reign from 1998, he explained his unseemly advice. The country's EU accession is at stake.

Haunting the fragmented political scene is Vladimir Meciar, Slovakia's erstwhile strongman and prime minister between 1992-8. Besieged by serial scandals, PR gaffes, and the secession of some of its stars who formed their own party - the fortunes of his misnamed Movement for a Democratic Slovakia wax and wane in the opinion polls. But he still masters the affection of the poor, the rural, and the less educated - about one quarter of the flustered electorate.

Vehement protestations to the contrary by all involved notwithstanding, Meciar may yet form a coalition government if he sweeps the poll. In 1998 he was outflanked by an anti-Meciar bloc, though he garnered the bulk of the votes. He has learned his lesson. He is lying low and he sounds respectable.

But his lurid past of authoritarianism, cronyism, and corruption provoked the US and the EU to openly weigh against him. US Ambassador to NATO, Nicholas Burns told the Austrian daily Die Presse in June: "If his party were to return to power in Bratislava, that would be a fundamental obstacle to Slovakia's entry into NATO."

Gunter Verheugen, the EU enlargement commissioner, chose the Danish daily "Politiken" to issue a thinly-veiled warning to the ardently pro-NATO and pro-EU Slovaks to "vote with widely open eyes". Austrian prime minister Wolfgang Schussel, notorious for his co-habitation, in a now defunct coalition, with Jorg Haider and his ultrarightist party, cajoled the Slovaks to re-elect Mikulas Dzurinda, the prime minister.

Yet, the parties of the coalition are in utter disarray. Support for the Party of the Democratic Left - once a stolid 14 percent of the electorate - has all but evaporated. The two Christian-Democratic members of the coalition, KDH and SDKU, fare no better.

This unappetizing gamut gave rise to new parties, both left and right. These will decide the fate and composition of Slovakia's future governments. The West's flagrant meddling may yet backfire. ANO, the New Citizens Alliance, is headed by a Berlusconi clone, the local TV kingpin Pavol Rusko. It is reformist, liberal - and virulently nationalistic.

A 38-year old lawyer, Robert Fico, has surged in popularity on a platform which consists of concomitantly blasting the government, the EU, and the Roma community. His party, "Smer" ("Direction"), boasts of its roster of fresh, untainted, faces and of its non-alliance. Fico claims to have close contacts with the British Labor Party and the German Social Democrats.

Campaign finances are as murky as ever. The financial backers of Smer are ominously unknown. Conspiracy theorists talk about a Maciar ploy with Fico as his puppet. Rusko will no doubt put ANO to good use in bolstering his growing empire. The much-maligned Meciar is still heavily implicated in corruption charges though, shockingly, none of his cronies was ever brought to justice.

Underlying this seething cauldron of resentments and mutual recriminations is Slovakia's identity crisis. Formerly, the poorer part of the Czechoslovak state, it has seceded peacefully in 1993. But it is teeming with restless minorities, ethnic tensions, and grievances old and new.

The Hungarians, organized in their own ethnic party, have been pressing, from within the coalition, for greater political and cultural autonomy and the return of property confiscated by the Benes decrees. A recent joint report by the World Bank, the Open Society Institute, and two Slovak NGOs, "Poverty and Welfare of Roma in the Slovak Republic", states:

"Living conditions are especially poor for Roma living in isolated settlements. Poverty in these areas is multidimensional - related to high levels of unemployment, poor housing conditions, and lack of access to basic public services - and is exacerbated by social exclusion." Experts reckon that Romas constitute 8-10 percent of Slovakia's population.

The government's much praised reforms and prudent monetary policy have rendered one in five Slovaks unemployed despite an economy growing by 4 percent annually. In its eastern and crime-infested parts, bordering Ukraine, the rate of unemployment is a staggering 40 percent.

Inflation, though subdued, has not succumbed. The Economist Intelligence Unit projects a rebound from c. 3 percent in the first quarter of this year to c. 7 percent by mid-2003 fuelled by price deregulation and adjustment to EU levels. Spiraling budget deficits recently compelled the central bank to issue a warning to the government.

The current account deficit has reverted to form, climbing from 3 percent of GDP in 2000 back to more than 9 percent last year. It is - unrealistically - projected to be 5 percent of GDP this year. The health and education system have long crumbled. "The Economist" describes how patients in state hospitals have to bring their lavatory paper with them. Judges and teachers openly solicit bribes.

Slovakia endured one of the worst post-communist contractions among countries in transition. Its industry's share of GDP was almost halved to less than 29 percent. The service sector now constitutes two thirds of a consumption-driven economy. GDP per capita is less than $4000. The informal economy, according to the National Bank of Slovakia, is 12 of GDP. In reality, it is at least three times that. In February, a string of pyramid schemes collapsed, leaving in its trail thousands of impoverished investors.

The private sector - largely the outcome of crony privatizations and bilking the state-owned banks - is insolvent and still dominated by tottering behemoths. The banking industry - though increasingly foreign owned - is drowning in non-performing loans.

Slovakia's imposing location guarantees a steady, though unimpressive, stream of foreign direct investment - pegged at 1.5 billion last year. But even so, Slovakia is closer to Romania than to Hungary in its opaqueness, venality, and misrule. It will take more than one elections to restore it to a semblance of good governance.

Slovenia, Economy of

The most exciting event in Slovenia in December 2001 was when a group of young army recruits spat on the national flag and sang the anthem of the now defunct former Yugoslavia. They were sent to a military psychiatrist for observation. Indeed, economically speaking, a preference for any other part of the late Federation over Slovenia would indicate mental deformity.

Slovenia is by far the most prosperous and pacific of the lot. Income per capita increased by 7% annually between 1995-2000 and reached 75% of the EU's average ($13,734 in mid-2004). Gross Domestic Product (GDP) growth rates (4% in 2001, down to 2.3% in 2003) are still double the European average and GDP per capita is almost equal to Greece's or Portugal's. Yugoslavia and Macedonia would require half a century to reach this level at their current growth rates.

Slovenia's public debt is negligible (c. 26% of GDP), its unemployment rate is almost American (less than 7% in 2004), its budget deficit a mere 1.4% of GDP. Slovenia's gross national savings is almost a quarter of its GDP - as is its gross domestic investment (28%). Moreover, agriculture comprises only 3% of its GDP sources - the rest is made up of industry (35%) and services (62%).

Slovenia is a respected member of both the World Bank and the IMF. The former has disbursed c. $250 million for purposes such as structural reforms and environmental cleanups. The latter praises its monetary targeting, the managed float of its tolar, and the lack of major (budget and current account) imbalances. This, despite erratic monetary management by the Bank of Slovenia, which, together with the introduction of VAT, the oil price shock, and a totally CPI-indexed financial environment, led to escalating inflation (c. 9% annually in 2001, up from an average of 6% - it is now down to 3.8% year on year in July 2004).

Slovenia's failure to secure agricultural and regional development concessions from their counterparts in Brussels, runs the risk of rendering it a net creditor of the EU. Slovenia, contrary to most other current members, was openly unhappy with the "Big Bang" enlargement of the Union. It has successfully concluded all 29 chapters to be agreed with the EU prior to accession and dreaded being held back by an unrealistic, politically motivated, process of enlargement which strained the EU's deficient institutions to their breaking point.

Slovenia is small. It is the size of pre-1967 Israel or New Jersey. With less than 2 million citizens (88% of which are ethnic Slovene), its population grows by a paltry 0.14% p.a. Still, had it not constituted the northern boundary of a war prone and unstable region, Slovenia might have attracted more FDI (it has one of the lowest rates among the new members of the EU), bordering as it does and integrated as it is with the (relatively) large and disinflated economies of Italy, Hungary, and Austria.

Many Slovenes actually live in Jorg Haider's part of Austria (Carinthia). Italians owned property (confiscated by the communists) in Slovenia before the Second World War (the source of a simmering grudge in Italy). Italians, Austrians, and Germans are invested in Slovenian banks, insurance companies, and industry.

Together with Poland, Hungary, and the Czech Republic (among others), Slovenia is a member of the now reawakened CEFTA (Central European Free Trade Agreement). Still, to its great ire, it is often associated with the Balkans.

But the bad neighborhood is not the only obstacle. Slovenia's privatization was as crony-infested as elsewhere in the Eastern Bloc and its legislation still incorporates investment-deterring anachronisms (restricted land and media ownership, an over-regulated labour market, lack of corporate governance). Capital account liberalization was implemented only recently. Close to half of the economy (including a chunk of the favoritism-ridden and inefficient banking system) is in the hands of the state. The private sector, though, is thriving.

It is amazing that Slovenia's prosperity has been achieved without much foreign investments. Slovenia dismantled its socialist economic legacy torturously slowly during the 1990s. The corporate tax rate is still a non-competitive 25%. Payroll taxes are high (employers pay 16% of gross wages in social security contributions alone). Value Added Tax (VAT) is at a standard of 20% (with a reduced rate of 8.5% for food, education, and other essentials).

A withholding tax of 25% is levied on all forms of investment income (interest, dividends, etc.). Individual tax rates are prohibitive (up to 50% from January 1, 2005) and apply to the income in or from Slovenia of non-residents as well. Capital taxes are as high as income taxes. Slovenia signed a mere ten tax treaties in its 15 years of existence (though it had adopted 14 Yugoslav tax treaties to complement them).

Slovenia's international trade amounts to 60% of its GDP. According to a July 2004 report by Deloitte Touche

Tohmatsu and the Economist Intelligence Unit (EIU), Slovenia ran a $700 million trade deficit in 2003 (the difference between $12.9 billion in exports and $13.6 billion in imports).

Slovenia's main markets are the European Union (Italy, Germany, and Austria) and Croatia, another former Yugoslav republic. Two thirds of its trade is with the EU (half of this with Germany and Austria, the former colonial mater). Its exchange with Russia, the USA (3% of the total each), and even with other republics of the disintegrated Yugoslavia is marginal. It still purchases raw materials from Macedonia and Yugoslavia - and sells back to them the finished products (as it used to do in former Yugoslavia). But this does not amount to much.

The decoupling is intentional - Slovenia considers itself an integral part of Western Europe. All it inherited from Communism, it feels, was polluted rivers and coastal water, acid rain, and depleted forests. Still, such exposure to the EU makes Slovenia susceptible to the Union's business cycles. Shortsightedly perhaps, until 2002 it did not have a trade representation or an economic attaché in the USA.

Of all its erstwhile confederates, Slovenia maintains tenuous political contacts only with Croatia. At the end of 2001 it resolved a long standing dispute with Croatia regarding the Krsko nuclear power plant. Both countries agreed to continue discussions regarding the final demarcation of the hotly disputed (in Slovenia) border between the two as a prelude to the introduction of the Schengen agreement. Overtures are made to post-Milosevic Yugoslavia. Slovene legislation is eagerly copied by Macedonia. Gradually, albeit reluctantly, Slovenia comes to be regarded as a role model by its southern neighbors who strive to emulate its success.

Slush Funds

According to David McClintick ("Swordfish: A True Story of Ambition, Savagery, and Betrayal"), in the late 1980's, the FBI and DEA set up dummy corporations to deal in drugs. They funneled into these corporate fronts money from drug-related asset seizures.

The idea was to infiltrate global crime networks but a lot of the money in "Operation Swordfish" may have ended up in the wrong pockets. Government agents and sheriffs got mysteriously and filthily rich and the whole sorry affair was wound down. The GAO reported more than $3.6 billion missing. This bit of history gave rise to at least one blockbuster with Oscar-winner Halle Berry.

Alas, slush funds are much less glamorous in reality. They usually involve grubby politicians, pawky bankers, and philistine businessmen - rather than glamorous hackers and James Bondean secret agents.

The Kazakh prime minister, Imanghaliy Tasmaghambetov, freely admitted on April 4, 2002 to his country's rubber-stamp parliament the existence of a $1 billion slush fund. The money was apparently skimmed off the proceeds of the opaque sale of the Tengiz oilfield. Remitting it to Kazakhstan - he expostulated with a poker face - would have fostered inflation. So, the country's president, Nazarbaev, kept the funds abroad "for use in the event of either an economic crisis or a threat to Kazakhstan's security".

The money was used to pay off pension arrears in 1997 and to offset the pernicious effects of the 1998 devaluation of the Russian ruble. What was left was duly transferred to the $1.5 billion National Fund, the PM insisted. Alas, the original money in the Fund came entirely from another sale of oil assets to Chevron, thus casting in doubt the official version.

The National Fund was, indeed, augmented by a transfer or two from the slush fund - but at least one of these transfers occurred only 11 days after the damning revelations. Moreover, despite incontrovertible evidence to the contrary, the unfazed premier denied that his president possesses multi-million dollar bank accounts abroad.

He later rescinded this last bit of disinformation. The president, he said, has no bank accounts abroad but will promptly return all the money in these non-existent accounts to Kazakhstan. These vehemently denied accounts, he speculated, were set up by the president's adversaries "for the purpose of compromising his name".

On April 15, 2002 even the docile opposition had enough of this fuzzy logic. They established a People Oil's Fund to monitor, henceforth, the regime's financial shenanigans. By their calculations less than 7 percent of the income from the sale of hydrocarbon fuels (c. $4-5 billion annually) make it to the national budget.

Slush funds infect every corner of the globe, not only the more obscure and venal ones. Every secret service - from the Mossad to the CIA - operates outside the stated state budget. Slush funds are used to launder money, shower cronies with patronage, and bribe decision makers. In some countries, setting them up is a criminal offense, as per the 1990 Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime. Other jurisdictions are more forgiving.

The Catholic Bishops Conference of Papua New Guinea and the Solomon Islands issued a press release November 2001 in which it welcomed the government's plans to abolish slush funds. They described the poisonous effect of this practice:

"With a few notable exceptions, the practice of directing funds through politicians to district projects has been disastrous. It has created an atmosphere in which corruption is thought to have flourished. It has reduced the responsibility of public servants, without reducing their numbers or costs. It has been used to confuse people into believing public funds are the 'property' of individual members rather than the property of the people, honestly and fairly administered by the servants of the people.

The concept of 'slush-funds' has resulted in well-documented inefficiencies and failures. There were even accusations made that funds were withheld from certain members as a way of forcing them into submission. It seems that the era of the 'slush funds' has been a shameful period."

But even is the most orderly and lawful administration, funds are liable to be mislaid. "The Economist" reported recently about a $10 billion class-action suit filed by native-Americans against the US government. The funds, supposed to be managed in trust since 1880 on behalf of half a million beneficiaries, were "either lost or stolen" according to officials.

Rob Gordon, the Director of the National Wilderness Institute accused "The US Interior Department (of) looting the special funds that were established to pay for wildlife conservation and squandering the money instead on questionable administrative expenses, slush funds and employee moving expenses".

Charles Griffin, the Deputy Director of the Heritage Foundation's Government Integrity Project, charges:

"The federal budget provides numerous slush funds that can be used to subsidize the lobbying and political activities of special-interest groups."

On his list of "Top Ten Federal Programs That Actively Subsidize Politics and Lobbying" are: AmeriCorps, Senior Community Service Employment Program, Legal Services Corporation, Title X Family Planning, National Endowment for the Humanities, Market Promotion Program, Senior Environmental Employment Program, Superfund Worker Training, HHS Discretionary Aging Projects, Telecomm. & Info. Infrastructure Assistance. These federal funds alone total $1.8 billion.

"Next" and "China Times" - later joined by "The Washington Post" - accused the former Taiwanese president, Lee Teng-hui, of forming a $100 million overseas slush fund intended to finance the gathering of information, influence-peddling, and propaganda operations. Taiwan footed the bills trips by Congressional aides and funded academic research and think tank conferences.

High ranking Japanese officials, among others, may have received payments through this stealthy venue. Lee is alleged to have drawn $100,000 from the secret account in February 1999. The money was used to pay for the studies of a former Japanese Vice-Defense Minister Masahiro Akiyama's at Harvard.

Ryutaro Hashimoto, the former Japanese prime minister, was implicated as a beneficiary of the fund. So were the prestigious lobbying firm, Cassidy and Associates and assorted assistant secretaries in the Bush administration.

Carl Ford, Jr., currently assistant secretary of state for intelligence and research, worked for Cassidy during the relevant period and often visited Taiwan. James Kelly, assistant secretary of state for East Asian and Pacific Affairs enjoyed the Taiwanese largesse as well. Both are in charge of crafting America's policy on Taiwan.

John Bolton, erstwhile undersecretary of state for arms control and international security, admitted, during his confirmation hearings, to having received $30,000 to cover the costs of writing 3 research papers.

The Taiwanese government has yet to deny the news stories.

A Japanese foreign ministry official used slush fund money to finance the extra-marital activities of himself and many of his colleagues - often in posh hotel suites. But this was no exception. According to Asahi Shimbun, more than half of the 60 divisions of the ministry maintained similar funds. The police and the ministry are investigating. One arrest has been made. The ministry's accounting division has discovered these corrupt practices twenty years before but kept mum.

Even low-level prefectural bureaucrats and teachers in Japan build up slush funds by faking business trips or padding invoices and receipts. Japanese citizens' groups conservatively estimated that $20 million in travel and entertainment expenses in the prefectures in 1994 were faked, a practice known as "kara shutcho" (i.e., empty business trip).

Officials of the Hokkaido Board of Education admitted to the existence of a 100 million yen secret fund. In a resulting probe, 200 out of 286 schools were found to maintain their own slush funds. Some of the money was used to support friendly politicians.

But slush funds are not a sovereign prerogative. Multinationals, banks, corporation, religious organizations, political parties, and even NGO's salt away some of their revenues and profits in undisclosed accounts, usually in off-shore havens.

Secret election campaign slush funds are a fixture in American politics. A 5-year old bill requires disclosure of donors to such funds but the House is busy loosening its provisions. "The Economist" listed in 2002 the tsunami of scandals that engulfs Germany, both its major political parties, many of the Lander and numerous highly placed and mid-level bureaucrats. Secret, mainly party, funds seem to be involved in the majority of these lurid affairs.

Italian firms made donations to political parties through slush funds, though corporate donations - providing they are transparent - are perfectly legal in Italy. Both the right and, to a lesser extent, the left in France are said to have managed enormous political slush funds.

President Chirac is accused of having abused for his personal pleasure, one such municipal fund in Paris, when he was its mayor. But the funds were mostly used to provide party activists with mock jobs. Corporations paid kickbacks to obtain public works or local building permits. Ostensibly, they were paying for sham "consultancy services".

The epidemic hasn't skipped even staid Ottawa. Its Chief Electoral Officer told Sun Media in September 2001 that he is "concerned" about millions stashed away by Liberal candidates. Sundry ministers who coveted the prime minister's job, have raised funds covertly and probably illegally.

On April 11, 2002 UPI reported that Spain's second-largest bank, Banco Bilbao Vizcaya Argentaria (BBVA), held nearly $200 million hidden in secret offshore accounts, "which were allegedly used to manipulate politicians, pay off the 'revolutionary tax' to ETA - the Basque terrorist organization - and open the door for business deals, according to news reports."

The money may have gone to luminaries such as Venezuela's Hugo Chavez, Peru's Alberto Fujomori and Vladimiro Montesinos. The bank's board members received fat, tax-free, "pensions" from the illegal accounts opened in 1987 - a total of more than $20 million.

Latin American drug money launderers - from Puerto Rico to Colombia - may have worked through these funds and the bank's clandestine entities in the Cayman Islands and Jersey. The current Spanish Secretary of State for the Treasury has been the bank's tax advisor between 1992-7.

The "Financial Times" reported in June 2000 that, in anticipation of new international measures to curb corruption, "leading European arms manufacturers" resorted to the creation of off-shore slush funds. The money is intended to bribe foreign officials to win tenders and contracts.

Kim Woo-chung, Daewoo's former chairman, is at the center of a massive scandal involving dozens of his company's executive, some of whom ended up in prison. He stands accused of diverting a whopping $20 billion to an overseas slush fund.

A mind boggling $10 billion were alleged to have been used to bribe Korean government officials and politicians. But his conduct and even the scale of the fraud he perpetrated may have been typical to Korea's post-war incestuous relationship between politics and business.

In his paper "The Role of Slush Funds in the Preparation of Corruption Mechanisms", reprinted by Transparency International, Gherardo Colombo defines corporate slush funds thus:

"Slush funds are obtained from a joint stock company's finances, carefully managed so that the amounts involved do not appear on the balance sheet. They do not necessarily have to consist of money, but can also take the form of stocks and shares or other economically valuable goods (works of art, jewels, yachts, etc.) It is enough that they can be used without any particular difficulty or that they can be transferred to a third party.

If a fund is in the form of money, it is not even necessary to refer to it outside the company accounts, since it can appear in them in disguised form (the 'accruals and deferrals' heads are often resorted to for the purpose of hiding slush money). In light of this, it is not always correct to regard it as a reserve fund that is not accounted for in the books. Deception, trickery or forgery of various kinds are often resorted to for the purpose of setting up a slush fund."

He mentions padded invoices, sham contracts, fictitious loans, interest accruing on holding accounts, back to back transactions with related entities (Enron) - all used to funnel money to the slush funds. Such funds are often set up to cover for illicit and illegal self-enrichment, embezzlement, or tax evasion.

Less known is the role of these furtive vehicles in financing unfair competitive practices, such as dumping. Clients, suppliers, and partners receive hidden rebates and subsidies that much increase the - unreported - real cost of production.

BBVA's payments to ETA may have been a typical payment of protection fees. Both terrorists and organized crime put slush funds to bad use. They get paid from such funds - and maintain their own. Ransom payments to kidnappers often flow through these channels.

But slush funds are overwhelmingly used to bribe corrupt politicians. The fight against corruption has been titled against the recipients of illicit corporate largesse. But to succeed, well-meaning international bodies, such as the OECD's FATF, must attack with equal zeal those who bribe. Every corrupt transaction is between a venal politician and an avaricious businessman. Pursuing the one while ignoring the other is self-defeating.

Note - The Psychology of Corruption

Most politicians bend the laws of the land and steal money or solicit bribes because they need the funds to support networks of patronage. Others do it in order to reward their nearest and dearest or to maintain a lavish lifestyle when their political lives are over.

But these mundane reasons fail to explain why some officeholders go on a rampage and binge on endless quantities of lucre. All rationales crumble in the face of a Mobutu Sese Seko or a Saddam Hussein or a Ferdinand Marcos who absconded with billions of US dollars from the coffers of Zaire, Iraq, and the Philippines, respectively.

These inconceivable dollops of hard cash and valuables often remain stashed and untouched, moldering in bank accounts and safes in Western banks. They serve no purpose, either political or economic. But they do fulfill a psychological need. These hoards are not the megalomaniacal equivalents of savings accounts. Rather they are of the nature of compulsive collections.

Erstwhile president of Sierra Leone, Momoh, amassed hundreds of video players and other consumer goods in vast rooms in his mansion. As electricity supply was intermittent at best, his was a curious choice. He used to sit among these relics of his cupidity, fondling and counting them insatiably.

While Momoh relished things with shiny buttons, people like Sese Seko, Hussein, and Marcos drooled over money. The ever-heightening mountains of greenbacks in their vaults soothed them, filled them with confidence, regulated their sense of self-worth, and served as a love substitute. The balances in their bulging bank accounts were of no practical import or intent. They merely catered to their psychopathology.

These politicos were not only crooks but also kleptomaniacs. They could no more stop thieving than Hitler could stop murdering. Venality was an integral part of their psychological makeup.

Kleptomania is about acting out. It is a compensatory act. Politics is a drab, uninspiring, unintelligent, and, often humiliating business. It is also risky and rather arbitrary. It involves enormous stress and unceasing conflict. Politicians with mental health disorders (for instance, narcissists or psychopaths) react by decompensation. They rob the state and coerce businessmen to grease their palms because it makes them feel better, it helps them to repress their mounting fears and frustrations, and to restore their psychodynamic equilibrium. These politicians and bureaucrats "let off steam" by looting.

Kleptomaniacs fail to resist or control the impulse to steal, even if they have no use for the booty. According to the Diagnostic and Statistical Manual IV-TR (2000), the bible of psychiatry, kleptomaniacs feel "pleasure, gratification, or relief when committing the theft." The good book proceeds to say that " ... (T)he individual may hoard the stolen objects ...".

As most kleptomaniac politicians are also psychopaths, they rarely feel remorse or fear the consequences of their misdeeds. But this only makes them more culpable and dangerous.

Small Business

Everyone is talking about small businesses. In 1993, when it was allowed in Macedonia, more than 90,000 new firms were registered by individuals. Now, less than three years later, official figures show that only 40,000 of them still pay their dues and present annual financial statements. These firms are called "active" - but this is a misrepresentation. Only a very small fraction really does business and produces income.

Why this reversal? Why were people so enthusiastic to register companies - and then became too desperate to operate them?

Small business is more than a fashion or a buzzword. In the USA, only small businesses create new jobs. The big dinosaur firms (the "blue-chips") create negative employment - they fire people. This trend has a glitzy name: downsizing.

In Israel many small businesses became world class exporters and big companies in world terms. The same goes, to a lesser extent, in Britain and in Germany.

Virtually every Western country has a "Small Business Administration" (SBA).

These agencies provide many valuable services to small businesses:

They help them organize funding for all their needs: infrastructure, capital goods (machinery and equipment), land, working capital, licence and patent fees and charges, etc.

The SBAs have access to government funds, to local venture capital funds, to international and multilateral investment sources, to the local banking community and to private investors. They act as capital brokers at a fraction of the costs that private brokers and organized markets charge.

They assist the entrepreneur in the preparation of business plans, feasibility studies, application forms, questionnaires - and any other thing which the new start-up venture might need to raise funds to finance its operations.

This saves the new business a lot of money. The costs of preparing such documents in the private sector amount to thousands of DM per document.

They reduce bureaucracy. They mediate between the small business and the various tentacles of the government. They become the ONLY address which the new business should approach, a "One Stop Shop".

But why do new (usually small) businesses need special treatment and encouragement at all? And if they do need it - what are the best ways to provide them with this help?

A new business goes through phases in the business cycle (very similar to the stages of human life).

The first phase - is the formation of an idea. A person - or a group of people join forces, centred around one exciting invention, process or service.

These crystallizing ideas have a few hallmarks:

They are oriented to fill the needs of a market niche (a small group of select consumers or customers), or to provide an innovative solution to a problem which bothers many, or to create a market for a totally new product or service, or to provide a better solution to a problem which is solved in a less efficient manner.

At this stage what the entrepreneurs need most is expertise. They need a marketing expert to tell them if their idea is marketable and viable. They need a financial expert to tell them if they can get funds in each phase of the business cycle - and wherefrom and also if the product or service can produce enough income to support the business, pay back debts and yield a profit to the investors. They need technical experts to tell them if the idea can or cannot be realized and what it requires by way of technology transfers, engineering skills, know-how, etc.

Once the idea has been shaped to its final form by the team of entrepreneurs and experts - the proper legal entity should be formed. A bewildering array of possibilities arises:

A partnership? A corporation - and if so, a stock or a non-stock company? A research and development (RND) entity? A foreign company or a local entity? And so on.

This decision is of cardinal importance. It has enormous tax implications and in the near future of the firm it greatly influences the firm's ability to raise funds in foreign capital markets. Thus, a lawyer must be consulted who knows both the local applicable laws and the foreign legislation in markets which could be relevant to the firm.

This costs a lot of money, one thing that entrepreneurs are in short supply of. Free legal advice is likely to be highly appreciated by them.

When the firm is properly legally established, registered with all the relevant authorities and has appointed an accounting firm - it can go on to tackle its main business: developing new products and services. At this stage the firm should adopt Western accounting standards and methodology. Accounting systems in many countries leave too much room for creative playing with reserves and with amortization. No one in the West will give the firm credits or invest in it based on domestic financial statements.

A whole host of problems faces the new firm immediately upon its formation.

Good entrepreneurs do not necessarily make good managers. Management techniques are not a genetic heritage.

They must be learnt and assimilated. Today's modern management includes many elements: manpower, finances, marketing, investing in the firm's future through the development of new products, services, or even whole new business lines. That is quite a lot and very few people are properly trained to do the job successfully.

On top of that, markets do not always react the way entrepreneurs expect them to react. Markets are evolving creatures: they change, they develop, disappear and re-appear. They are exceedingly hard to predict. The sales projections of the firm could prove to be unfounded. Its contingency funds can evaporate.

Sometimes it is better to create a product mix: well-recognized brands which sell well - side by side with innovative products.

I gave you a brief - and by no way comprehensive - taste of what awaits the new business and its initiator, the entrepreneur. You see that a lot of money and effort are needed even in the first phases of creating a business.

How can the Government help?

It could set up an "Entrepreneur's One Stop Shop".

A person wishing to establish a new business will go to a government agency.

In one office, he will find the representatives of all the relevant government offices, authorities, agencies and municipalities.

He will present his case and the business that he wishes to develop. In a matter of few weeks he will receive all the necessary permits and licences without having to go to each office separately.

Having obtained the requisite licences and permits and having registered with all the appropriate authorities - the entrepreneur will move on to the next room in the same building. Here he will receive a list of all the sources of capital available to him both locally and from foreign sources. The terms and conditions of the financing will be specified for each and every source. Example: EBRD - loans of up to 10 years - interest between 6.5% to 8% - grace period of up to 3 years - finances mainly industry, financial services, environmental projects, infrastructure and public services.

The entrepreneur will select the sources of funds most suitable for his needs - and proceed to the next room.

The next room will contain all the experts necessary to establish the business, get it going - and, most important, raise funds from both local and international institutions. For a symbolic sum they will prepare all the documents required by the financing institutions as per their instructions.

But entrepreneurs in many developing countries are still fearful and uninformed. They are intimidated by the complexity of the task facing them.

The solution is simple: a tutor or a mentor will be attached to each and every entrepreneur. This tutor will escort the entrepreneur from the first phase to the last.

He will be employed by the "One Stop Shop" and his role will be to ease life for the novice businessman. He will transform the person to a businessman.

And then they will wish the entrepreneur: "Bon Voyage" - and may the best ones win.

Sovereign Debt

In a little noticed speech, given in January 2003 at an IMF conference in Washington, Glenn Hubbard, then Chairman of President Bush's Council of Economic Advisers, delineated a compromise between the United States and the International Monetary Fund regarding a much mooted proposal to allow countries to go bankrupt.

In a rehash of ideas put forth by John Taylor, then Treasury Undersecretary for International Affairs, Hubbard proposed to modify all sovereign debt contracts pertaining to all forms of debt to allow for majority decision making, the pro-rata sharing of disproportionate payments received by one creditor among all others and structured, compulsory discussions led by creditor committees. The substitution of old debt instruments by new ones, replete with "exit consents" (the removal of certain non-payment clauses) will render old debt unattractive and thus encourage restructuring.

In a sop to the IMF, he offered to establish a voluntary sovereign debt resolution forum. If it were to fail, the IMF articles can be amended to transform it into a statutory arbiter and enforcer of decisions of creditor committees. Borrowing countries will be given incentives to restructure their obligations rather than resort to an IMF-led bailout.

In conformity with the spirit of proposals put forth by the Bank of England and the Bank of Canada, Hubbard insisted that multilateral financing should be stringently conditioned on improvements in public sector governance and the legal and regulatory frameworks, especially the protection of investor and creditor rights. He rejected, though, suggestions to strictly limit official financing by international financing institutions.

Yet, these regurgitated schemes suffer from serious flaws.

It is not clear why would creditors voluntarily forgo their ability to extort from other lenders and from the debtor an advantageous deal by threatening to withhold their consent to a laboriously negotiated restructuring package. Nor would a contractual solution tackle the thorny issues of encompassing different debt instruments and classes of creditors and of coordinating action across jurisdictions. Taylor's belated proviso that such clauses be a condition for receiving IMF funds would automatically brand as credit risks countries which were to introduce them.

The IMF is, effectively, a lender of last resort. When a country seeks IMF financing, its balance of payments is already ominously stretched, its debt shunned by investors, and its currency under pressure. The IMF's clients are illiquid (though never insolvent in the strict sense of the word).

The IMF's First Deputy Managing Director, Anne Krueger, proposed in November 2001 to allow countries to go bankrupt within a Sovereign Debt Restructuring Mechanism (SDRM). Legal action by creditors will be "stayed" while the country gets its financial affairs in order and obtains supplemental funding. Such an approach makes eminent sense.

Today, sovereign debt defaults lead to years of haggling among bankers and bondholders. It is a costly process, injurious to the distressed country's future ability to borrow. The terms agreed are often onerous and, in many cases, lead to a second event of default. The experiences of Ukraine and Ecuador in the 1990s are instructive. Russia - another serial debt restructurer, lastly in 1998 -

was saved from a recurrent default by the fortuitous surge in oil prices. Argentina and its emasculated debtors were not as lucky.

Moreover, as Hubbard observed in his speech, both creditors and debtors have a perverse incentive to aggravate the situation. The more calamitous the outlook, the more likely are governments and international financial institutions to step in with a bailout package, replete with soft loans, debt forgiveness and generous terms of rescheduling. This encourages the much-decried "moral hazard" and results in reckless borrowing and lending.

A carefully thought-out international sovereign bankruptcy procedure is likely to yield at least two important improvements over the current mayhem. Troubles now tackled by a politically-compromised and bloated IMF will be relegated to the marketplace. Bailouts will become rarer and far more justified. Moreover, the "last man syndrome", the ability of a single creditor to blackmail all others - and the debtor - into an awkward deal, will be eliminated.

By streamlining and elucidating the outcomes of financial crises, an international bankruptcy court, or arbitration mechanism, will, probably, enhance the willingness of veteran creditors to lend to developing countries and even help attract new funding. The creditworthiness of lenders increases as procedures related to collateral, default and collection are clarified. It is the murkiness and arm-twisting of the current non-system that deter capital flows to emerging economies.

Still, the analogy is partly misleading. What if a developing country abuses the bankruptcy procedures? As The Economist noted wryly "an international arbiter can hardly threaten to strip a country of its assets, or forcibly change its 'management'".

Yet, this is precisely where market discipline comes in. A rogue debtor can get away with legal shenanigans once - but it is likely to be spurned by lenders henceforth. Good macroeconomic policies are bound to be part and parcel of any package of debt rescheduling and restructuring in the framework of a sovereign bankruptcy process.

Addendum - Vulture Funds

Vulture funds are financial firms that purchase sovereign debt at a considerable disaggio and then demand full payment from the issuing country. A single transaction with a solitary series of heavily discounted promissory notes can wipe out the entire benefit afforded by much-touted international debt relief schemes and obstruct debt rescheduling efforts.

Addendum - Nationalizing Risk

During the months of September-October 2008, governments throughout the world took a series of unprecedented steps to buttress tottering banks. In the USA, the Federal Reserve and the Treasury Department have flooded the financial system with liquidity; granted commercial banking licenses to the few investment banks left standing; lent funds against financial instruments turned toxic; and purchased non-voting equity and senior debt in a host of firms and banks. Several European countries have guaranteed all bank deposits and short-term interbank loans.

These steps served to halt the panic at least temporarily and have thus prevented runs on banks and the seizing up of the credit markets. Still, these were mere palliatives. They did not tackle the roots of the crisis, though they averted it.

Instead of eliminating risky, ill-considered investments and bad loans by allowing defaults and bankruptcies, governments have shifted debts and risks from financial institutions to taxpayers and sovereigns. The question was thus no longer: will this or that bank survive, but: will this or that country remain solvent. Iceland, for instance, essentially went belly up. Other countries, including the USA, are liable to pay for this largesse with a bout of pernicious inflation.

And even as the United States begins its long recovery, Europe and Asia are left to bear the brunt of American profligacy, avarice, regulatory dysfunction, and shortsightedness. According to a research note published by Credit Suisse, the Baltics, Bulgaria, Ukraine, Romania and Hungary "face many of the same macro-economic strains as Iceland, with deep balance of payments deficits and a high ratio of private sector credit to GDP". To these one can add South Africa.

Shifting risk from the private sector to the public one and from one locale (the USA) to others (Europe, Asia) are not long-term solutions. They only postpone the inevitable. The imbalances in the international financial system are such that unwinding them requires a prolonged and painful global recession. In economics, there is no free lunch.

Martin Schubert and his New-York (now Miami) based investment boutique, European Inter-American Finance, in joint venture with Merrill Lynch and Aetna, pioneered the private trading of sovereign obligations of emerging market economies, including those in default. In conjunction with private merchant banks, such as Singer Friedlander in the United Kingdom, he conjured up liquidity where there was none and captured the imagination of businesses on both sides of the Atlantic.

Today, his vision is vindicated by the proliferation of ventures similar to his and by the institutionalization of the emerging economies sovereign debt market. Even obligations of countries such as Serbia and Iraq are traded, though sporadically. Recently, according to Dow Jones, Iraqi debt doubled itself and is now changing hands at about 15 to 20 cents to the dollar.

The demand is so overwhelming that Geneva-based brokerage firm Trigone Capital Finance created a special fund to provide interested investors with exposure to Iraqi paper. Nor is the enthusiasm confined to this former member of the axis of evil. Yugoslav debt is firm at 50 cents, despite recent political upheavals, including the assassination of the reformist and pro-Western prime minister.

Emerging market sovereign debts are irresistible. Some of them now yield 1000 basis points above comparable US Treasuries. The mean spread, according to JP Morgan's Emerging Markets Bond Index Plus is c. 600 points. Corporate securities are even further in the stratosphere.

But with frenzied buying all around, returns have been declining precipitously in the last few weeks. Investors in emerging market bonds saw average profits of 10 percent this year - masking a surge of 30 percent in Brazilian and Ecuadorian paper, for instance. JP Morgan Chase's EMBI Global index is up 19 percent since September 2002.

Nor is this a new trend. The EMBI Global Index has witnessed in each of the last four years an average gain of 14 percent. According to Bloomberg, the assets of emerging market debt funds surged by one tenth since the beginning of the year, or $948 million - compared to $648 received during throughout last year.

The party is on. Emerging market debt is either traded on various exchanges or brokered privately to wealthy or institutional clientele. The obligations fall into categories too numerous to mention: insured and uninsured credits, defaulted or performing, corporate against municipal or sovereign and so on.

A dominant class of obligations is called "Brady bonds" after the former U.S. Treasury Secretary Nicholas Brady. These securities are the outcomes of the rescheduling pf commercial bank loans (sometimes defaulted) to developing nations. The principal of the rescheduled debt - guaranteed by U.S. zero coupon Treasuries deposited by the original issuer in the Federal Reserve or some other credible institution - remains to be fully paid. The interest accrued on the principal until the moment of rescheduling is reduced and the term of payment is prolonged.

Brady countries include Venezuela, Brazil, Argentina, Ecuador and Mexico, to name just a few. The bonds have been trading since 1989. Only one Brady bond has ever defaulted (Ecuador). No interest payment was ever missed or skipped.

As Nazibrola Lordkipanidze and Glenn C. W. Ames observe in their paper, "Hedging Emerging Market Debt", the terms of individual Brady packages vary. Individual countries have issued as few as one, and as many as eight different bonds, each of which can vary with respect to maturity, fixed or floating coupons, amortization schedules, and the degree to which principal and interest payments are collateralized.

The market is besieged by - mostly offshore - mutual funds managed by the likes of Pacific Investment Management Company (PIMCO), AllianceBernstein, Scudder Investments, MFS Investment Management and Mainstay Investment Management.

Emerging market debt attracted entrepreneurial fund managers who set up nimble and agile shop. Ashmore Investment Management was divested to its current owners by Australia & New Zealand Banking Group. Despite the obvious shortcomings of its size - limited access to information and research - it runs a successful Russian fund, among others.

When the United Kingdom based firms, Garban Securities and Intercapital Securities, merged late in 1999, they transferred their illiquid emerging market securities businesses into a common vehicle, Exotix. The new outfit's team was poached from the trading side of emerging markets divisions of various investment banks. Exotix brokers the purchase and sale of fixed income products from risky countries.

Maxcor Financial, a broker-dealer subsidiary of Maxcor Financial Group, is an inter-dealer broker of various securities products, including emerging market debt. It also conducts institutional sales and trading operations in high yield and distressed debt. AIG Trading, of the AIG group, maintains a full-fledged emerging markets team. It boasts of "senior level contacts within many central banks, allowing us to provide rare insight".

Other outfits stay out of the limelight and offer discrete services, custom-tailored to the needs of particular clients. The Weston Group, in operation since 1988, is active in the Mexican market. It does underwriting, private placements and structured finance.

Companies such as Omni Whittington have specialized in "debt recovery" - the placement and conversion of defaulted bank and trade debt from political risk countries. They buy bad debt through a dedicated investment fund, collect on non-performing credits (on a "no cure, no pay" basis) and manage portfolios of loans gone sour, including the negotiation of their rescheduling.

One sure sign of this niche's growing importance is the proliferation of conferences, consultancies, seminars, trade publications and books. Banks and law and accounting firms have set up dedicated departments to tackle the juridical and commercial intricacies of defaulted debt, both corporate and sovereign. International law is adapting itself through a growing body of legislation and precedents. Moody's Investors Service, Standard & Poor's and Fitch regularly rate emerging market issues.

RBC Investment Services (Asia), a business unit of the Royal Bank Financial Group, a Canadian investment bank, advises its clients in their investments in Bradys. Union des Banques Arabes et Francaises, 44 percent owned by Credit Lyonnais and the rest by Arab banks, including the Iraqi Rafidain, is an aggressive buyer of Iraqi and other Middle Eastern debt.

But the market is still immature and inefficient. In an address to the Sovereign Debt Restructuring Mechanism Conference earlier this year, Kenneth Rogoff, Research Director of the International Monetary Fund surveyed the scorched landscape:

"Private debt flows to emerging markets (produce) wild booms, spectacular crashes, over indebtedness, excessive reliance on short-term and foreign-currency denominated debt, and protracted stagnation following a debt crisis. Emerging economies' governments ... sometimes borrow more than is good for their citizens (and are) ... sometimes willing to take on excessive risk to save on interest costs. On the investor side, there is often a reluctance to hold instruments that would provide for more flexibility and risk sharing, such as GDP-indexed bonds, domestic equity, and local currency debt—in part, because of poor policy credibility and weak domestic institutions. The result is an excessive reliance on 'dangerous' forms of debt, such as foreign-currency denominated debt and short-term debt, which aggravate the pain of crises when they occur."

Weak property rights, uncertain debt recovery mechanisms, political risks, excessive borrowing, collective action problems among creditors and moral hazard are often associated with credit-insatiable emerging economies, failed states, erstwhile empires, developing countries and polities in transition.

Signs of trouble abound from Turkey to Bolivia and from Paraguay to Africa. Nigerian President Olusegun Obasanjo said last July that paying civil servants was more important than avoiding default on the country's $30 billion debt. Its Supreme Court ruled in April 2002 that it is unconstitutional to pay down the external debt before all other government expenses. Nor would that be the first time Nigeria reneges. The Paris Club of creditor countries has been rescheduling its debts repeatedly.

This is not to mention Argentina. Its corporate sector missed $4.6 billion in payments in the last six months alone and the country defaulted on a whopping $95 billion in obligations. The conduct of debtors, transparency and accountability are not improving either. Russia all but withheld information regarding a French lawsuit in a plan to swap $3.1 billion in new Eurobonds for about $6 billion of defaulted Soviet-era debt.

The status of creditors is under further strains by the repeated floating of schemes to put in place some kind of sovereign bankruptcy mechanism. The Bush administration proposed to modify all sovereign debt contracts pertaining to all forms of debt to allow for majority decision making, the pro-rata sharing of disproportionate payments received by one creditor among all others and structured, compulsory discussions led by creditor committees.

The IMF's First Deputy Managing Director, Anne Krueger, countered, in November 2001, with the idea to allow countries to go bankrupt within a Sovereign Debt

Restructuring Mechanism (SDRM). Legal action by creditors will be "stayed" while the country gets its financial affairs in order and obtains supplemental funding. Such an approach makes eminent sense.

In opening remarks to the Council of the Americas in November 2001, Martin Schubert offered these observations:

"Talk of adopting bankruptcy procedure protection for governments ... similar to that employed by private companies, could be the match that lights the fire, due to the conflicts such a standstill would create. Moreover, what government debtor would be willing or able to assign assets to a trustee or assignee in bankruptcy, for the benefit of creditors?"

But investors never learn. In a world devoid of attractive investment options, they keep ploughing their money into the high-yield scenes of financial crimes committed against them. This self-defeating tendency is reinforced by the general stampede from equities to bonds and by the slow-motion implosion of the US dollar, partly as a result. Until the next major default, that is.

Space Industry (in East Europe)

The recent (December 2005) spate of news about Russia's space program was decidedly mixed. According to Space News, the 17-country European Space Agency (ESA) declined to participate in Russia's $60 million, two-year Clipper manned and winged space vehicle program, a touted alternative to NASA's Crew Exploration Vehicle.

With an anual budget of $800 million, the Russian Federal Space Agency sought to minimize the importance of this surprising turnabout. In a press conference, Nikolay Sevastiyanov, President of the Russian aerospace contractor RSC-Energia, said: "We're starting to design this new transportation system to support the International Space Station (ISS) once it's complete." A space tug, dubbed Parom, will tow the Clipper to the ISS.

But this is not the whole truth. The Clipper - a combined crew and cargo vehicle - is at the heart of Russia's renewed attempt to land crafts on the moon and on Mars.

The Clipper is the culmination of a decade of research, development, and geopolitical maneuvering, involving many other elements.

Consider the "Volga". It is the name of a new liquid-fueled retrievable and reusable (up to 50 times) booster-rocket engine. It will be built by two Russian missile manufacturers for a consortium of French, German, and Swedish aerospace firms. ESA - the European Space Agency - intends to invest 1 billion euros over 10-15 years in this new toy. This is a negligible sum in an $80 billion a year market.

Russian rockets, such as the Soyuz U and Tsiklon, have been launching satellites to orbit for decades now and not only for the Russian defense ministry, their erstwhile exclusive client. Communications satellites, such as Gonets D1 ("Courier" or "Messenger"), and other commercial loads are gradually overtaking their military observation, navigation, and communications brethren. The Strategic Rocket Forces alone have earned more than

$100 million from commercial launches between 1997-9, reports "Kommersant", the Russian business daily.

Still, many civilian satellites are not much more than stripped military bodices. Commercial operators and Rosaviakosmos (Russia's NASA) report to the newly re-established (June 2001) Russian Military Space Forces. Technology gained in collaborative efforts with the West is immediately transferred to the military.

Russia is worried by America's lead in space. The USA has 600 satellites to Russia's 100 (mostly obsolete) birds, according to space.com. The revival of US plans for an anti-missile shield and the imminent, unilateral, and inevitable American withdrawal from the Anti-Ballistic Missile Treaty add urgency to Russian scrambling to catch up.

Despite well-publicized setbacks - such as the ominous crash at Baikonur in Kazakhstan in July 1999 - Russian launchers are among the most reliable there are. Fifty-seven of 59 launch attempts were successful last year. By comparison, in 1963, only 55 out of 70 launch attempts met the same happy fate.

American aerospace multinationals closely collaborate with Rosaviakosmos. Boeing maintains a design office in Russia to monitor joint projects such as the commercial launch pad Sea Launch and the ISS. It employs hundreds of Russian professionals in and out of Russia.

There is also an emerging collaboration with the European Aeronautic Defense and Space (EADS) company as well as with Arianespace, the French group. A common launch pad is taking shape in Kourou and the Soyuz is now co-owned by Russians and Europeans through Starsem, a joint venture. Russia also intends to participate in the hitherto dormant European RLV (Reusable Launch Vehicle) project.

The EU's decision, in the 2002 Barcelona summit, to give "Galileo" the go ahead, would require close cooperation with Russia. "Galileo" is a $3 billion European equivalent of the American GPS network of satellites. It will most likely incorporate Russian technology, use Russian launch facilities, and employ Russian engineers.

This collaboration may well revive Russia's impoverished and, therefore, moribund space program with an infusion of more than $2 billion over the next decade.

But America and Europe are not the only ones queuing at Russia's doorstep.

Stratfor, the Strategic Forecasting firm, reported about a deal concluded in May 2001 between the Australian Ministry of Industry, Science and Resources and the Russian Aviation and Space Agency. Australian companies were granted exclusive rights to use the Russian Aurora rocket outside Russia. In return, Russia will gain access to the ideally located launch site at Christmas Island in the Indian Ocean. This is a direct blow to competitors such as India, South Korea, Japan, China, and Brazil.

Russian launch technology is very advanced and inexpensive, being based, as it is, on existing military R&D. It has been licensed to other space-aspiring countries. India's troubled Geosynchronous Satellite Launch Vehicle (GSLV) is based on Russian technology, reports Stratfor. Many private satellite launching firms - Australian and others - find Russian offerings commercially irresistible. Russia - unlike the US - places no restrictions on the types of load launched to space with its rockets.

Still, launch technologies are simple matters. Until 1995, Russia launched more loads annually than the rest of the world combined - despite its depleted budget (less than Brazil's). But Russia's space shuttle program, the Energia-Buran, was its last big investment in R&D. It was put to rest in 1988. Perhaps as a result, Russia failed dismally to deliver on its end of the $660 million ISS bargain with NASA. This has cost NASA well over $3 billion in re-planning.

The living quarters of the International Space Station (ISS), codenamed "Zvezda", launched two years late, failed to meet the onerous quality criteria of the Americans. It is noisy and inadequately protected against meteorites, reported "The Economist". Russia continues to supply the astronauts and has just launched from Baikonur a Progress M1-8 cargo ship with 2.4 tons of food, fuel, water, and oxygen.

The dark side of Russia's space industry is its sales of missile technology to failed and rogue states throughout the world.

Timothy McCarthy and Victor Mizin of the U.S. Center for Nonproliferation Studies wrote in the "International Herald Tribune in November 2001:

"[U.S. policy to date] leaves unsolved the key structural problem that contributes to illegal sales: over-capacity in

the Russian missile and space industry and the inability or unwillingness of Moscow to do anything about it ... There is simply too much industry [in Russia] chasing too few legitimate dollars, rubles or euros. [Downsizing] and restructuring must be a major part of any initiative that seeks to stop Russian missile firms from selling 'excess production' to those who should not have them."

The official space industry has little choice but to resort to missile proliferation for its survival. The Russian domestic market is inefficient, technologically backward, and lacks venture capital. It is thus unable to foster innovation and reward innovators in the space industry. Its biggest clients - government and budget-funded agencies - rarely pay or pay late. Prices for space-related services do not reflect market realities.

According to fas.org's comprehensive survey of the Russian space industry, investment in replacement of capital assets deteriorated from 9 percent in 1998 to 0.5 percent in 1994. In the same period, costs of materials shot up 382 times, cost of hardware services went up by 172 times, while labour costs increased 82-fold. The average salary in the space industry, once a multiple of the Russian average wage, has now fallen beneath it. The resulting brain drain was crippling. More than 35 percent of all workers left - and more than half of all the experts.

Private firms are doing somewhat better, though. A Russian company unveiled, in March 2002, a reusable vehicle for space tourism. The ticket price - $100,000 for a 3-minutes trip. One hundred tickets were already sold. The mock-up was exposed to the public in a Russian air base.

As opposed to grandiosity-stricken Russia, Kazakhstan has few pretensions to being anything but a convenient launching pad. It reluctantly rents out Baikonur, its main site, to Russia for an $115 million a year. Russia pays late, reports accidents even later, and pollutes the area frequently. Baikonur is only one of a few civilian launch sites (Kapustin Yar, Plesetsk). It is supposed to be abandoned by Russia in favor of Svobodny, a new (1997) site.

Kazakhstan expressed interest in a Russian-Kazakh-Ukrainian carrier rocket, the Sodruzhestvo. It is even budgeted for in the Russian-Kazakh space program budget 2000-2005. But both the Russians and the Ukrainians were unable to cough up the necessary funds and the project was put on indefinite hold.

Umirzak Sultangazin, the head of the Kazakh Institute for Space Research, complained bitterly in an interview he granted last year to the Russian-language "Karavan":

"Our own satellite is an dire need. So far, we are using data "received" from US and Russian satellites. Some information we use is free, but we have to pay for certain others ... We have high-class specialists but they are leaving the institute for commercial structures because they are offered several times bigger salaries. I have many times raised this question and said: Look, Russia pays us not a small amount to lease Baykonur [some 115m dollars a year], why should we not spend part of this money on space research? We could have developed the space sector and become a real space power."

Kazakhstan has its own earth profiling program administered by its own cosmonauts. It runs biological and physical experiments in orbit. The "tokhtar" is a potato developed in space and named after Kazakhstan's first astronaut, the eponymous Tokhtar Aubakirov.

Almost all the former satellites of the USSR have established their own space programs after they broke away, vowing never again to be dependent on foreign good will. Romania founded ROSA, the Romanian Space Agency in 1991. Hungary created the Hungarian Space Office.

The Baltic states - to the vocal dismay of many of their citizens - work closely with NATO on military applications of satellites within the framework of BALTNET (the Baltic air space control project). Poland (1994), Hungary (1991), Romania (1992) and the Czech Republic have been cooperating with ESA on a variety of space-related commercial and civil projects.

Ukraine hedges its bets. It signed with Brazil a space industry bilateral accord in January. A month later it signed five bilateral agreements regarding the space industry with Russia.

Many Western academic institutions, NGO's, and commercial interests created frameworks for collaboration with space scientists from Central Asia, Central and Eastern Europe, Russia, CIS, and NIS. The University of Maryland pioneered this trend with its East-West Space Science Center, formed in 1990.

The space industry - and particularly the emerging field of launch technologies - represents one of the few areas in which the former communist countries may retain a competitive edge and a relative advantage. The West would do well to encourage the commercialization of this knowledge. The alternative is proliferation of missile technologies and military applications of technology transferred within collaborative efforts on civilian projects with Western partners. The West can save itself a lot of money and heartache by being generous early on.

Spam

Tennessee resident K. C. "Khan" Smith owes the internet service provider EarthLink $24 million. According to the CNN, in August 2001 he was slapped with a lawsuit accusing him of violating federal and state Racketeering Influenced and Corrupt Organizations (RICO) statutes, the federal Computer Fraud and Abuse Act of 1984, the federal Electronic Communications Privacy Act of 1986 and numerous other state laws. On July 19, 2002 - having failed to appear in court - the judge ruled against him. Mr. Smith is a spammer.

Brightmail, a vendor of e-mail filters and anti-spam applications warned that close to 5 million spam "attacks" or "bursts" occurred in June 2002 and that spam has mushroomed 450 percent since June 2001. This pace continued unabated well into the beginning of 2004 when the introduction of spam filters began to take effect. PC World concurs.

Between one half and three quarters of all e-mail messages are spam or UCE (Unsolicited Commercial Email) - unsolicited and intrusive commercial ads, mostly concerned with sex, scams, get rich quick schemes, financial services and products, and health articles of dubious provenance. The messages are sent from spoofed or fake e-mail addresses. Some spammers hack into unsecured servers - mainly in China and Korea - to relay their missives anonymously.

Starting in 2003, malicious hackers began using spam to install malware - such as viruses, adware, spyware, and Trojans - on the unprotected personal computers of less savvy users. They thus transform these computers into "zombies", organize them into spam-spewing "bots" (networks), and sell access to them to criminals on penumbral boards and forums all over the Net.

Spam is an industry. Mass e-mailers maintain lists of e-mail addresses, often "harvested" by spamware bots - specialized computer applications - from Web sites. These lists are rented out or sold to marketers who use bulk mail services. They come cheap - c. $100 for 10 million addresses. Bulk mailers provide servers and bandwidth, charging c. $300 per million messages sent.

As spam recipients become more inured, ISPs less tolerant, and both more litigious - spammers multiply their efforts in order to maintain the same response rate. Spam works. It is not universally unwanted - which makes it tricky to outlaw. It elicits between 0.1 and 1 percent in positive follow ups, depending on the message. Many messages now include HTML, JavaScript, and ActiveX coding and thus resemble (or actually contain) viruses and Trojans.

Jupiter Media Matrix predicted in 2001 that the number of spam messages annually received by a typical Internet user will double to 1400 and spending on legitimate e-mail marketing will reach $9.4 billion by 2006 - compared to $1 billion in 2001. Forrester Research pegs the number at $4.8 billion in 2003.

More than 2.3-5 billion spam messages are sent daily. eMarketer puts the figures a lot lower at 76 billion messages in 2002. By 2006, daily spam output will soar to c. 15 billion missives, says Radicati Group. Jupiter projects a more modest 268 billion annual messages this year (2005). An average communication costs the spammer 0.00032 cents.

PC World quotes the European Union as pegging the bandwidth costs of spam worldwide in 2002 at $8-10 billion annually. Other damages include server crashes, time spent purging unwanted messages, lower productivity, aggravation, and increased cost of Internet access.

Inevitably, the spam industry gave rise to an anti-spam industry. According to a Radicati Group report titled "Anti-virus, anti-spam, and content filtering market trends 2002-2006", anti-spam revenues were projected to exceed $88 million in 2002 - and more than double by 2006. List blockers, report and complaint generators, advocacy groups, registers of known spammers, and spam filters all proliferate. The Wall Street Journal reported in its June 25, 2002 issue about a resurgence of anti-spam startups financed by eager venture capital.

ISPs are bent on preventing abuse - reported by victims - by expunging the accounts of spammers. But the latter simply switch ISPs or sign on with free services like Hotmail and Yahoo! Barriers to entry are getting lower by the day as the costs of hardware, software, and communications plummet.

The use of e-mail and broadband connections by the general population is spreading. Hundreds of thousands of technologically-savvy operators have joined the market in the last five years, as the dotcom bubble burst. Still, Steve Linford of the UK-based Spamhaus.org insists that most spam emanates from c. 80 large operators.

Now, according to Jupiter Media, ISPs and portals are poised to begin to charge advertisers in a tier-based system, replete with premium services. Writing back in 1998, Bill Gates described a solution also espoused by Esther Dyson, chair of the Electronic Frontier Foundation:

"As I first described in my book 'The Road Ahead' in 1995, I expect that eventually you'll be paid to read unsolicited e-mail. You'll tell your e-mail program to discard all unsolicited messages that don't offer an amount of money that you'll choose. If you open a paid message and discover it's from a long-lost friend or somebody else who has a legitimate reason to contact you, you'll be able to cancel the payment. Otherwise, you'll be paid for your time."

Subscribers may not be appreciative of the joint ventures between gatekeepers and inbox clutterers. Moreover, dominant ISPs, such as AT&T and PSINet have recurrently been accused of knowingly collaborating with spammers. ISPs rely on the data traffic that spam generates for their revenues in an ever-harsher business environment.

The Financial Times and others described how WorldCom refuses to ban the sale of spamware over its network, claiming that it does not regulate content. When "pink" (the color of canned spam) contracts came to light, the implicated ISPs blame the whole affair on rogue employees.

PC World begs to differ:

"Ronnie Scelson, a self-described spammer who signed such a contract with PSInet, (says) that backbone providers are more than happy to do business with bulk e-mailers. 'I've signed up with the biggest 50 carriers two or three times', says Scelson ... The Louisiana-based spammer claims to send 84 million commercial e-mail messages a day over his three 45-megabit-per-second DS3 circuits. 'If you were getting $40,000 a month for each circuit', Scelson asks, 'would you want to shut me down?'"

The line between permission-based or "opt-in" e-mail marketing and spam is getting thinner by the day. Some list resellers guarantee the consensual nature of their wares. According to the Direct Marketing Association's guidelines, quoted by PC World, not responding to an unsolicited e-mail amounts to "opting-in" - a marketing strategy known as "opting out". Most experts, though, strongly urge spam victims not to respond to spammers, lest their e-mail address is confirmed.

But spam is crossing technological boundaries. Japan has just legislated against wireless SMS spam targeted at hapless mobile phone users. Many states in the USA as well as the European parliament have followed suit. Ideas regarding a "do not spam" list akin to the "do not call" list in telemarketing have been floated. Mobile phone users will place their phone numbers on the list to avoid receiving UCE (spam). Email subscribers enjoy the benefits of a similar list under the CAN-Spam Act of 2003.

Expensive and slow connections make mobile phone spam and spim (instant messaging spam) particularly resented. Still, according to Britain's Mobile Channel, a mobile advertising company quoted by "The Economist", SMS advertising - a novelty - attracts a 10-20 percent response rate - compared to direct mail's 1-3 percent.

Net identification systems - like Microsoft's Passport and the one proposed by Liberty Alliance - will make it even easier for marketers to target prospects.

The reaction to spam can be described only as mass hysteria. Reporting someone as a spammer - even when he is not - has become a favorite pastime of vengeful, self-appointed, vigilante "cyber-cops". Perfectly legitimate, opt-in, email marketing businesses and discussion forums often find themselves in one or more black lists - their reputation and business ruined.

In January 2002, CMGI-owned Yesmail was awarded a temporary restraining order against MAPS - Mail Abuse Prevention System - forbidding it to place the reputable e-mail marketer on its Real-time Blackhole list. The case was settled out of court.

Harris Interactive, a large online opinion polling company, sued not only MAPS, but ISPs who blocked its email messages when it found itself included in MAPS' Blackhole. Their CEO accused one of their competitors for the allegations that led to Harris' inclusion in the list.

Coupled with other pernicious phenomena - such as viruses, Trojans, and spyware - the very foundation of the Internet as a fun, relatively safe, mode of communication and data acquisition is at stake.

Spammers, it emerges, have their own organizations. NOIC - the National Organization of Internet Commerce threatened to post to its Web site the e-mail addresses of millions of AOL members. AOL has aggressive anti-spamming policies. "AOL is blocking bulk email because it wants the advertising revenues for itself (by selling pop-up ads)" the president of NOIC, Damien Melle, complained to CNET.

Spam is a classic "free rider" problem. For any given individual, the cost of blocking a spammer far outweighs the benefits. It is cheaper and easier to hit the "delete" key. Individuals, therefore, prefer to let others do the job and enjoy the outcome - the public good of a spam-free Internet. They cannot be left out of the benefits of such an aftermath - public goods are, by definition, "non-excludable". Nor is a public good diminished by a growing number of "non-rival" users.

Such a situation resembles a market failure and requires government intervention through legislation and enforcement. The FTC - the US Federal Trade Commission - has taken legal action against more than 100 spammers for promoting scams and fraudulent goods and services.

"Project Mailbox" is an anti-spam collaboration between American law enforcement agencies and the private sector. Non government organizations have entered the fray, as have lobbying groups, such as CAUCE - the Coalition Against Unsolicited Commercial E-mail.

But, a few recent anti-spam and anti-spyware Acts notwithstanding, Congress is curiously reluctant to enact stringent laws against spam. Reasons cited are free speech, limits on state powers to regulate commerce, avoiding unfair restrictions on trade, and the interests of small business. The courts equivocate as well. In some cases - e.g., Missouri vs. American Blast Fax - US courts found "that the provision prohibiting the sending of unsolicited advertisements is unconstitutional".

According to Spamlaws.com, the 107th Congress, for instance, discussed these laws but never enacted them:

Unsolicited Commercial Electronic Mail Act of 2001 (H.R. 95), Wireless Telephone Spam Protection Act (H.R. 113), Anti-Spamming Act of 2001 (H.R. 718), Anti-Spamming Act of 2001 (H.R. 1017), Who Is E-Mailing Our Kids Act (H.R. 1846), Protect Children From E-Mail Smut Act of 2001 (H.R. 2472), Netizens Protection Act of 2001 (H.R. 3146), "CAN SPAM" Act of 2001 (S. 630).

Anti-spam laws fared no better in the 106th Congress. Some of the states have picked up the slack. Arkansas, California, Colorado, Connecticut, Delaware, Idaho, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Missouri, Nevada, North Carolina, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Tennessee, Utah, Virginia, Washington, West Virginia, and Wisconsin.

The situation is no better across the pond. The European parliament decided in 2001 to allow each member country to enact its own spam laws, thus avoiding a continent-wide directive and directly confronting the communications ministers of the union. Paradoxically, it also decided, in March 2002, to restrict SMS spam. Confusion clearly reigns. Finally, in May 2002, it adopted strong anti-spam provisions as part of a Directive on Data Protection.

Responding to this unfavorable legal environment, spam is relocating to developing countries, such as Malaysia, Nepal, and Nigeria. In a May 2005 report, the OECD (Organization for Economic Cooperation and Development) warned that these countries lack the technical know-how and financial resources (let alone the will) to combat spam. Their users, anyhow deprived of bandwidth, endure, as a result, a less reliable service and an intermittent access to the Internet;

"Spam is a much more serious issue in developing countries...as it is a heavy drain on resources that are scarcer and costlier in developing countries than elsewhere" - writes the report's author, Suresh Ramasubramanian, an OECD advisor and postmaster for Outblaze.com.

ISPs, spam monitoring services, and governments in the rich industrialized world react by placing entire countries - such as Macedonia and Costa Rica - on black lists and, thus denying access to their users en bloc.

International collaboration against the looming destruction of the Internet by crime organizations is budding. The FTC had just announced that it will work with its counterparts abroad to cut zombie computers off the network. A welcome step - but about three years late. Spammers the world over are still six steps ahead and are having the upper hand.

Steel Industry

The recent steel spat between the USA and, among others, the EU, is a classic case of suicidal protectionism. American steel producers ended up imposing quotas and tariffs on manufacturers they have only recently purchased in central and eastern Europe.

The battle is far from over. US producers of oil country tubular goods have just applied for relief under the infamous section 201. They blame Ukraine and Romania - as well as 11 other countries - of dumping. They demand to apply duties at the border on this steel product, so as to restore fairness and "equilibrium" to the market.

Last month Bush imposed tariffs of up to 30 percent in the first year of the new regime on $8 billion of steel imports, mainly from Europe, South Korea, and Japan. This is about one tenth of the global market. The tariffs are scheduled to decline to 24 percent in the second year and 18 percent in the third. Both Europe and Japan are challenging these measures in the WTO.

Bush was fiercely chastised for his decision by free-traders and economic liberals the world over. Many believe that this is merely the opening shot in an all-encompassing trade war. They fear a 1930's-style world depression.

The administration has already backtracked. It promised to consider more than 1000 requests to exclude up to $1 billion in steel imports from the tariffs. The gaffe-prone US Treasury Secretary, Paul O'Neill, said that this is done in order to reduce the "shrillness" of the conversation. More likely, it is aimed to prevent the emergence of an anti-American trade coalition.

One of the chief complainants to the American administration is US Steel, the largest American producer, now that LTV, National Steel, and Bethlehem Steel went bust.

The absurd is that US Steel is a major European steel producer as well. Two years ago it has purchased the continent's second largest steel mill, VSZ, in Kosice, Slovakia. It paid over $60 million in cash, assumed more than $320 million in obligations and agreed to invest c. $700 million in plant over a ten year period.

This was no small acquisition. VSZ has a capacity of 4 million tons (and a production run of 3.4 million tons) - to US Steel's 13 million tons. Next year, the Slovak factory will be upgraded with new tin-plate steel facilities and an automotive-grade galvanized steel line. This will boost its annual production by 15 percent.

Last year, US Steel lost $62 per every domestically produced ton. US Steel Kosice (USSK) made a profit of $55 per ton. USSK plans to purchase still mills in the Czech Republic as well. No wonder other American companies - such as Harsco - were drawn to invest in eastern Slovakia.

Non-American firms were slow to react to the American takeover of the European steel industry. The only notable acquisition was by LNM, the world's fourth-largest steelmaker. It purchased the Romanian Sidex, a loss leader with 28,000 workers. Its bid was backed by Britain's prime minister, Tony Blair, in a now-notorious letter to the Romanian government.

The unilateral slapping of tariffs by their biggest market - the EU - threw central European producers into disarray. Hungarian Radio announced that Hungary will impose import restrictions later this month "to protect the domestic steel industry and market". The EU was likely to institute import barriers against cheap Hungarian steel as well.

According to the April issue of "Rzeczpospolita", the Deputy Minister of Economy, Janusz Kaczurba, threatened to introduce import restrictions on foreign producers, if they attempt to bring the surplus of their steel output to Poland." His posturing was aimed mainly at Russian mills, now somewhat deprived on both the American and the EU markets.

Poland epitomizes the dilemma facing central European countries in the wake of the American action.

Exports from central and eastern Europe to the USA will not be adversely affected. Actually, they may yet increase. But steel imports to the region may explode. It is thus forced into protectionism by the hasty moves of other, much larger, market players.

Polish exporters are damaged by any European retaliatory move. Poland is the third largest steel exporter to the EU, after Russia and Turkey. The BBC reported that the Polish press quoted Polish experts in Brussels as:

"(Warning) that the EU protective measures (safeguard quotas and tariffs of up to 26 percent) may hit Polish exporters arguing that the import quotas will require exporters to implement swift and precise administrative procedures to win a chunk from the overall import pool which is to be distributed on a "first come, first serve" basis. They also warned that Polish steel exporters could be pushed out from the EU market by more aggressive rivals, such as South Korean steel concerns, that could offer more attractive commercial terms."

Poland is going through an agonized restructuring of its inefficient steel mills. The government actually pays these decrepit and rusty plants to phase out their production over a few years. EU competition policy officials have lodged vocal - and often petty - objections to the aid the Polish government plans to provide to the consolidating steel industry. Poland will submit a revamped plan to Brussels by April 20.

The US also spared other niche players, such as Slovenia. This tiny country's steel industry, geared to the needs of the now-defunct Yugoslav Federation, has dwindled from 15,000 workers to less than 4000 workers, according to the Financial Times. What's left of "Slovenske Zelazarne" will likely be privatized this year. Smaller steel mills have already been sold to Swedish and other European investors.

"Vecer", a Macedonian daily, estimated that the measures and countermeasures in the latest trade conflict will have no serious effect on Macedonian producers such as Makstil, and Balkanstil. The paper noted that the USA has exempted developing countries, members of the WTO, with less than 3 percent of the American market.

Countries like Macedonia and Poland may even see their exports to the US increase at the expense of larger fish. According to "Plus Biznesu", Poland, for instance, is allowed, under WTO regulations, to export up to 850,000 tons of steel products to the American market. It currently exports less than one eighth of this quantity.

"Vecer" expects Macedonia to negotiate a bilateral compromise with the USA. Macedonian exports to the EU are also sheltered under the Stabilization and Association Agreement signed last year. Most of Macedonia's $120 million in annual steel exports go to the EU.

Even Russian exports to the US will go largely untouched. No tariffs were imposed on the first 5.4 million tons of slab steel. Imports from Russia constitute one quarter of this tariff-free quota. Kasyanov, the Russian premier, went as far as supporting the American move. Quoted by Radio Free Europe/Radio Liberty, he said:

"One should not regard this [U.S. decision] as a step towards a trade war with anyone ... It is the right of any country. If there was a difficult situation with certain imports in the Russian Federation that would jeopardize a whole industry, I would not exclude the possibility of taking similar measures, in accordance with our laws ... Nevertheless, as I have already pointed out, the negative effect is evident."

The steel industry in central and eastern Europe is in dire straits. Over-capacity may have been exacerbated by massive investments enthusiastically promoted by multilateral financial institutions such as the EBRD.

The European Bank for Reconstruction and Development invested hundreds of millions of dollars since its inception in steel production from Kazakhstan to Macedonia. It awarded a $25 million revolving credit line to a privatized

Ukrainian mill. The ill-timed loan was intended to help the plant increase its exports and penetrate new markets.

Another $100 million were lent to Sidex, the recently privatized Romanian producer. These funds are intended to help it reduce emissions. Magnitogorsk Iron and Steel Works in Russia received $105 million. The investment in Kazakhstan is envisaged at c. $400 million. Similar investments were made in Hungary.

The result is a glut of production capacity in some categories - mainly long and flat steel, rolled aluminum, and semi-fabricated copper.

Other desperate steel mills throughout the region are being nationalized.

The Czech daily, "Mlada Fronta Dnes" reports that the Vitkovice Steel Company was sold to Osinek, a subsidiary of the National Property Fund (FNM). Osinek was preferred to the likes of US Steel, Shiran (from Israel), and Trinec Iron Works. The state vouched to privatize the mill - but only in a package with Nova Hut, another tottering steel plant in Ostrava.

In Poland, the Treasury Ministry - in cahoots with a consortium of five banks - had to bail out Huta Katowice. One third of the mill's debt was written off and the Polish state issued bonds to guarantee the rest. HK will now be consolidated with other crumbling steel assets to form a holding company, Polskie Huty Stali.

While the manufacturing side of the business is being vigorously privatized and modernized - mining, smelting, and fabrication are still technologically backward and state-owned. According to Adam Stobart in his presentation to the Adam Smith Conference in Vienna in August 2000 - the main problem is developing and capturing markets. Central and eastern Europe has become a net importer from Western Europe of many steel products.

The old sales strategies in captive domestic and east European markets no longer work. Competition from Western Europe and Asia is awesome. Consumers - including branches of multinationals - have become more sophisticated and demanding. Some manufacturers adapted - but the majority haven't.

Stobart enumerates the advantages of steel producers in central and eastern Europe: good location, low labour costs, skilled labour and "enthusiastic managers", growing domestic markets, customers that are keen to buy locally. Will these be translated into a dominant market share? Not if free trade is thwarted by blatant politicking and rampant protectionism.

Stock Exchange, Macedonian and Regional (Balkans)

The Macedonian Stock Exchange (MSE) is not operating successfully. True, some of the parameters which we use to measure the success of a stock exchange have lately improved in the MSE. For instance, the monthly money volume has increased together with the number of transactions. But this is a far cry from success.

Who is to blame? Is the current management of the MSE incompetent?

I do not think so. Actually, I think the MSE has an excellent management team, doing their best to incorporate new trading techniques and to list new firms. The problems lie elsewhere.

A stock exchange is a very important financial market. It is a highly efficient and visible instrument of financing. In the West, it is used to finance most of the needs of corporations, way above financing available from banks. Individuals and firms save some of their income and invest it. The stock exchange is meeting grounds for savers wishing to invest their savings - and firms looking for investments.

Another function of stock exchanges is to assist governments in financing their internal borrowing requirements. Governments sell obligations (called bonds) to investors through the stock exchanges in their countries. A stock exchange is, therefore, an indispensable tool for re-financing national debt.

But a few conditions must prevail before a stock exchange functions properly.

The most important condition is the existence of a healthy, growing economy in the stock exchange's country. Investors flock to robust economies and shy away from sickly ones.

On the face of it, the Macedonian economy belongs to the latter category. High unemployment, low savings, retarded growth, a gaping trade and payments deficits. But this is an optical illusion. The economy is in much better conditions that most Macedonians would care to admit. The unemployment figures are skewed. They reflect efforts to evade paying social taxes - not real unemployment. The economy is growing, even by official estimates. The black economy is growing even faster. The deficits are covered by enormous capital infusions from donor countries. Macedonia is receiving more international credits per capita than Russia. It is always convenient to blame the worsening economic climate - but the cold, objective figures do not bear this out.

When an economy is growing - the profits of companies (including those listed in the MSE) will grow with it. This makes the shares of these companies an interesting buy.

Since no one is buying - we must look for the problem elsewhere.

A prospering stock exchange is linked to the existence of the right micro and macro economic management. Macedonia has more than its share of problems in this respect.

The process of transformation of businesses with social capital had four basic flaws:

first, it introduced no new management, ideas or capital to the beleaguered firms which were "transformed". The market simply does not believe that they were transformed. The same people run the same shows under a different hat.

Second, such transformation violates the concept of Hierarchy, a chain of command.

It blurs the distinction between labour (workers) and capital (owners). What is wrong with that is that a ship must have a captain - and only one. Someone must have the authority and the responsibility. Collective management is no management at all.

Moreover, innovation change and revitalization are all prevented. What change could come from the same set of worn out managers? How can thousands of owners decide to worsen the conditions of the workforce - if owners and labourers are one and the same? So, management is polluted by irrelevant, non-economic considerations: power struggles amongst groups of workers, social considerations and political ones.

We identified one villain. The other one is high (real) interest rates. When interest rates are high, three effects prevent the resuscitation of the stock exchange:

First, firms have high financing expenses (interest payments) - which reduces their profits.

Second, it is not worthwhile to borrow money and to invest in shares.

Third, it is more tempting to invest money in bank deposits, yielding high interest rates - than in shares. High interest rates are the poison of stock exchanges.

The same is true for low savings rates. If people and firms do not save - there is no capital available for investment in stocks.

This, exactly, is the current situation in Macedonia : impossibly high interest rates coupled with exceedingly low savings. There is basic mistrust between clients and their banks. They prefer other ways of keeping their money.

But all the above is far from exhausting the list of pre-conditions for the proper functioning of a stock exchange.

Investors must have timely, accurate and full information about the firms that they invest in. This will allow them to respond in real time to developments in the company and to prevent losses. This will also make it difficult to cheat them - which is were we come to the question of accounting standards. Only lately have the accounting rules in Macedonia been revised to conform to the Western systems of accounting. Even now, the similarity is very slight. Macedonian firms maintain a double accounting system. One set of books is tax-driven. It is intended to show losses or profits at the whim of the management. An elaborate scheme of hidden reserves lies at the heart of the typical financial statements of the Macedonian firm. Another set of books - if they are kept at all - reflects reality. This is an enormous barrier to foreign investment - and foreign investors are the driving force in every modern stock exchange.

The trust of investors in the stock exchange is based on legislation to protect their property rights against the firm's management' against the authorities and against other investors who might wish to rig the market or manipulate the prices of stocks.

But legislation without an effective judicial and law enforcement systems is like a stock exchange without money. To enforce property rights in Macedonia takes ages and even then the outcome is not certain. Laws, regulations are in their embryonic stage and some of them seem to have had an abortion: they were hastily and unwisely copied verbatim from legal codices of other countries (Germany, Britain).

Last - but definitely not least - is the existence of a fair, transparent and non-corrupt marketplace. The stock exchange, the banks, the regulatory authorities, the police and the courts have to be above suspicion. For the market to be utterly efficient - it must be utterly free of any ulterior considerations and motives. Corruption distorts the market's allocative mechanisms and powers. It is easily discernible in dealings in the stock exchange for all to see. A stock exchange is, after all, the showcase of the local economy.

But there is a problem which towers above all other problems and it is almost endemic to Macedonia. It helps to explain much of the predicament of the stock exchange in Skopje. It is the fact that the market is missing its most important player: the Government.

Investors - both foreign and domestic - look for the Government to be active in the local stock exchange. Governments throughout the world use their stock exchanges to sell shares of state-owned enterprises to their populace. The stock exchange becomes a mechanism for the distribution of the national wealth - as embodied by the state owned enterprises - to all the citizens. As we said before, governments also use the stock exchange to borrow money from their citizens.

The Government of Macedonia does neither. It totally ignores the MSE. Not one company was privatized through the MSE. Not one Denar was borrowed from a Macedonian citizen through it. A government's activity in the stock exchange is proof that the government believes in it. Therefore, if it does not operate in the stock exchange - it proves that it does not believe in it. If the government does not believe in the stock exchange in its own country - why should the investors believe in it?

There are a few additional structural characteristics which are considered to be the hallmarks of a healthy stock exchange. But those are the by-products of all the above mentioned conditions.

A stock exchange must be liquid so that investors would be able to convert their shares into cash easily and expediently. It must include many investment options - professionally put, it must be diversified. This will allow the investors to choose from a variety of investments and also to reduce their risks by dividing their money among a few types of investments.

The management of the stock exchange can help it by introducing efficient trading techniques, computerized trading and settlement systems and so on. The faster investors meet their money when they sell their shares - the more they will be inclined to operate in the stock exchange that allows them that. The easier it is for them to liquidate their assets by meeting buyers - the more they will prefer to work in that stock exchange.

Investing in the stock exchanges in the markets of the emerging economies has been an unfortunate decision in the last three years. Stock exchanges from Russia to Hungary and from Lithuania to Poland have jeered wildly since the end of 1993.

They resembled a roller coaster in their performance, going up and down by tens of percents annually. There are exceptions to this rule. The Ljubljana Stock exchange, for instance. The trading volume there has gone up 10 times since December 1993 - and the market capitalization is up 30 times. But this is because of the performance of the general economy in Slovenia. In Croatia, the government is privatizing its holdings in state owned companies by auctioning shares to the public through the Zagreb Stock Exchange. This has helped it a lot.

Newly-established stock exchanges are highly volatile and very dangerous. Volatility goes hand in hand with risk. They are long term investments. Since 1988, they outperformed the more established stock exchanges in the world, like Wall Street.

But these stock exchanges are growing fast, they are cheap by any measure and they are the best investment that a country can make in its own future.

Overview of the Macedonian Stock Exchange - December 2007

The Macedonian Stock Exchange, as measured by its MBI-10 index, rose to a record high of close to 10,500 in mid-2007. It has since shed 40% of its gains. This correction, or, rather, rout has its roots is a series of converging factors.

The multiple failure of the financial system in the United States, brought on by the subprime mortgage crisis and its contagion, resulted in a dollar plunge and the ascendance of the euro. Investors fled the ailing American scene in search of higher and safer returns in the markets of emerging economies of commodities and oil producing countries.

This stampede coalesced with other trends to create a bubble of hyperliquidity. Financial technology made money transfers almost instantaneous, thus reducing the need for a non-productive and illiquid float. International trade expanded at a breakneck pace, shifting unprecedented amounts of wealth from consumers to producers and manufacturers. GDP growth throughout the world outstripped inflation, generating sizable surpluses. The global monetary environment swung from inflation to deflation leading to a precipitous decline in interest rates.

Inevitably, investors migrated from cash and bonds to assets such as real-estate and stocks, fostering in the process a series of bubbles, booms, and busts as volatile "hot money" pursued returns everywhere.

Moreover: in contradistinction to the recent past, diversification offered no refuge as financial markets merged and integrated with global, around the clock networks. To their dismay, investors found that, paradoxically, as markets became more efficient, they also become more correlated. This convergence was further enhanced by geopolitical and geo-economic processes, such as the enlargement of the European Union.

Macedonia could not remain aloof. As its informal economy emerged from the shadows, capital controls were lifted, capital mobility increased, and foreign firms and investors entered the scene. The more the business climate improved, the better Macedonia's prospects appeared, the higher Macedonian stocks were valued by an euphoric public. Macedonia's professionals did nothing to restrain the hysteria or to ameliorate the casino mentality that pervaded the entire system. They benefited personally from the bubble.

The newfound optimism of Macedonia led to a repricing of risk and to heightened expectations of corporate profits, boosted by a more lenient tax regime and by decreasing interest rates. Equity risk premium plummeted until it vanished altogether and even became negative. The P/E multiple reached a stratospheric 50 before the recent correction. It is still pegged at an unsustainable 37.

Throughout this Bacchanalia, foreigners flocked into the Macedonian Stock Exchange, constituting 30-40% of the buy side. But they have begun to withdraw owing to big privatizations back home, troubles in their domestic financial systems, a more restrictive monetary policy in some countries, and the changing fortunes of the Macedonian marketplace.

The down trend in the Macedonian Stock Exchange is not a mere correction. It is a repricing of assets. It still has a long way to go. Even at 4300 - the next massive technical support - Macedonian shares are inanely overvalued.

Interview with Alexandar Dimishkovski of BID Consulting

Conducted October 2007

The Balkans as a region is experiencing a confluence of events of both fundamental and technical nature that augur well, as far as its economies go. Accession to the huge and unified market of the European Union (and to

NATO) is closer and more realistic than ever. Two decades of transition from socialism and communism, privatization, institution-building, and private sector reform are finally bearing fruits. Emerging markets - and Europe - are more attractive than ever as investment destinations, now that the United States is caught in a vicious cyclical downturn which might result in a recession. These shifts in fortunes inevitably are reflected in the stellar performance of many Balkan stock exchanges and other asset markets, such as real estate.

But will the euphoria last? Is the exuberance irrational? Are we in the throes of a bubble about to burst?

Until recently and for four years, Aleksandar Dimishkovski worked as a business and finance correspondent in Macedonia's best-selling daily newspaper, "Dnevnik". In the past year, he also served as a personal advisor to the general manager of a foreign-owned company that has established its network in Macedonia. He is known as a market analyst and a business consultant and has recently founded "BID Consulting".

1. Why did the Macedonian Stock Exchange (MSE) skyrocket when other stock exchanges plummeted in the wake of the subprime mortgage crisis and,

similarly, why has it collapsed recently when Wall Street is setting new records?

AD: There are many reasons for this, starting with the size, the position, and the strength of the floated companies and down to the origin of the portfolio investors and the speed of the reaction to global trends.

The Macedonian Stock Exchange is a relatively young market and in its early phase of development. Though it has existed since 1996, it has just recently started to open its doors to foreign portfolio investments. It has been only a few years since the annual as well as the daily turnover on MSE started to be dictated mainly by foreign investors (especially investment funds), which could be cited as the sole reason for the incredible percentages of price hikes in the past few years.

Bearing in mind the fact that the speed of reaction even to internal factors and influences is still relatively low, global trends impact the MSE with a delay of between three to six months. For example: there were some instances when oil or steel prices grew rapidly, but the value of the shares of Macedonian companies, which work with the production or distribution of oil or steel has decreased!

Nevertheless, this started to change recently. If the period of delay in reaction to global trends was more than six months in 2006, now in some cases it is less than a month.

One other fundamental reason for the difference in trends between the MSE and the major Stock Exchanges like New York, Tokyo or London is the origin of its major investors. For instance, the majority of the foreign money invested in the MSE is of Balkan origin and does not constitute a diversified list of portfolio investors coming from all parts of the world. Therefore, the fluctuations in the investing of capital in the major Stock Exchanges or in its allocation from one market to another at this time don't affect the trends in the MSE, or at least not instantly, because the investors present at the Macedonian capital market are not present in the big Stock Exchanges such as Wall Street.

2. Are the stock exchanges in the Balkans correlated? Do they move and react to external shocks in unison?

AD: Yes, they are correlated in many ways, and not just by way of reacting to external shocks. Actually, if you look at the statistics, especially of the Stock Exchanges of the countries of former Yugoslavia, you can find similarities in almost all parts of the capital markets, from price growth, crisis management, and institutional establishment, to reactions to shocks.

It seems like every Stock Exchange in the Balkans is growing in a similar pattern. They all faced similar crises, obstacles to growth, lack of efficiency and especially lack of general knowledge regarding financial tradable instruments. In some cases, it even seemed like two stock exchanges faced an identical situation within just a few months, disregarding the phase of development they were in. In 2006, there was even a case of two stock exchanges from two different countries that have had almost identical annual index growth.

However, what determines the type of reaction and development is the palette of investors. Investors from Slovenia are present in Macedonia, Croatia, Serbia, Montenegro, Bosnia, etc. And the ones from Croatia are also present in Macedonia, Serbia, Slovenia…So these markets are all intertwined within the borders of the Balkans. Even in Slovenia and Croatia or Serbia, which may be seen as the most developed, the majority of investors hail from the neighborhood.

Because of all of these similarities, your suggestion in the question is correct. They do react and move in unison. And this is also one of the postulates for the initiative for the creation of one Balkan Stock Exchange, similar to the case of the Nordic countries and NORDEX. Because of these similarities and interconnections, the creation of one single stock exchange, in my opinion, would be beneficial to all parties involved. Unfortunately this process is developing very slowly.

3. How vulnerable are the stock exchanges in the region to insider trading? Is there a need for Sarbanes-Oxley types of laws?

AD: The transition process left many open wounds as far as legislation in the Balkans goes, especially in fields where there was no experience to draw on for the creation of laws. The Stock Exchange is a perfect example of this deficiency, likewise the protection of industrial property, the protection of copyrights etc. All these were emerging fields in the newly established democratic order. Though in many cases laws were translated and adapted to the needs of the market, relics of the communist regime can still be found, thus engendering an open space for manipulations like insider trading.

Attempts to deny the existence of insider trading are unquestionably present. But in practice, little has been done and can be done to protect shareholders from it. So, there is a definite need for Sarbanes-Oxley type of laws in almost all Balkan countries. Nevertheless, these laws can't be merely translations of the legal corpus of some Western Europe country. Experiences from abroad are welcome and helpful, but only as a basis on which to build.

In fact, to protect shareholders and investors from insider trading, first a new and up to date corporate law must be implemented. When even the smallest shareholders would know their rights and obligations concomitant with the corporate-responsibility type of organization, the efforts and the laws intended to prevent insider trading will take hold.

However, it must be noted that discernible progress in this field has already been made with the present legislation and strangely, by inertia, under the influence of foreigners. This progress must continue at a faster clip.

4. Some analysts say that foreign money makes the bulk of investments in the smaller, poorer stock exchanges in the region (Macedonia, for one). Is this your impression as well? Will this money dry up now that the world is in the throes of a global credit crunch? What will happen if sentiment changes and the foreigners leave?

AD: It seems that the fact that the world is in the throes of a global credit crunch doesn't influence investor decisions in the Balkans. In fact, in Macedonia for instance, the tremendous growth in share prices in the past two years contributed to an increase in the demand for credit. People started to borrow money in order to invest in the Stock Exchange, expecting a quick return on their investments and "fat" profits. Nevertheless, the lottery type of investment didn't have sufficient influence to noticeably tilt the capital markets.

Bearing in mind the fact that the majority of foreign investors in the smaller stock exchanges, like the one in Macedonia, are regional, of Balkan origin, I can't say that foreign investments will decrease. On the contrary, the official statistical data, released by the MSE, show a constant increase in the presence of foreign money in the market, especially on the buying side.

At this point, foreign portfolio investors contribute as much as half of the buying side, and 30 percent of the overall turnover. I think that this is only the beginning of the "bulk of investments" as you say. With the MBI-10 (the MSE's index- SV) growing by more than 100 percent in 2006, the Macedonian Stock Exchange caught the eyes of even more distant investors who started to invest in this market.

Will this trend continue? If there is no major crisis – political or economic - in the region, it is not too optimistic to expect that it will. However, if the money inflow from foreign investors starts to decrease, it will be a major step back for the capital market. The influence and the financial clout of foreign investors can't be easily substituted for by an increase in domestic demand. It can even be the sole reason for a total collapse of some of the smaller stock exchanges in the region.

5. Can you tell us a bit about the recent financial innovations in the region: mutual and investment funds, short selling, options?

AD: Except for investment funds, which were accepted with open arms, it seems like these markets are very heavy and slow as far as the introduction of new financial instruments or innovations goes. This could be easily verified by having a look at the gamut of tradable securities in almost all the countries in the region.

The typical capital market comprises state bonds and corporate stocks. In Macedonia for instance, the Securities Law actually allows for the issuance of corporate bonds and even for financial instruments such as short selling and options. But, because of the low level of general knowledge as well as the phase of development of the market, these instruments are not in place. Nobody is even willing to ask, or to do something to expand the range of tradable securities, which may be the most frightening thing. This leaves serious portfolio investors with very little flexibility and it may be the principal determinant of how these markets will develop in the mid term, and especially in the long term.

On the other hand, the paucity of the sell side is one of the reasons for the increases on the bid side and, consequently, in the prices and value of the floated shares. The value of the shares of some companies skyrocketed by more than 2000 percent in the second half of 2006 and in the first half of 2007.

However, the massive growth in the inflow of money will eventually stop mainly because of the insufficient number and type of securities on offer.

6. What is the role of bonds - both government and corporate - in the capital markets in the region? Are there any municipal bonds issued and traded?

AD: State bonds are of interest to investors in Macedonia's neighborhood mainly because they represent a safe investment or even more so a type of savings. The banking system in this area faced huge risks on many occasions and interest rates are still prohibitively high for debtors and low for savers. This exerted an upward pressure on the interest rates payable on government issued bonds: they offer a stable source of interest income which in most cases is higher than the interest rates offered by the banks on savings by at least 30 percent annually.

As for corporate bonds - hmmm... Now, this is one of the issues that I have mentioned earlier. In Macedonia, these type of bonds are not yet developed, nor are municipal bonds. Although, there are some announcements that a few firms will issue bonds, there still are none extant. It seems that they tend to prefer the issuance of shares as a source of financing. Still, even shares are not issued too often.

Bonds in general aren't that interesting when the prices of shares grow exponentially. Even investors with no professional knowledge at all are more willing to risk and to invest in shares than to expect safe and stable returns from an investment in bonds. When these capital markets will mature, price growth will level off and I guess that then investing in bonds will become more interesting.

7. How would you rate the performance of the Securities and Exchange Commissions in the region? Are the courts able to tackle securities fraud and complex financial transactions and instruments?

AD: With the lack of general knowledge ruling this part of the world, to expect the Securities and Exchange Commissions, or the courts to ably perform in cases involving very complex financial scams or illegal activities is exaggerated. While the SECs do have some influence and they do take some basic actions to prevent illegal activities such as insider trading, the courts aren't sufficiently prepared to handle these kinds of cases.

However, reforms in the judicial system yielded some results even in the first phases of their implementation. Now, these types of frauds and criminal activities are taken much more seriously and the whole attitude is changed, not just by the courts, but in general, by all other relevant institutions. Big progress has been accomplished even with the adjustment of domestic laws to European Union code.

However, if I have to rate the performance of the SECs and the courts in the region, I would have to say that they are "trailing behind" the actual market players, both from an organizational as well as from a technical point of view. With insufficient human resources, lack of finance and deficient inter-institutional cooperation, the SECs and the courts are not as efficient as they should be, especially in these early phases of development of the capital markets, when big changes in a company's shareholders list can be done in a minute.

Stock Options

Aligning the interests of management and shareholders in the West by issuing stock options to the former - has failed miserably. Options are frequently re-priced in line with the decline in share prices, thus denuding them of their main incentive. In other cases, fast eroding stock options motivated managers to manipulate the price of the underlying stock through various illegal and borderline practices. Stock options now constitute c. 60 percent of the pay of Fortune 500 executives.

Whitney Tilson of Tilson Capital Partners notes in "The Motley Fool" that the hidden dilution of corporate equity caused by stock options inflates the stated profit per share. In the USA, stock options are not treated as a business expense. Payment of the strike price by employees exercising their options augments cash flow from financing activities. Companies also get to deduct from their taxable income the difference between the strike price of the options and the market price of the stocks. As a result, overall earnings figures are exaggerated, sometimes grossly.

"The Economist" quotes studies by Bear Stearns, the Federal Reserve, and independent economists, such as the British anti-stock-options crusader, Andrew Smith.

These show that earnings per share may have been inflated by as much as 9 percent in 2000, that options amounted to c. 20 percent of the profits of big American firms (and three quarters of the profits of dot.coms), and that the distorted tax treatment of options overstated earnings growth by 2.5 percent annually between 1995 and 2000.

The Federal Reserve concludes:

"... There is presently no theoretical or empirical consensus on how stock options affect ... firm performance."

Towers Perrin, a leading global management consultancy, spot a trend.

"(There is) a move by employees towards placing greater emphasis on long-term incentive plans ... (This is) creating new international currencies in remuneration ... (There is) a rapid, worldwide growth in stock option plans ... Regardless of the type of company, stock options are much more widely used than performance plans, restricted stock plans, and other long-term incentive (LTI) programs in most countries."

Stock options are now used not only to reward employees - but also as retention tools, building up long term loyalty of employees to their workplace. Multinationals the world over, in an effort to counter competitive pressures exerted by their US adversaries in the global labour market, have resorted to employee stock options plans (ESOP).

Vesting periods and grant terms as well as the events which affect the conditions of ESOPs - in short, the exact structure and design of each plan - are usually determined by local laws and regulations as well as by the prevailing tax regime. As opposed to popular mythology, in almost all countries, options are granted at market price (i.e., fair market value) and subject to certain performance criteria ("hurdles").

Eligibility is mostly automatic and determined either by the employee's position or by his reporting level within the organization. Management in most countries was recently stripped of its discretionary powers to allocate options to employees - the inevitable outcome of widespread abuses.

Ed Burmeister of Baker McKenzie delineates two interlocking trends in the bulletin "Global Labour, Employment, and Employee Benefits":

"Two common trends are the broad-based, worldwide option grant, such as recently implemented at such companies as PepsiCo, Bristol-Myers, Squibb, Merck, and Eli Lilly & Company, and the extension of more traditional executive stock plans or rank-and-file, payroll-based stock purchase plans to employees of overseas subsidiaries. Employers are also beginning to implement stock-based incentive plans through use of offshore trusts.

These trends have led to increased scrutiny of equity-based compensation by overseas taxing and regulatory bodies. Certain trends, such as the relaxation of exchange and currency controls in Europe and South America, have favored the extension of U.S.-based equity compensation plans to overseas employees."

Granting stock options is only one of the ways to motivate an employee. Some companies award their workers with stocks, rather than options, a practice known as "non-restrictive stock bonus". Others dispense "phantom stocks" or "simulated equity plans" - using units of measurement and accounting whose value corresponds to the price fluctuations of a given number of shares. Yet others allow their employees to purchase company shares at a discount (section 423 stock purchase plans).

David Binns, Associate Director of the Foundation for Enterprise Development describes novel solutions to the intricate problem of customizing a global stock options and equity plan:

"Often the companies provide international staff with a 24-hour loan facility whereby they can direct a designated stock broker in the U.S. to give them a loan sufficient to exercise their options. The broker then immediately sells enough shares to pay off the loan and transaction fees and deposits the remaining shares in the employee's account."

"Another approach to international equity plans is to create an 'International ESOP' in a tax-free haven. Each of the company's international subsidiaries are given an account within the trust and each participating employee has an individual account with the appropriate subsidiary. The subsidiary corporations then either purchase shares of the parent corporation based on profitability or receive grants of stock from the parent and those shares are allocated to the accounts of the participating employees.

The shares are held in a trust for the employees; at termination of service, the ESOP trustee sells the employee's shares and makes a distribution of the proceeds to the employee. This has the advantage of alleviating securities registration concerns in most countries as well as avoiding certain country regulations associated with the ownership of shares in foreign corporations."

As far back as 1997, virtually all American, Canadian, and British companies offered one kind of LTI plan, or another. According to the Foundation for Enterprise Development, employees own significant blocks of shares - aggregately valued at more than $300-400 billion - in more than 15,000 American corporations. This amounts to 5-7 percent of the market capitalization of American firms. The process was facilitated by the confluence of divestiture, corporate downsizing, and privatization of state and federal assets.

Dramatic increases have occurred elsewhere as well. In Argentina - 40 percent of all firms offered LTI last year (compared to 20 percent in 1997). In Belgium, the swing was even more impressive - from 25 percent to 75 percent.

Hong Kong went from 25 percent to 50 percent. China - from 5 percent to 45 percent. Germany tripled from 20 to 60 percent. Italy jumped from 20 to half of all companies. Spain galloped from 5 to 50 percent. Even staid Switzerland went from 20 percent of all firms offering LTI - to 60 percent.

Stock options are gaining in popularity in central Europe as well. More than 10 percent of the employees of S&T, a

Vienna-based IT solutions provider, owned stock options by the end of 2000. The company operates mainly in Slovenia, Slovakia, and the Czech Republic - but is fast expanding in a host of other countries, including Bulgaria and Russia.

"Internet Securities" - a publisher of emerging market news and information based in Bratislava, Bucharest, Budapest, Prague, Sofia, and Warsaw- also rewards its employees with stock options. The list is long and is getting longer by the day.

Watson Wyatt, a human resources consultancy, conducted a detailed survey among firms in CEE (central and east Europe) in 1999. It traced the introduction of non-wage employee benefits to the fierce competition for scarce human capital among multinationals at the beginning of the 1990's. Later, as qualified and skilled personnel became more abundant, employers faced the need to retain them.

Perks such as cars, death and disability insurance, medical benefits, training, and relocation and housing loans have become the norm in the leading EU candidates - Poland, Hungary, Czech Republic, the Baltic States, and Slovenia. Such habits are spreading even as far as Kazakhstan, where most workers enjoy supplementary medical benefits. But progress is by no means uniform. In some countries, such as Croatia, supplemental coverage extends to less than one quarter of the work force.

LTI programs are offered mainly by IT and telecom companies - 63 percent of the 25 surveyed by Watson Wyatt had an ESOP in place. But, as opposed to the practice in the West, few, if any, firms in CEE limit eligibility to the upper hierarchy. Still, management enjoys more sizable benefits that non-executive employees.

Watson Wyatt note that offering enhanced retirement benefits is fast becoming a major attraction and retention technique. Where state provision of pensions is insecure or dwindling - Russia, Bulgaria, Hungary, Slovenia - close to 20 percent of all workers had supplementary retirement funds provided by their employers in 1999.

Their ranks have been since joined by other pension-reforming countries, such as Croatia and Romania. Where pension reform has stalled - e.g., Lithuania and the Czech Republic - less than 1 percent of all workers enjoyed employer retirement largesse in 1999.

There is a convergence between East and West. Privatization in post-communist CEE countries often took the form of management and employee buyouts (MEBO). Employees ended up with small stakes in their firms, now owned by the managers. This model proved popular in countries as diverse as Croatia, Macedonia, Poland, Romania, Slovakia, and Slovenia.

In Poland, more than 1000 small and medium enterprises were privatized by "liquidation" - a management cum employee lease-buyout. Leveraged ESOP's - employees purchasing company shares over many years and on credit - played a part in at least 150 major Hungarian privatization deals.

Russia has become the country with the largest employee-ownership in the world. More than two thirds of the 12,000 medium and big Russian enterprises privatized after 1992 are majority owned by employees. But MEBO also characterized privatizations in France, the UK, Nigeria, Sri Lanka, Chile, Argentina, Pakistan, and Egypt, among many others.

More than 4 percent of all Dutch firms - c. 2000 in all - are partly employee-owned. More than 12,000 French companies sold $10 billion in shares to their employees - an average of $1000 per employee. Profit sharing schemes in firms with less than 50 employees are compulsory in France. More than a quarter of the workforce - some 5 million people - are covered by 16,000 such schemes. Ten thousand other, voluntary, plans cover 2.5 million workers.

Sixty percent of all MEBO's in the former East Germany relied on public financing. The government of British Columbia in Canada is equally involved through its "Employee Share Ownership Program". Chile provided employees with subsidized loans to purchase shares in privatized firms in what was dubbed "labour capitalism". Egypt encouraged the establishment of almost 150 Employee Shareholder Associations.

Initially, MEBO resulted in gross inefficiencies as the new owners looted their own firms and maintained an insupportably high level of employment. The newly private firms suffered from under-investment and poor management. Shoddy, unwanted, products and deficient marketing led to poor sales, massive layoffs, and labour conflicts. Employees were quick to turn around and sell their privatization vouchers or shares to their managers, to speculators, or to foreign investors.

Yet, as foreign capital replaced corrupt or inapt indigenous managers and as workers became more sophisticated and less amenable to manipulation - employee ownership began to bear fruit. China has learned the lesson and has introduced a gradual transition to employee ("social") ownership of enterprises at the grassroots, local community, level. It also strives to emulate Japan's extensive and successful experience since the early 1960's.

Employee ownership is evolving in ways the fathers of socialism would have approved of. Employees throughout Asia, Africa, and Latin America - egged on by the likes of the World Bank and regional development institutions - now form numerous collectives and labour or producer cooperatives. Some firms are even owned by trade unions through their proactive pension funds.

Jacquelyn Yates describes a typical cooperative in her essay "National Practices in Employee Ownership":

"... The employees own their firms. Typically, prospective members work for a probationary period, must apply to join the cooperative and are screened by a membership committee. Labor cooperatives vary in the percentage of their employees who are members. A common guideline is to take no more members than the cooperative can guarantee to employ on a full-time basis. Members make a capital contribution in kind or in cash, sometimes through payroll withholdings. This is the member's account value, which will be refunded (with or without interest), at the time of separation from the enterprise.

Governance is usually based on one vote for each member, and the elected directors of the enterprise set overall policy and hire top management. The main benefits of membership are job security, participation in the distribution of profits, and above average social benefits. Sometimes membership means participation in enterprise losses or making additional contributions to the reserve. In some countries, the assets of the cooperative can never be distributed to its members, preventing them from realizing long-term appreciation in the cooperative's value, but creating an incentive to continue it over many years."

Yates reviews other practices, such as the labour banks and the workingmen's funds. The former are financial institutions that invest in the shares of companies that employ their depositors. Workingmen's funds are collectively owned portfolios of the employer's stock owned by employees and they were first tried in Sweden. Similarly, the UK and Ireland have legalized the employee stock ownership trust.

Employee ownership of firms is a controversial issue with strange bedfellows on both sides of the raging debate. Thus, the idea has been fiercely resisted in the past by both employers and unions. There is no social consensus regarding the voting rights of stocks owned by employees, their voluntary or compulsory nature, their tax treatment, their relationship to retirement accounts, the desired length of holding period, the role of the unions and the state, employee representation on the board of directors and so on.

It is ironic, though, that the ostensible triumph of capitalism resulted in the resurgence of employee-ownership of the means of production. It seems that to preserve industrial peace as well as to motivate one's workers - sharing of ownership and its attendant pecuniary benefits is called for, on a scale which far exceeds anything dreamt of in socialist countries.

There is an inherent conflict between owners and managers of companies. The former want, for instance, to minimize costs - the latter to draw huge salaries as long as they are in power.

In publicly traded companies, the former wish to maximize the value of the stocks (short term), the latter might have a longer term view of things. In the USA, shareholders place emphasis on the appreciation of the stocks (the result of quarterly and annual profit figures). This leaves little room for technological innovation, investment in research and development and in infrastructure. The theory is that workers who also own stocks avoid these cancerous conflicts which, at times, bring companies to ruin and, in many cases, dilapidate them financially and technologically. Whether reality lives up to theory, is an altogether different question.

A stock option is the right to purchase (or sell - but this is not applicable in our case) a stock at a specified price (=strike price) on or before a given date. Stock options are either not traded (in the case of private firms) or traded in a stock exchange (in the case of public firms whose shares are also traded in a stock exchange).

Stock options have many uses: they are popular investments and speculative vehicles in many markets in the West, they are a way to hedge (to insure) stock positions (in the case of put options which allow you to sell your stocks at a pre-fixed price). With very minor investment and very little risk (one can lose only the money invested in buying the option) - huge profits can be realized.

Creative owners and shareholders began to use stock options to provide their workers with an incentive to work for the company and only for the company. Normally such perks were reserved to senior management, thought indispensable. Later, as companies realized that their main asset was their employees, all employees began to enjoy similar opportunities. Under an incentive stock option scheme, an employee is given by the company (as part of his compensation package) an option to purchase its shares at a certain price (at or below market price at the time that the option was granted) for a given number of years. Profits derived from such options now constitute the main part of the compensation of the top managers of the Fortune 500 in the USA and the habit is catching on even with more conservative Europe.

A Stock Option Plan is an organized program for employees of a corporation allowing them to buy its shares. Sometimes the employer gives the employees subsidized loans to enable them to invest in the shares or even matches their purchases: for every share bought by an employee, the employer awards him with another one, free of charge. In many companies, employees are offered the opportunity to buy the shares of the company at a discount (which translates to an immediate paper profit).

Dividends that the workers receive on the shares that they hold can be reinvested by them in additional shares of the firm (some firms do it for them automatically and without or with reduced brokerage commissions). Many companies have wage "set-aside" programs: employees regularly use a part of their wages to purchase the shares of the company at the market prices at the time of purchase. Another well known structure is the Employee Stock Ownership Plan (ESOP) whereby employees regularly accumulate shares and may ultimately assume control of the company.

Let us study in depth a few of these schemes:

It all began with Ronald Reagan. His administration passed in Congress the Economic Recovery Tax Act (ERTA - 1981) under which certain kinds of stock options ("qualifying options") were declared tax-free at the date that they were granted and at the date that they were exercised. Profits on shares sold after being held for at least two years from the date that they were granted or one year from the date that they were transferred to an employee were subjected to preferential (lower rate) capital gains tax. A new class of stock options was thus invented: the "Qualifying Stock Option". Such an option was legally regarded as a privilege granted to an employee of the company that allowed him to purchase, for a special price, shares of its capital stock (subject to conditions of the Internal Revenue - the American income tax - code). To qualify, the option plan must be approved by the shareholders, the options must not be transferable (i.e., cannot be sold in the stock exchange or privately - at least for a certain period of time).

Additional conditions: the exercise price must not be less than the market price of the shares at the time that the options were issued and that the employee who receives the stock options (the grantee) may not own stock representing more than 10% of the company's voting power unless the option price equals 110% of the market price and the option is not exercisable for more than five years following its grant. No income tax is payable by the employee either at the time of the grant or at the time that he converts the option to shares (which he can sell at the stock exchange at a profit) - the exercise period. If the market price falls below the option price, another option, with a lower exercise price can be issued. There is a 100,000 USD per employee limit on the value of the stock covered by options that can be exercised in any one calendar year.

This law - designed to encourage closer bondage between workers and their workplaces and to boost stock ownership - led to the creation of Employee Stock Ownership Plans (ESOPs). These are programs which encourage employees to purchase stock in their company. Employees may participate in the management of the company. In certain cases - for instance, when the company needs rescuing - they can even take control (without losing their rights). Employees may offer wage concessions or other work rules related concessions in return for ownership privileges - but only if the company is otherwise liable to close down ("marginal facility").

How much of its stock should a company offer to its workers and in which manner?

There are no rules (except that ownership and control need not be transferred). A few of the methods:

1. The company offers packages of different sizes, comprising shares and options and the employees bid for them in open tender.

2. The company sells its shares to the employees on an equal basis (all the members of the senior

management, for instance, have the right to buy the same number of shares) - and the workers are then allowed to trade the shares between them.

3. The company could give one or more of the current shareholders the right to offer his shares to the employees or to a specific group of them.

The money generated by the conversion of the stock options (when an employee exercises his right and buys shares) usually goes to the company. The company sets aside in its books a number of shares sufficient to meet the demand which may be generated by the conversion of all outstanding stock options. If necessary, the company issues new shares to meet such a demand. Rarely, the stock options are converted into shares already held by other shareholders.

Switzerland, Economy of

In a series of referenda in 2003-5, Swiss citizens transformed their country forever, economically aligning it with the European Union and opening it up to work migration. It was an uncharacteristic response to increasingly worrisome times.

In March 2003, Switzerland's annual rate of inflation dipped to 1.3 percent. Once a cause for celebration, it is now construed to be a worrisome sign of lurking deflation. Growth has been below trend for years now. Demand is ever-weakening and capacity is idle. Taxes are high, the national debt soaring.

Interest rates are vanishingly low, having been chopped by half a percentage point in March 2003. But the Swiss franc, impervious to these monetary gambits, is at a five year high against the dollar. Switzerland depends on exports and tourism - they constitute more than half its gross domestic product. The almighty currency does its trade balance no favors.

National economic emblems are crumbling left, right and center. In an interview to the daily Blick, Andre Dose, chief of Swiss International Air Lines, the tottering successor of the bankrupt Swissair, begged for tax exemptions, lower insurance premiums and a waiver of airport charges as well as soft loans and subsidies from both government and banks. The airline lost more than $700 million in 2002.

A study recently released by Agrarplattform – a group representing farmers, processors and retailers – disabused the Swiss of their long held conviction that their cherished agricultural sector - notably milk, potatoes and meat - is profitable. Indigenous armaments technology firms - such as the state-owned Ruag group - besieged by anti-war protesters, saw their profits slashed.

In 2002-5, Switzerland's leading brand names - Roche (pharmaceuticals), Credit Suisse (banking), Adecco (manpower) and Zurich Financial Services - have announced record losses and job cuts.

And then there is Severe Acute Respiratory Syndrome (SARS) and avian (bird) flu. Switzerland has been struck with ten suspected cases of the former. It tightened inspections at its airports, cancelled flights and allocated funds for research into the new pandemic. Swiss pharmaceutical company, Roche, produced a diagnostic kit by end-2003.

No sector is spared the slump. Swiss banks, much-decried over the last few years for their alleged complicity in money laundering, are being pried open by assertive United States regulators and a zealous, mainly European, Financial Action Task Force.

In 2002, Swiss banks begun to repatriate to Nigeria more than $670 million looted by late dictator Sani Abacha and deposited with them. In the run-up to the war in Iraq, the government froze $368 million in Iraqi financial assets at Washington's behest, repeating its act in 1990.

Mobsters, terrorists, scammers, venal politicians and tax dodgers now look for anonymity and discretion to Lebanon and Cyprus, or even to Austria, the USA, the United Kingdom and Luxemburg . Switzerland's reputation as a safe pecuniary haven is in tatters.

This was only the latest in a series of upsets suffered by the ailing banking industry.

In August 1998, following intensive public pressure by Jewish organizations - and a thinly-disguised anti-Semitic backlash -Switzerland's two major banks, UBS and Credit Suisse, agreed to set up a $1.25 billion fund to settle claims by holocaust survivors and their relatives. The red-faced Swiss government threw in $210 million. It seems that the banks were in no hurry to find the heirs to the murdered Jewish owners of dormant accounts with billions of dollars in them.

A settlement was reached only when legal action was threatened against the Swiss National Bank and both public opinion and lawmakers in the USA turned against Switzerland. It covers owners of dormant accounts, slave laborers, and 24,000 of 110,000 refugees turned back to certain death at the Swiss border - or their heirs.

A high level international commission, headed by Paul Volcker, a former chairman of the Federal Reserve Board, identified 54,000 accounts opened by holocaust victims - not before it inspected 350,000 accounts at an outlandish cost, borne by the infuriated banks, of $400 million. To compound matters further, the Bergier Commission, set up in 1996 by the Swiss parliament, revealed, in March 2002, that Swiss banks provided the Axis powers with interest free loans.

Wall Street dealt Swiss financial intermediaries and their US-based brokerages, another blow. Recently, they settled with US regulators over charges of issuing biased stock analyses and recommendations. But this did not prevent former star investment banker with Credit Suisse First Boston, Frank Quattrone, from being charged with obstructing justice and destruction of evidence. Many mid-size and large Swiss firms are exiting the tainted capital markets altogether.

In April 2003, according to Swissinfo, the news Web site of Swiss Radio, Jean-Pierre Roth, chairman of the Swiss National Bank (SNB), warned, in its annual meeting, against undue optimism. Deteriorating trading conditions, stagnant consumption and diminished government spending heighten the "risks of a renewed worsening of the situation ... Compared to the previous year, conditions for our companies have worsened."

The country is still hobbled by red tape and anti-competitive cartels. Growth in 2003 was lower than the Bank predicted only five months ago, he admitted. The

Organization for Economic Cooperation and Development (OECD) concurs. In its outlook, it warned that subdued conditions abroad and an inexorably appreciating franc continue to threaten the country's recovery.

GDP grew by an imperceptible 0.6 percent in 2003 and 1.9 percent in 2004. The International Monetary Fund (IMF), more upbeat, projected a 0.3 percent uptick in 2003 and 2.4 percent the year after. In 2002 the economy froze at zero growth. Unemployment stood at an unprecedented 3.9 percent in February 2003.

Not all is bleak, though. German chipmaker, Infineon, is considering to relocate to Switzerland. In April 2003, San-Diego based Netrom's Tempest Asset Management inaugurated a currency trading center in Zurich "to gain access to the multi-trillion dollar financial markets in Europe". Swiss firms, from gourmet baker Hiestand to computer peripherals manufacturer, Logitech, are showing record sales and surging profits.

The UBS Index of Investor Optimism, maintained by Swiss mammoth bank, UBS and the Gallup Organization, climbed 61 points in March 2003 - albeit to reach only one third its size in January 2000. Half the population foresee a recovering economy and two fifths believe in improving employment prospects.

Moreover, globalization has coerced Switzerland into abandoning its splendid - and costly - isolation. In March 2002 it voted to join the United Nations - something it has resisted for decades. Swisspeaks, a two month festival promoting Switzerland, took place in April 2003 in New-York.

Ten million visitors attended Expo.02 - a national exhibition in Neuchatel. Seven agreements with the European Union came into force in June 2003. Incredibly, Switzerland is poised to join the Schengen agreement, leading to the scrapping of internal borders with the EU. Banking secrecy will be partially lifted in line with Union directives.

With 7 million inhabitants (one fifth of which are immigrants) - Switzerland is among the richest polities on Earth. Income per capita is more than $38,000. The economy's openness - its weakness - is also its fount of strength. It endows Switzerland with enviable resilience and flexibility.

The country survived intact the first and second world wars, fought on its doorstep. It has reinvented itself, metamorphosing in the process from a backward rustic landlocked domain to a financial cum engineering global empire. It will emerge, as it always does, invigorated and ready for new challenges.

Syria, Economy of

Well into the 1980's, Syria - which could have been the Switzerland of the Middle East - was derided as its North Korea. Belligerent, steeped in paranoia and xenophobia, and socialist to boot - it revolved around the personality cult of the current president's late father, Hafiz al-Assad.

The Western media reported how Syria colonized Lebanon, suppressed the Sunni majority at home, and aided and abetted unsavory terrorist organizations inside the region and without. It is still on the USA's black list, though not a member of the tripartite "axis of evil".

These perceptions are gradually changing. Under the leadership of the soft-spoken, 40 years old ophthalmologist, Bashar al-Assad, Syria seems to be bent on re-joining the international community. In his inaugural address, Bashar encouraged "positive criticism" of the regime, suppressed a nascent personality cult centered around him, and called for economic liberalization.

On March 29, 2002 the Syrian parliament rubber-stamped a law, tabled by the Ministry of Economy and Foreign Trade. According to Sana, the state news agency, the act established a Monetary and Credit Council. But its most daring departure from past practices was to allow banking joint ventures between the government and the private sector.

Applying firms must still be at least 51% owned by Syrians. A January 2002 cabinet decision to allow foreign owned banks to operate in Syria still awaits the habitually-glacial presidential approval.

This ends four decades of ruinous government monopoly, the result of a nationalization campaign by the triumphant Ba'ath party in 1963. Deputy Prime Minister for Economic Affairs, Khaled Ra'ad, said that some 50 foreign banks are interested to set up shop in Syria. This may be an exaggerated figure. One hundred applications were reported following a late 2000 law opening the door to private investment in the banking sector - yet not a single license was issued in the first three years of its implementation.

Foreign, tax-exempt, banks have been allowed to operate in Syria's five free zones since June 2000. But the conditions were so onerous that not many did. Only "first rank" banks with $11 million in capital - in foreign exchange - were supposed to be let in. They were permitted to transfer and receive foreign exchange, usually on behalf of foreign clients. Yet, even these mundane operations were hobbled by a mountain of restrictions and regulations.

A year later, the free zones became nests of money laundering. Six (now five) obscure Lebanese banks provided services to less than 300 clients. Few others followed. The Oxford Business Group quotes a senior Lebanese banker:

"...The CEO of Lebanon's Byblos Bank, Francois Bassil, which is one of the five Lebanese banks established in Syria's free trade zones, told a London-based newspaper that the banks saw almost no activity. He cited problems in Syria's economic and financial environment, as well as the lack of a financial reform law. In a positive step, Syrian media reported in mid-February that one of France's largest commercial banks, Societe Generale was looking to set a up a network in Syria through the bank in France and its Lebanese affiliate, Societe Generale de Banque au Liban.

Despite this disheartening prelude, Syria has no choice but to liberalize its moribund and ossified banking sector. In recognition of this inevitability, Bashar al-Assad, the current president, has shuffled most of the economic positions in his cabinet on December 2001.

He surrounded himself with reformers, some of them Western-educated, as he is. Four of them are members of his "Syrian Computer Society", a hotbed of reform. A notable appointment is Ghassan al-Rifai, the Minister of Economy and Foreign Trade, who spent 30 years with the World Bank. Among his many achievements, he was an active member of the team that launched MIGA - the Bank's Multilateral Investment Guarantee Agency.

This " palace coup" did not go down well with old, Ba'athist, hands and with entrenched economic interests - some of them criminal - in both Syria and Lebanon. Resentment and dejection are mounting and may yet lead to open confrontation. To placate them, the Syrian government has decided not to pursue the privatization of state companies and their numerous sinecures.

Xenophobia and sentiments against liberalization and deregulation are not limited to Ba'athist interest groups. In "Emerging Syria 2002", published by the Oxford Business Group, IFC Senior Investment Officer, Bassel Hamwi is quoted as saying:

"While on a business trip to Syria in 1998 in the wake of the far eastern economic collapse, a Syrian official boasted to me that the Asian Tigers had become vegetarian. Surprisingly, the same antagonism towards liberalization was echoed by many of the private sector businessmen I met as well.

Up to that point, Syrians had chosen to insulate themselves not only from the risks inherent in the global economy, but also from its potential rewards. Two years later, however, it was a very different picture with the government making a concerted effort to open up to the financial world by allowing private banks to be established for the first time in some 40 years. The international community quickly took notice, and considered Damascus' efforts as a welcome signal that further liberalization was ahead.

The local community, however, was more divided. Indeed, Syrian businessmen were happy at the prospects of not having to travel abroad to service their banking needs. But one question that seemed to be on the minds of many was: 'Would liberalization bring about a financial crisis similar to that experienced in East Asia?'"

Syria's tottering economy can be salvaged only by the introduction of a functioning, competitive, well-capitalized, and foreign-managed banks. The EU made this abundantly clear to President al-Assad in his talks about an EU association agreement in March 2002 with Pascal Lamy, the EU's trade commissioner. The same message was trumpeted by an EIB (European Investment Bank) visiting delegation.

Close to 60% of Syria's exports - c. $1.5 billion - are received by the EU. Syria also imported $2.9 billion from the EU last year.

The Heritage Foundation Index of Economic Freedom ranked Syrian banks as 5 - very high level of restrictions. It expounded thus:

"The banking system is completely controlled by the government, which owns all of the country's major banks, and most banks lend only to the public sector. According to the Economist Intelligence Unit, "Syria's financial services are poor, unsophisticated and a serious obstacle to economic development.

There are five banks working alongside the Central Bank of Syria, all of them state-run and state-owned... CBS (Syrian Central Bank) discount rates to the private sector have been fixed at 9% since 1981 (7% for the public sector) irrespective of the rate of inflation. As a result, real interest rates have often been negative in times of high inflation."

Though state-owned, Syrian banks are woefully under-capitalized. The only retail network in the country, the "Commercial Bank of Syria" had less than $25 million in foreign currency reserves in 2000, according to government figures. There are $9 billion on deposit in state banks.

The Central Bank of Syria supervises the Commercial Bank of Syria, Industrial Bank, Agricultural Cooperative Bank, Loan and Savings Bank, Real Estate Bank, the General Syrian Insurance Agency and the General Postal Savings Establishment. These provide the entire range of banking services - but in a cumbersome, costly, and maddeningly inefficient manner.

The banks are subject to intense political meddling. Interest rates are purposefully negative. Public and mixed-sector enterprises crowd out private sector lending. Additionally, Syria has no capital or foreign exchange financial markets to speak of. Surprisingly, non-residents often fare better than locals: they can obtain (Syrian currency) loans based on bank guarantees.

Laws and regulations are often contradictory. Law number 24 prohibits Syrians from holding foreign exchange. Law number 10 permits Syrian investors to deal in foreign currency. This is merely one of a myriad examples.

Corruption is rife. In a typical case, the general director of "Commercial Bank", Nadim Mithqal, was arrested three years ago. According to "Tishreen", an official daily, he diverted loan re-payments to an unidentified, but "marginal", foreign bank. The damage is estimated to be a sorely-needed $5 million. The Miro government seized on this opportunity to re-iterate its demand to limit the term of bank directors to four years.

Syria's banks were treated by the late al-Assad as Ba'ath fiefdoms and venues of patronage. In 1995 he appointed a lackluster but well-connected presidential advisor with no previous banking experience, Mohammed Bashar Kabbara, as governor of Syria's oft-idle Central Bank. Syrian bankers complained bitterly - though anonymously - about this appointment to the Middle East Economic Digest. The latest developments may have made them happier - though, probably, in the Syrian tradition, only incrementally so.

Was Saddam Hussein hiding in Syria? DEBKAfile, an Israeli-owned rumor mill thought so two years ago. He was supposed to be in the Mediterranean coast town of Latakia in the Cote d'Azur De Cham Resort, a neighbor of the al-Assads, the indigenous dynastic rulers. Allowing him entry was supposed to be one of a series of manifestly anti-American moves by the Syrian regime.

The Department of Defense has repeatedly accused the country - still on the State Department's list of terror-abetting polities - of shipping weapons and materiel, such as night goggles and jamming systems for satellite global positioning devices, across the border to Hussein's depleted and besieged forces. Arab volunteers, some bent on suicide attacks, have been crossing into Iraq from an accommodating Syria.

Donald Rumsfeld, the American Secretary of Defense, called these unhindered flows "hostile acts". The CNN quoted former CIA director James Woolsey calling the Syrian regime "fascist". Even the docile Colin Powell warned Syria during his tenure that it is facing a "critical choice".

According to the Kuwaiti daily, Al Rai Al Am, in a related incident, U.S. special forces have demolished two years ago a pipeline which delivered more than 200,000 barrels of heavily discounted oil a day from Kirkuk in Iraq to Syria, in defiance of repeated American requests. A railroad link between the neighboring countries was also blown up. Western sources denied both these reports.

Structures within Syria's military and secret services, acting through business fronts, have been implicated in arms trafficking from Syria to Iraq, including, according to the pro-Israeli Forward magazine and the Israeli daily, Ha'aretz, anti-aircraft missiles, rockets and Scud missile guidance systems, tank transporters and antitank missiles from Russia, Yugoslavia, Ukraine, Belarus and Bulgaria.

The American Israel Public Affairs Committee, a powerful Jewish lobby, intends to capitalize on such bad blood. Its executive director, Howard Kohr, told various media recently that AIPAC will target the transfer of missile technologies from Russia to Syria, Iran and North Korea, two of which are charter members of the "axis of evil" together with Iraq.

On Apruil 2003, repeating accusation aired on December 2002 by Prime Minister Ariel Sharon, Brigadier General Yossi Kupperwasser, a senior officer in the Israeli intelligence community, told the Foreign Affairs and Defense Committee of Israel's Knesset that Syria was harboring Iraqi chemical and biological agents and long-range missiles. Even the Americans found these charges too outlandish to endorse.

Despite fears publicly expressed by Bashar al-Assad and other senior Syrian officials, Syria is unlikely to be the next target of the coalition forces. It is an American strategic asset. An ardent historical foe of Iraq, it joined the American-led coalition in the first Gulf War and the war on terrorism.

Syria also voted for resolution 1441 in the Security Council, calling for Iraq's disarmament under pain of war. It is also indispensable to any lasting Middle East settlement. The administration torpedoed the Syria Accountability Act, a Congressional attempt to impose sanctions on Damascus. According to the official Syrian news agency SANA, Tony Blair called al-Assad to inform him "that Britain disagrees completely with those who promote the targeting of Syria".

At the time, in an interview to the London-based Arabic language al-Hayat newspaper, Powell denied any intention to invade either Syria or Iran. But the conspiracy-minded noted the revival, by Israel, of a plan to carry oil from Mosul to Haifa, through a disused pipeline running via Syrian territory. Hooman Peimani in Asia Times concluded:

"Unless the pipeline were redirected through Jordan, another country bordering Israel and Iraq with normalized relations with Israel, the pipeline project will require a different regime in Syria. In other words, regime change in both Iraq and Syria is the prerequisite for the project. As (Israeli Minister of National Infrastructure, Yosef) Paritzky did not mention a redirecting option, it is safe to suggest that the Israelis are also optimistic about a regime change in Syria in the near future."

The demise of Hussein's pariah regime spells economic trouble for Syria. Still largely a socialist command economy, it has only recently embarked on a hesitant and partial path towards market reforms. Iraq served as both the source of cheap energy and a captive market for shoddy Syrian goods. Bilateral trade, excluding oil, amounted to $2 billion, according to the Khaleej Times, a United Arab Emirates daily.

Syria, itself a fledgling oil producer, re-exported some of the Iraqi crude and much of its own output through a pipeline leading from Kirkuk directly to the port of Banias. It reaped between $500 million to $1 billion annually from such arbitrage. Syria extracts about 400,000 barrels of crude per day and c. 8 billion cubic meters of natural gas a year.

Lebanon is another paradise likely to be lost to Syria in the wake of the Iraq war. The country, largely occupied by the Syrian security apparatus, has been divvied to lucrative fiefdoms controlled by politicians belonging to the late Hafiz al-Assad's old guard.

The Lebanese economy and its financial sector are far superior to Syria's. But the United States is pressing a reluctant Syria to terminate its "occupation" of Lebanon and, thus, to let the West dismantle the infrastructure of terrorist organizations, such as the Iran-backed Hizbullah, that thrive there.

Observers say that the subtraction of the Iraqi and Lebanese windfalls is a blessing in disguise. It will force Syria to modernize, reform its bloated public sector, restructure or genuinely privatize its numerous state-owned enterprises, develop its energy sector and introduce the rudiments of a monetary policy and a banking system. Syrian manufacturers have already begun to develop markets in other Arab countries and in East Europe.

Not all is lost. Syria, a largely agricultural country, enjoyed bumper crops in 2003-4. Its ports inevitably serve as the entry points for goods used in Iraq's reconstruction. Such traffic is a boon to its budding service industries.

Nor is Syria as isolated as the United States and Israel might wish it were.

In April 2003, Jordan and Syria signed an agreement to construct the $87 million Al Wihda dam on the northern Yarmuk River which flows from Syria to its neighbor. It will add 80 million cubic meters of drinking and irrigation water to Jordan's dilapidated supplies. The facility will be erected by Ozaltin, a Turkish construction firm, and financed by Jordan with loans from the Abu Dhabi Development Fund and the Arab Fund for Economic and Social Development.

Turkey has also been reaching out to Syria and Iran in a belated effort to counter an emerging Kurdish polity within a federated postwar Iraq. This rapprochment started prior to the latest Iraq war, days after Colin Powell departed Turkey in the belief that fences have been mended. Iranian Foreign Minister Kamal Kharrazi visited Ankara and Turkish Foreign Minister Abdullah Gul embarked on a trip to Syria.

Iran's President Mohammad Khatami traveled to Syria and Lebanon in early May 2003. President Bashar al-Assad briefly stopped in Tehran in March 2003 to discuss the brewing crisis in Iraq. A common statement of mutual defense against "common enemies" was signed last month (February 2005) .

This flurry of summits indicates the formation of a broad front aimed at countering certain American allies - notably the Kurds. The participants also aspire to affect the future shape of their region. It is a tall order and they may well be too late.

As Richard Murphy, US Assistant Secretary of State for Near Eastern Affairs from 1983 to 1989, recently told the Daily Telegraph:

"There's a perception that the time has come to spread democracy in the Middle East. Their view is that the US paid heavily on September 11 for having not stood by its principles in dealing with autocracies in the Middle East."

T

Taxation

To tax or not to tax - this question could have never been asked twenty years ago.

Historically, income tax is a novel invention. Still, it became so widespread and so socially accepted that no one dared challenge it seriously. In the lunatic fringes there were those who refused to pay taxes and served prison sentences as a result. Some of them tried to translate their platforms into political power and established parties, which failed dismally in the polls. But some of what they said made sense.

Originally, taxes were levied to pay for government expenses. But they underwent a malignant transformation. They began to be used to express social preferences. Tax revenues were diverted to pay for urban renewal, to encourage foreign investments through tax breaks and tax incentives, to enhance social equality by evenly redistributing income and so on. As Big Government became more derided - so were taxes perceived to be its instrument and the tide turned. Suddenly, the fashion was to downsize government, minimize its disruptive involvement in the marketplace and reduce the total tax burden as part of the GNP.

Taxes are inherently unjust. They are enforced, using state coercion. They are an infringement of the human age old right to property. Money is transferred from one group of citizens (law abiding taxpayers) - to other groups. The recipients are less savoury: they either do not pay taxes legally (low income populations, children, the elderly) - or avoid paying taxes illegally. But there is no way of preventing a tax evader from enjoying tax money paid by others.

Research demonstrated that most tax money benefited the middle classes and the rich, in short: those who need it least. Moreover, these strata of society were most likely to use tax planning to minimize their tax payments. They could afford to pay professionals to help them to pay less taxes because their income was augmented by transfers of tax money paid by the less affluent and by the less fortunate. The poor subsidized the tax planning of the rich, so that they could pay less taxes. No wonder that tax planning is regarded as the rich man's shot at tax evasion. The irony is that taxes were intended to lessen social polarity and friction - but they achieved exactly the opposite.

In economies where taxes gobble up to 60% of the GDP (France, Germany, to name a few) - taxes became THE major economic disincentive. Why work for the taxman? Why finance the lavish lifestyle of numerous politicians and bloated bureaucracies through tax money? Why be a sucker when the rich and mighty play it safe?

The results were socially and morally devastating: an avalanche of illegal activities, all intended to avoid paying taxes. Monstrous black economies were formed by entrepreneuring souls. These economic activities went unreported and totally deformed the processes of macroeconomic decision making, supposedly based on complete economic data. This apparent lack of macroeconomic control creates a second layer of mistrust between the citizen and his government (on top of the one related to the collection of taxes).

Recent studies clearly indicate that a reverse relationship exists between the growth of the economy and the extent of public spending. Moreover, decades of progressive taxation did not reverse the trend of a growing gap between the rich and the poor. Income distribution has remained inequitable (ever more so all the time) - despite gigantic unilateral transfers of money from the state to the poorer socio - economic strata of society.

Taxes are largely considered to be responsible for the following:

- They distorted business thinking;
- Encouraged the misallocation of economic resources;
- Diverted money to strange tax motivated investments;
- Absorbed unacceptably large chunks of the GDP;
- Deterred foreign investment;
- Morally corrupted the population, encouraging it to engage in massive illegal activities;
- Adversely influenced macroeconomic parameters such as unemployment, the money supply and interest rates;
- Deprived the business sector of capital needed for its development by spending it on non productive political ends;
- Caused the smuggling of capital outside the country;
- The formation of strong parallel, black economies and the falsification of economic records thus affecting the proper decision making processes;

- Facilitated the establishment of big, inefficient bureaucracies for the collection of taxes and data related to income and economic activity;
- Forced every member of society to - directly or indirectly - pay for professional services related to his tax obligations, or, at least to consume his own resources (time, money and energy) in communicating with authorities dealing with tax collection.

Thousands of laws, tax loopholes, breaks and incentives and seemingly arbitrary decision making, not open to judicial scrutiny eroded the trust that a member of the community should have in its institutions. This lack of transparency and even-handedness led to the frequent eruption of scandals which unseated governments more often than not.

All these very dear prices might have been acceptable if taxes were to achieve their primary stated goals. That they failed to do so is what sparked the latest rebellious thinking.

At first, the governments of the world tried a few simple recipes:

They tried to widen the tax base by better collection, processing, amalgamation and crossing of information. This way, more tax payers were supposed to be caught in "the net". This failed dismally. People found ways around this relatively unsophisticated approach and frequent and successive tax campaigns were to no avail.

So, governments tried the next trick in their bag: they shifted from progressive taxes to regressive ones. This was really a shift from taxes on income to taxes on consumption. This proved to be a much more efficient measure - albeit with grave social consequences. The same pattern was repeated: the powerful few were provided with legal loopholes. VAT rules around the world allow businesses to offset VAT that they paid from VAT that they were supposed to pay to the authorities. Many of them ended up receiving VAT funds paid the poorer population, to which these tax breaks were, obviously, not available.

Moreover, VAT and other direct taxes on consumption were almost immediately reflected in higher inflation figures. As economic theory goes, inflation is a tax. It indirectly affects the purchasing power of those not knowledgeable enough, devoid of political clout, or not rich enough to protect themselves. The salaries of the lower strata of society are eroded by inflation and this has the exact same effect as a tax would. This is why inflation is called the poor man's tax.

When the social consequences of levying regressive taxes became fully evident, governments went back to the drawing board. Regressive taxes were politically and socially costly. Progressive taxes resembled Swiss cheese: too many loopholes, not enough substances. The natural inclination was to try and plug the holes: disallow allowances, break tax breaks, abolish special preferences, eliminate loopholes, write-offs, reliefs and a host of other, special deductions. This entailed conflicts with special interest groups whose interests were duly reflected in the tax loopholes.

Governments, being political creatures, did a half hearted job. They abolished on the one hand - and gave with the other. They wriggled their way around controversial subjects and the result was that every loophole cutting measure brought in its wake a growing host of others. The situation looked hopeless.

Thus, governments were reduced to using the final, nuclear-like, weapon in their arsenal: the simplification of the tax system.

The idea is aesthetically appealing: all tax concessions and loopholes will be eliminated, on the one hand. On the other, the number of tax rates and the magnitude of each rate will be pared down. Marginal tax rates will go down considerably and so will the number of tax rates. So, people will feel less like cheating and they will spend less resources on the preparation of their tax returns. The government, on its part, will no longer use the tax system to express its (political) preferences. It will propagate a simple, transparent, equitable, fair and non arbitrary system which will generate more income by virtue of these traits.

Governments from Germany to the USA are working along the same lines. They are trying to stem what is in effect a tax rebellion, a major case of civil disobedience. If they fail, the very fabric of societies will be affected. If they succeed, we may all inherit a better world. Knowing the propensities of human beings, the safe bet is that people will still hate to see their money wasted in unaccounted for ways on bizarre, pork barrel, projects. As long as this is the case, the eternal chase of the citizen by his government will continue.

Teapot Dome Scandal

With the exception of Watergate, there has never been a scandal more egregious and with wider implications than the Teapot Dome affair during the presidency of Warren G. Harding. It involved the secret leasing to private companies of oil-containing tracts owned by the Navy, mainly in Wyoming and California.

"Domes" are natural reservoirs of crude oil. The "Teapot Dome" - named after a rock resembling the kitchen implement - was near Casper, Wyoming. It was "reserved" in 1920 for the future energy needs of American Navy vessels.

Senator Albert B. Fall of New Mexico - Harding's secretary of the Interior - opposed this "conservation" policy. Hence his furtive attempt - in collusion with Secretary of the Navy, Edward Denby and others - to lease the domes to private extractors. Teapot Dome was leased to Harry F. Sinclair's Mammoth Oil Company. The Elk Hills reserve in California was rented to Edward L. Doheny's Pan-American Petroleum and Transport Company. The two gave Fall and others gifts and "loans" amounting to $400,000 - an enormous fortune at the time.

The scandal was made public in 1922 in a long investigation by the U.S. Senate's Committee on Public Lands led by Senator Thomas J. Walsh from Montana and Senator Robert M. Lafollette.

After much prevarication by Attorney General Harry M. Daugherty, Fall was brought to justice. He sentenced to one year in prison and $100,000 fine in 1929 and many officials were implicated. Daugherty himself resigned in

1924. When Harding died in 1923, he was succeeded by Calvin Coolidge and public outrage subsided. Coolidge acted resolutely and appointed special prosecutors under his personal supervision to protect the interests of the government.

The Supreme Court annulled both the Elk Hills and the Teapot Dome leases in 1927. But, though government officials were convicted of corruption and conspiracy - no oilman was found guilty of bribing (still, they paid damages). Sinclair refused to collaborate with a second Senate investigation and hired gumshoes to shadow members of the jury in his case. He served a short sentence for tampering with a jury and for criminal contempt.

The Democrats failed to capitalize on the affair and lost the presidential elections in both 1924 and 1928.

Technology (and Development)

In many countries in transition cellular phones are more ubiquitous than the fixed-line kind. Teledensity is vanishingly low throughout swathes of Central and Eastern Europe (CEE). Broadband and e-commerce are distant rumors (ISDN is available in theory but not so in practice - DSL and ADSL are not available at all). Rare phone lines - especially in urban centers - are still being multiplexed and shared by 4-8 subscribers, greatly reducing both quality and usability. Terrestrial television competes ferociously with satellite TV, though cable penetration is low. Internet access is prohibitively expensive and intermittent. Many technologies rely on network effects (i.e., a critical mass of users). CEE is far from reaching this elusive point.

When communism imploded in 1989, pundits were quick to spot the silver lining. The countries in transition, they said, could now leapfrog whole stages of development by adopting novel technologies and through them the expensive Western research they embody. The East can learn from the West's mistakes and, by avoiding them, achieve a competitive edge.

In his seminal book, "Leapfrogging Development - The Political Economy of Telecommunications Restructuring", J.P. Singh, examined the acceleration of development through the adoption of ready-made, off the shelf, technologies. His melancholy conclusion was that development preferences are the outcomes of an intricate inter-play between sectoral pressure groups and coalitions of interest groups - and not the result of progress ex machina. He distinguished three types of states - catalytic, near-catalytic, and dysfunctional. Though he deals exclusively with Asia and Latin America, his typology is applicable to post-Communist Europe.

I. An Overview

The Central and East European market will double itself (to $17 billion) by 2003, says IDC. Pyramid Research predicts a $60 billion communications market by 2005. "Information Society", ICT (Information and Communication Technologies), "leapfrogging", and "better online than in line" are buzzwords and slogans oft-used throughout the region. A horde of NGO's - local and international - collaborate with domestic government and local authorities, with foreign governments, multinationals, and international organizations to make the dream of a digital Europe come true.

Russia pledged to attract $33 billion in investments in its telecommunications infrastructure and services by the year 2010 (the "Electronic Russia" initiative). The US Commercial Service, in the American Embassy in Moscow, predicts an annual growth rate of the Russian ICT sector of 15-20 percent through 2003. Conferences abound (an important one regarding municipal collaboration in constructing an information highway is to be held in the Czech Republic on March 26-27).

Even devastated Armenia succeeded to export $20 million worth of IT goods in 2001 (its IT sector has grown by 30% last year). It hosts branches of Silicon Valley household names such as Credence, HPL, and Virage Logic. More than 4000 professionals are employed in 200 companies. Of 60 software development outfits - 26 were founded with American capital. LEDA, a prominent local IT firm, finances IT programs at the Armenian State Engineering University.

All EU candidates strive to get incorporated in existing European networks (such as ELANET, Telecities, IDA, and ERISA) and new, candidate-only, initiatives (such as eEurope+). The EU has applied its "universal (i.e., also affordable) service" rule to Internet access. EU members adopted a variety of measures to increase Internet awareness and usage. Portugal, for instance, granted individuals with tax incentives coupled with free e-mail accounts and Web hosting services to encourage them to purchase PC's. The Dutch established public computer literacy centers for the disenfranchised (e.g., the unemployed) and provided them with discounted and subsidized hardware and connection time.

In one of its more grandiose moments, the heads of governments of the EU countries have decided in Lisbon (2000) that "each citizen should have access to the Internet and the whole European Union should become computer-literate", in the words of the Czech conference organizers.

This is an ambitious undertaking not only because Europe in general is behind the USA where Internet matters (with the exception of wireless Internet) are concerned - but because the countries which used to be behind the Iron Curtain, now lurch in the Digital Divide.

According to Vasile Baltac from the Information Technology and Communications Association of Romania ("The Balkan and Eastern Europe - Digital Divide or Digital Opportunity"), Romania has invested $25 per capita in ICT in 1999 (compared to Greece's $567 and the EU's average of $1215). There were only 2.5 Internet users per 1000 inhabitants in Romania and Bulgaria - compared to 56.4 in Westward-looking Slovenia.

New technologies are used mostly by the elites in CEE (as pointed out by Zassourski and Vartanova in "Transformation in the Context of Transition") - and perhaps advertently so. Still, Baltac fingers the managerial class as the main obstacle to leapfrogging (i.e., the rapid dissemination and assimilation of advanced technologies). They pay lip service to modernization but feel threatened and repelled by it. On the positive side, Baltac notes the annual yield of qualified professionals (who mostly find work in the West) and the emergence of telework and e-commerce. The technological vacuum makes the CEE countries receptive to state of the art technologies. GSM penetration in Romania surpassed the level of fixed line coverage in 1989. The number of cable TV subscribers in the region is projected to double (to 20 million) by 2005.

But the true picture is often obscured by anecdotal evidence, wishful thinking, phobias (e.g., the West European fear of mass migration from East Europe), lack of reliable statistics, and absence of qualified analysts and investment bankers. Factors like hostile terrain and climate, cross-subsidies, lack of real competition, corruption, red tape, moribund financial systems, archaic legal ones, dearth of credit card holders, urban-rural gaps, and English language illiteracy - rarely appear in neat, colorful, presentations.

Pyramid Research is bearish on broadband. "Internet access is and will remain for the foreseeable future a predominantly narrowband, dial-up affair, even in the most advanced countries (in Central Europe)". This despite plans by regional operators to offer DSL, FWA (Fixed Wireless Access), cable TV and leased-line broadband access (already offered in the Czech Republic by cable networks) and despite a regulatory welcome in all three CE candidates (Hungary, Poland, and the Czech Republic).

Luckily, mobile telephony - the other pillar of the leapfrogging theory - is getting increasingly concentrated in the hands of fewer operators (though at least 3 per every major market). Pyramid projects that by 2006, 94 percent of Russia's cellular phone market will be in the hands of the five leading providers (compared to 85 percent at the end of 2001). Mobile penetration will increase (to c. 10 percent) and prepaid customers will account for the vast majority of users.

Revenues from cellular networks exceed revenues from fixed line networks in certain markets. SMS is booming. Second and third mobile operator licenses are tendered by all cash strapped governments in the region (though a Polish attempt to sell an UMTS license ended in a fiasco). Poland introduced a wireless local loop service. Macedonia just handed a second mobile operator license to the Greek OTE.

"By the end of 2005, the total number of mobile subscribers in CEE will exceed 50 million (compared to 30 million by end-2001) and mobile Internet accounts will constitute approximately 21 percent of total mobile accounts", projects Pyramid. The Czech Republic will have 78 mobile users per 100 population - and Hungary 66. In a second tier of countries - the likes of Bulgaria, Romania, Ukraine, and Russia - a mobile phone will remain a luxury and a status symbol.

Hitherto domestic operators - from the Greek OTE to the Russian MTS - are becoming regional. Multinationals, such as the British Vodafone and the French Orange - have entered the regional fray. Some CEE markets are as saturated (and customers as savvy and demanding) as many advanced Western European ones. A host of value added services (VAS) is thrust upon the - sometimes reluctant - users, leading naturally to WAP (recently introduced throughout much of CEE), 2.5G, and 3G (wi-fi or wireless Internet) services.

Moreover, Pyramid sees an intriguing opportunity in VoIP (Voice over IP) telephony. It says:

"As the incumbents in the CEE markets continue to dominate long-distance circuit-switched telephony, VoIP offers a unique opportunity for new operators to gain a foothold in this traditional monopolistic stronghold."

Internet Telephony Service Providers (ITSP's) have sprung up all over the region (an Israeli firm is now planning to offer VoIP services in Macedonia, Kosovo, and Albania). Even incumbents have been offering VoIP - as early as 1998 in the Czech Republic. In his keynote address to The Economist CEE Telecommunications Conference, in December 2001, Ofer Gneezy, President and CEO of iBasis (a global ITSP), cited industry analysts projecting VoIP average annual growth rates in CEE of 80 percent through 2006.

This, coupled with a growing number of Internet users and access providers (spurred on by telecoms liberalization and growing incomes), may revolutionize the landscape in the next 5-10 years. Pyramid expects annual Internet adoption growth rates of 40 percent through 2005 (that's 30,000 new users a day!). Internet related revenues will reach $10 billion by 2005 (five times today's $1.8 billion - but only one seventh the Internet market in Western Europe).

Internet penetration in Central Europe will reach 15 percent in 2005 (from 4 percent today and 3 percent in Russia) - and 40 percent in Western Europe (compared to 18 percent today). Mobile Internet accounts will constitute one third of the total in CEE - c. 20 million users. Harald Gruber of the European Investment Bank is even more optimistic, saying ("Competition and Innovation: The Diffusion of Telecommunications in CEE", March 2000): "About 20 percent of the population will adopt mobile telecommunications".

II. The Future

Leapfrogging is not a linear function of the ubiquity of hardware and software. Though not a homogeneous lot, some lessons common to all countries in transition are already evident.

Technology is a social phenomenon with social implications. It fosters entrepreneurship and social mobility. By allowing the countries in transition to skip massive investments in outdated technologies - the cellular phone, the Internet, cable TV, and the satellite came to be perceived as shortcuts to prosperity, the generators of the dual ethoses of "rags to riches", and "creative destruction" (dizzying, constant, and disruptive innovation). They are the future, a youthful promise, and a landscape of opportunities.

Software developers in CEE countries tried to establish local versions of "Silicon Valley", or the flourishing software industry in India. Russian entrepreneurs developed anti virus software, Yugoslavs offered web design services, electronic media flourished in the Czech Republic and so on. But, as hard reality set in, most of these talents left for Western Europe, the USA, Canada, and Australia - where technology firms snatched them eagerly. Central and Eastern Europe is a major net exporter of engineers, programmers, systems analysts, Web designers, and concepts analysts.

Internet penetration in these countries - even in the most wired - is still very low by European standards, let alone American ones. The trauma of communism left them with decrepit and rarefied infrastructure, a prohibitive, extortionist, and skewed cost structure, computer illiteracy, inefficient competition, insufficient investment capital, and entrenched luddism (e.g., computer phobia). Foreign operators often exacerbate the situation. ArmenTel, the Greek owned monopoly in Armenia, keeps Internet access costs prohibitively high, ignoring court actions by the government and loud complaints by disgruntled customers.

The Center for Democracy and Technology (in its report "Bridging the Digital Divide: Internet Access in Central and Eastern Europe") says that, as contrasted with India (or Malaysia), the countries of the CEE did not invest in computerizing their schools, public libraries, and higher education institutions, or in subsidizing private computer-training colleges.

More crucially and less reversibly, decades of central (mis-)planning rendered the societies of Central and Eastern Europe inert and dependent, apart from their traditional conservatism. Many - especially older mid- and high-level managers and engineers - feel threatened by technology. Technology makes people redundant.

To a few open minded (i.e., foreign owned) firms, computer networking stands for decentralized channels of distribution and marketing as well as potential global penetration. But even there, only a minuscule number of businesses took advantage of e-commerce (though the countries of Central Europe and the Baltic may be the global pioneers of m-commerce due to their wireless networks).

E-commerce is leapfrogging's litmus test because it represents the culmination and confluence of hardware, software, and process engineering. To have e-commerce, a country needs rich computer infrastructure, a functioning telecommunications network, and cheap access to the Internet. Its citizens need to be reasonably computer literate, possess both a consumerist mentality (e.g., inability to postpone gratification), and a modicum of trust between the players in the economy - and hold credit cards.

Alas, the countries in transition lack all of the above to varying degrees. The Economist Intelligence Unit ranked Russia 42nd (out of 60 countries) in its year 2000 "e-readiness survey". Other CEE countries fared little better.

Penetration and coverage rates (the number of computers and phone lines per household), network reliability, and the absolute number of Internet users - are all dismally low. Access fees are prohibitively high. Budding Internet enterprises in the countries in transition are happy exceptions that prove the depressing rule. They usually respond to erratic local demand. Few have expanded internationally. Even fewer engage in research and development.

Technology was supposed to be the great equalizer (with the rich, developed countries). It did not deliver on this promise. Unable to catch up with Western affluence and prosperity, the denizens of CEE are frustrated. They feel inferior, neglected, looked down upon, dictated to, and, in general, put down. New, ever-cheaper, technologies, thought the locals, would surely restore the rightful balance between impoverished East and filthy rich West. But the Internet - and even technologies such as cellular telephony - belong to those who can effectively deploy them (i.e., consumers in developed, infrastructure-rich, countries).

The news get worse.

The Internet is gradually permeated by commercial interests and going wireless. This convergence of content and business interests - means less access to the underprivileged. The digital divide is growing by the day. New technologies have done little to bridge this gap - on the contrary: they enhanced the productivity and economic growth (this is known as "The New Economy") of rich countries (mainly the United States) and left the have-nots in the dust.

The countries in transition also lack the proper legislative and law enforcement infrastructure (backed by the right cultural background). Property rights, contracts, intellectual property - are all new, often indigestible, concepts, emblems of Western hegemony and monopolistic practices. Widespread copyright violation, software piracy, and hacking are both status symbols and political declarations of sorts. Admittedly, the dissemination of illicit intellectual products may have served to level the playing field. But now it is hindering entrepreneurship and holding back development.

After Asia, the countries in transition are the second largest centre of piracy. Software, films, even books - are copied and distributed quite freely and openly. There are street vendors who deal in the counterfeit products - but most of it is sold through stores and OEMs. This despite massive efforts (e.g., in Russia, Bulgaria, Ukraine, and, lately, in Macedonia) by software developers, licensed film libraries, and distributors - to fight these phenomena.

Intellectual property may go the way the pharmaceutical industry has. Content owners and distributors may team up with sponsors (multilateral institutions, private charities and donors). The latter will subsidize intellectual property and, thus, make it affordable to the denizens of poor countries. This is already happening in scholarly publishing.

This is very promising. But it far from leapfrogging development. In hindsight, leapfrogging may have been nothing but another of those intellectual fads whose time has gone before it ever came.

The Productive Hardware

On March 21, 2005, Germany's prestigious Ifo Institute at the University of Munich published a research report according to which "More technology at school can have a detrimental effect on education and computers at home can harm learning".

It is a prime demonstration of the Solow Paradox.

Named after the Nobel laureate in economics, it was stated by him thus: "You can see the computer age everywhere these days, except in the productivity statistics". The venerable economic magazine, "The Economist" in its issue dated July 24th, 1999 quotes the no less venerable Professor Robert Gordon ("one of America's leading authorities on productivity") - p.20:

"...the productivity performance of the manufacturing sector of the United States economy since 1995 has been abysmal rather than admirable. Not only has productivity growth in non-durable manufacturing ***decelerated*** in 1995-9 compared to 1972-95, but productivity growth in durable manufacturing stripped of computers has ***decelerated even more."***

What should be held true - the hype or the dismal statistics? The answer to this question is of crucial importance to economies in transition. If investment in IT (information technology) actually ***RETARDS*** growth - then it should be avoided, at least until a functioning marketplace is in place to counter its growth suppressing effects.

The notion that IT retards growth is counter-intuitive. It would seem that, at the very least, computers allow us to do more of the same things only faster. Typing, order processing, inventory management, production processes, number crunching are all tackled more efficiently by computers. Added efficiency should translate into enhanced productivity. Put simply, the same number of people can do more, faster, and more cheaply with computers than without them. Yet reality begs to differ.

Two elements are often neglected in considering the beneficial effects of IT.

First, the concept of information technology comprises two very distinct economic entities: an all-purpose machine (the PC) plus its enabling applications and a medium (the internet). Capital assets are distinct from media assets and are governed by different economic principles. Thus, they should be managed and deployed differently.

Massive, double digit increases in productivity are feasible in the manufacturing of computer hardware. The inevitable outcome is an exponential explosion in computing and networking power. The dual rules which govern IT - Moore's (a doubling of chip capacity and computing prowess every 18 months) and Metcalf's (the exponential increase in a network's processing ability as it encompasses additional computers) - also dictate a breathtaking pace of increased productivity in the hardware cum software aspect of IT. This has been duly detected by Robert Gordon in his "Has the 'New Economy' rendered the productivity slowdown obsolete?"

But for this increased productivity to trickle down to the rest of the economy a few conditions have to be met.

The transition from old technologies rendered obsolete by computing to new ones must not involve too much "creative destruction". The costs of getting rid of old hardware, software, of altering management techniques or adopting new ones, of shedding redundant manpower, of searching for new employees to replace the unqualified or unqualifiable, of installing new hardware, software and of training new people in all levels of the corporation are enormous. They must never exceed the added benefits of the newly introduced technology in the long run.

Hence the crux of the debate. Is IT more expensive to introduce, run and maintain than the technologies that it so confidently aims to replace? Will new technologies emerge in a pace sufficient to compensate for the disappearance of old ones? As the technology matures, will it overcome its childhood maladies (lack of operational reliability, bad design, non-specificity, immaturity of the first generation of computer users, absence of user friendliness and so on)?

Moreover, is IT an evolution or a veritable revolution? Does it merely allow us to do more of the same only differently - or does it open up hitherto unheard of vistas for human imagination, entrepreneurship, and creativity? The signals are mixed.

Hitherto, IT did not succeed to do to human endeavour what electricity, the internal combustion engine or even the telegraph have done. It is also not clear at all that IT is a ***UNIVERSAL*** phenomenon suitable to all business climes and mentalities.

The penetration of both IT and the medium it gave rise to (the internet) is not globally uniform even when adjusting for purchasing power and even among the corporate class. Developing countries should take all this into consideration. Their economies may be too obsolete and hidebound, poor and badly managed to absorb yet another critical change in the form of an IT shock wave. The introduction of IT into an ill-prepared market or corporation can be and often is counter-productive and growth-retarding.

In hindsight, 20 years hence, we might come to understand that computers improved our capacity to do things differently and more productively. But one thing is fast becoming clear. The added benefits of IT are highly sensitive to and dependent upon historical, psychosocial and economic parameters outside the perimeter of the technology itself. When it is introduced, how it is introduced, for which purposes is it put to use and even by whom it is introduced. These largely determine the costs of its introduction and, therefore, its feasibility and contribution to the enhancement of productivity. Developing countries better take note.

Historical Note - The Evolutionary Cycle of New Media

The Internet is cast by its proponents as the great white hope of many a developing and poor country. It is, therefore, instructive to try to predict its future and describe the phases of its possible evolution.

The internet runs on computers but it is related to them in the same way that a TV show is related to a TV set. To bundle to two, as it is done today, obscures the true picture and can often be very misleading. For instance: it is close to impossible to measure productivity in the services sector, let alone is something as wildly informal and dynamic as the internet.

Moreover, different countries and regions are caught in different parts of the cycle. Central and Eastern Europe have just entered it while northern Europe, some parts of Asia, and North America are in the vanguard.

So, what should developing and poor countries expect to happen to the internet globally and, later, within their own territories? The issue here cannot be cast in terms of productivity. It is better to apply to it the imagery of the business cycle.

It is clear by now that the internet is a medium and, as such, is subject to the evolutionary cycle of its predecessors. Every medium of communications goes through the same evolutionary cycle.

The internet is simply the latest in a series of networks which revolutionized our lives. A century before the internet, the telegraph and the telephone have been similarly heralded as "global" and transforming. The power grid and railways were also greeted with universal enthusiasm and acclaim. But no other network resembled the Internet more than radio (and, later, television).

Every new medium starts with ***Anarchy -*** or ***The Public Phase***.

At this stage, the medium and the resources attached to it are very cheap, accessible, and under no or little regulatory constraint. The public sector steps in: higher education institutions, religious institutions, government, not for profit organizations, non governmental organizations (NGOs), trade unions, etc. Bedeviled by limited financial resources, they regard the new medium as a cost effective way of disseminating their messages.

The Internet was not exempt from this phase which is at its death throes. It was born into utter anarchy in the form of ad hoc computer networks, local networks, and networks spun by organizations (mainly universities and organs of the government such as DARPA, a part of the defence establishment in the USA).

Non commercial entities jumped on the bandwagon and started sewing and patching these computer networks together (an activity fully subsidized with government funds). The result was a globe-spanning web of academic institutions. The American Pentagon stepped in and established the network of all networks, the ARPANET. Other government departments joined the fray, headed by the National Science Foundation (NSF) which withdrew only lately from the Internet.

The Internet (with a different name) became public property - but with access granted only to a select few.

Radio took precisely this course. Radio transmissions started in the USA in 1920. Those were anarchic broadcasts with no discernible regularity. Non commercial organizations and not for profit organizations began their own broadcasts and even created radio broadcasting infrastructure (albeit of the cheap and local kind) dedicated to their audiences. Trade unions, certain educational institutions and religious groups commenced "public radio" broadcasts.

The anarchic phase is followed by a ***commercial*** one.

When the users (e.g., listeners in the case of the radio, or owners of PCs and modems in the realm of the Internet) reach a critical mass - businesses become interested. In the name of capitalist ideology (another religion, really) they demand "privatization" of the medium.

In its attempt to take over the new medium, Big Business pull at the heartstrings of modern freemarketry. Deregulating and commercializing the medium would encourage the efficient allocation of resources, the inevitable outcome of untrammeled competition; they would keep in check corruption and inefficiency, naturally associated with the public sector ("Other People's Money" - OPM); they would thwart the ulterior motives of the political class; and they would introduce variety and cater to the tastes and interests of diverse audiences. In short, private enterprise in control of the new medium means more affluence and more democracy.

The end result is the same: the private sector takes over the medium from "below" (makes offers to the owners or operators of the medium that they cannot possibly refuse)

- or from "above" (successful lobbying in the corridors of power leads to the legislated privatization of the medium).

Every privatization - especially that of a medium - provokes public opposition. There are (usually founded) suspicions that the interests of the public were compromised and sacrificed on the altar of commercialization and rating. Fears of monopolization and cartelization of the medium are evoked - and proven correct, in the long run. Otherwise, the concentration of control of the medium in a few hands is criticized. All these things do happen - but the pace is so slow that the initial apprehension is forgotten and public attention reverts to fresher issues.

Again, consider the precedent of the public airwaves.

A new Communications Act was legislated in the USA in 1934. It was meant to transform radio frequencies into a national resource to be sold to the private sector which will use it to transmit radio signals to receivers. In other words: the radio was passed on to private and commercial hands. Public radio was doomed to be marginalized.

From the radio to the Internet:

The American administration withdrew from its last major involvement in the Internet in April 1995, when the NSF ceased to finance some of the networks and, thus, privatized its hitherto heavy involvement in the Net.

The Communications Act of 1996 envisaged a form of "organized anarchy". It allowed media operators to invade each other's turf.

Phone companies were allowed to transmit video and cable companies were allowed to transmit telephony, for instance. This is all phased over a long period of time - still, it is a revolution whose magnitude is difficult to gauge and whose consequences defy imagination. It carries an equally momentous price tag - official censorship.

Merely "voluntary censorship", to be sure and coupled with toothless standardization and enforcement authorities - still, a censorship with its own institutions to boot. The private sector reacted by threatening litigation - but, beneath the surface it is caving in to pressure and temptation, constructing its own censorship codes both in the cable and in the internet media.

The third phase is ***Institutionalization***.

It is characterized by enhanced legislation. Legislators, on all levels, discover the medium and lurch at it passionately. Resources which were considered "free", suddenly are transformed to "national treasures not to be dispensed with cheaply, casually and with frivolity".

It is conceivable that certain parts of the Internet will be "nationalized" (for instance, in the form of a licensing requirement) and tendered to the private sector. Legislation may be enacted which will deal with permitted and disallowed content (obscenity? incitement? racial or gender bias?).

No medium in the USA (or elsewhere) has eschewed such legislation. There are sure to be demands to allocate time (or space, or software, or content, or hardware, or bandwidth) to "minorities", to "public affairs", to "community business". This is a tax that the business sector will have to pay to fend off the eager legislator and his nuisance value.

All this is bound to lead to a monopolization of hosts and servers. The important broadcast channels will diminish in number and be subjected to severe content restrictions. Sites which will not succumb to these requirements - will be deleted or neutralized. Content guidelines (euphemism for censorship) exist, even as we write, in all major content providers (AOL, Yahoo, Lycos).

The last, determining, phase is ***The Bloodbath***.

This is the phase of consolidation. The number of players is severely reduced. The number of browser types is limited to 2-3 (Mozilla, Microsoft and which else?). Networks merge to form privately owned mega-networks. Servers merge to form hyper-servers run on supercomputers or computer farms. The number of ISPs is considerably diminished.

50 companies ruled the greater part of the media markets in the USA in 1983. The number in 1995 was 18. At the end of the century they numbered 6.

This is the stage when companies - fighting for financial survival - strive to acquire as many users/listeners/viewers as possible. The programming is dumbed down, aspiring to the lowest (and widest) common denominator. Shallow programming dominates as long as the bloodbath proceeds.

In hindsight, 20 years hence, we might come to understand that computers improved our capacity to do things differently and more productively. But one thing is fast becoming clear. The added benefits of IT are highly sensitive to and dependent upon historical, psychosocial and economic parameters outside the perimeter of the technology itself. When it is introduced, how it is introduced, for which purposes is it put to use and even by who it was introduced - largely determine the costs of its introduction and, therefore, its feasibility and contribution to the enhancement of productivity. The CEE countries better take note.

Telecoms

Telecommunications is the most important physical infrastructure in the modern world. It is more important than roads because it can replace them. It is more important than office buildings because it allows for the formation of virtual offices. It is more crucial than legal and institutional systems because it surpasses national borders and undermines and subverts fossilized political structures.

Telecommunications eliminates distance and allows for the transfer of voice and other forms of information (data) virtually at the speed of light. It is the foundation for the future industries and the industries of the future: information, knowledge and intelligent data processing industries.

Telecommunications today is not limited to handsets, phone lines and telephony equipment. It incorporates computers and other media technologies. All these are an integral part of the new age of telecoms.

Telecommunications was partly responsible to the geopolitical sea changes of the last decade. It is enough to recall the role of satellite telephones in the media coverage of the televised Gulf War - or the anti Ceaucesco revolution in Romania.

These are precisely the reasons why regimes all over the world - in other words, politicians - strove to maintain unmitigated control of the PTT services in their countries and to block foreign and domestic competition. National telecommunication service providers and carriers became monopolistic monsters, operating highly inefficiently, charging exorbitant prices, employing far too many people at unreasonably high salaries and serving to boost the political fortunes of ministers and the like.

But all this is changing. The new World Trade Organization (WTO) set of agreements will force governments throughout the world to privatize their telecoms giants and to deregulate this industry. The deadline is 2003 with a few exceptions (Latvia has until 2013 to do so). There is a new realizations that telecommunications is too important an industry to be left to the devices of politicians - or to the flawed management of state organs.

A few privatization models have evolved over the last 20 years, or so.

In the more developed countries (the West, South East Asia), some countries have chosen to introduce free for all competition. This entails the sale of part or all of the state owned telecoms provider to shareholders through stock exchanges. A small part is usually also allocated to the workers and management of the company at favourable prices. Concurrently the industry is deregulated and licensing requirements are gradually abolished.

Initially, in this model, only certain services are open to competition, mainly the international calls segment and the mobile and wireless telephony (including paging).

But, ultimately, all types of services are opened to competition - both domestic or foreign.

The most extreme example is Finland, where competition is completely free, no licensing is required and 52 companies compete for the heart (and pocket) of the customers. They are all allowed to offer any kind of telecommunications service imaginable.

Still, very much the same situation is developing in Israel, Britain, Australia, Hong Kong and - with the 1996 Telecommunications Act - in the USA. This 1996 Act allows providers and carriers of international phone calls and of local phone calls (until now separated by regulation) to enter each other markets and compete. The result was a major spate of mergers and acquisitions as companies scrambled to offer combined, international and local, services.

The second alternative is to break up the national carriers into functional units, one dedicated to international calls and the other to local traffic. NTT in Japan is undergoing this surgical restructuring now. In the wake of this break-up, competition is allowed in certain services (again, mainly international calls and GSM and mobile telephony).

The other - less efficient - option is to sell minority stakes in the national carrier to investors (domestic or foreign), or, through the stock exchanges - while effectively preserving the monopoly of state owned provider. This was the case in Israel, until lately and is the case in Greece. In Israel, when the British Cables and wireless tried to gain control of Bezeq (the Israeli phone services provider) - it encountered the staunch opposition of the Israeli government, replete with threats of legal action.

Still, the benefits of privatization are enormous.

Prices drop. That is the most evident and immediately visible effect. The prices charged for international phone calls in Israel dropped by 80% in real terms with the introduction of two additional competitors. In Britain, prices went down by 25%.

There is a leap forward in the quality of service: waiting periods for new installations, second and third phone numbers, business dedicated lines, maintenance, fixing problems, times between faults, troubleshooting, hotlines, meter reading, detailed and allocated accounts and so on. The average wait for a new phone has been reduced in Israel and in Hungary, to take two notable examples, from months to days.

Naturally, overall economic efficiency is improved by cost savings and by more productive allocation of time previously spent on tackling bureaucratic hassles.

Last, but by no means least, is the marked improvement in technology, its upgrading and the introduction of novel, low cost alternatives.

In the less developed and developing countries, privatization has been achieved mainly through the introduction of foreign strategic partners - usually other telecoms firms from more developed countries. This necessitates the temporary preservation of the monopolies. No profit minded foreign investor will invest in infrastructure - and let future competitors reap the benefits. An investor wants to be assured that he will continue to rule the market and overcharge the customers for a proscribed period of time. Foreign investors like monopoly situations because this way they have a captive market and thus they can force their clients to defray their development costs through overcharging. But, this can be seen as the cost of modernization and integration into regional and global telecoms alliances. Once competition is allowed, everyone (especially the clients) will reap the benefits of modern information highways.

To my mind this thinking is flawed. The direct and indirect damages incurred by monopolies are immeasurable. Monopolies must be dismantled - and the sooner, the better. The transfer of part of a monopoly from domestic to foreign hands does not alter its economically cancerous nature. Monopolies are guilty of over or under optimal investments, of overcharging clients, of distorting the allocation of economic resources, of market rigging, corruption and other criminal activities, of providing poor service, of selecting the wrong technologies. Only the threat of competition - actual and fierce - can change all that. Even so, long after competition is introduced, monopolies seem to continue to control their markets. British Telecom still controls 72% of its markets - despite more than a decade of competition.

Despite these considerations - and due to rampant corruption and cronyism - the Czech Republic, Hungary, Yugoslavia-Serbia, Estonia, Latvia and Russia chose this path. Bulgaria and Romania will follow them next year and it seems that Macedonia might follow suit, more out of lack of choice of alternatives - than out of careful selection of them.

The other way is by selling shares to investors in the stock exchanges - local and foreign. Poland has adopted this path after years of foot-ragging. It will sell shares of its carriers early next year. This, however, is not a solution available to small countries with an undeveloped stock exchange and low liquidity. To float the local PTT in the Macedonian Stock Exchange would be absurd. Even to attract domestic capital in sufficient quantity would be unthinkable.

Some countries avoid privatization altogether. They regard the fix of privatization as a fad, or a passing craze (which, in its more extreme forms, it is). They declare the telecommunications sector to be a matter of national strategic importance (again, to a very limited extent, it is). Slovakia has introduced a law in 1995 to actively prohibit the privatization of its PTT.

But experience disproves the Slovak stance. Admittedly, privatization does have its unpleasant side effects: redundant workers are fired by the thousands and unemployment goes up, for instance. Another result, cutely felt by every potential voter, is the radical increase in the price of local phone calls which used to be subsidized by the outlandish charges imposed on international calls. Once cross - subsidization ceases and more realistic pricing is introduced - prices shoot up.

But the price of all other services drop as sharply and there is a dramatic improvement in the quality and speed of the services provided.

The technological aspect is not to be sneered at, either.

The current infrastructure is insufficient in all Central and East European countries. It is partly incompatible with European Union standards and networks. The existing backbones will, of course, still be used but they will be gradually replaced by fibre optics and digital switchboards.

Technologies like cable TV and broadcasting networks, satellites and above all, wireless and GSM networks will serve to bridge the capacity and compatibility gaps and deficiencies. They will also reduce the dependence of new market entrants on the infrastructure and services provided by local PTTs - and this is good news.

Theme Parks

War - especially coupled with a globally sluggish economy - has a contradictory effect on the consumption of entertainment. Disposable incomes plummet curtailing the sales of medium to big ticket items such as cruises and resort vacations. But people - besieged by anxiety and bad news - also wish to be diverted. As the conflict rages, they stay indoors and tune in. Home entertainment booms. But once physical insecurity abates, consumers go out in full force mobbing movie theatres and theme parks, making up for lost time and frayed nerves.

A Solomon Smith Barney report, published in December last year, concluded that large cap entertainment stocks plunged by 32 percent during the previous skirmish in the Gulf. Stocks of destination travel sites and cruise lines took an even harsher beating, plummeting by 52 percent - this despite the counterintuitive resilience of amusement parks to military and political unrest.

In anticipation of the next round of fighting, these stocks are trading at valuations below even the traumatic tail of 2001. Though quicker than other types of equity to recover postbellum, this holds true only for short and decisive conflicts.

Analysts often monitor the performance of theme and amusement parks to divine trends in the industry as a whole. This would prove impossible in Europe where the culture of theme and entertainment grounds is still in its infancy.

Denmark has Legoland and Tivoli. France boasts the recently recovering Disneyland, Vulcania and Futuroscope. Germany has Phantasialand. Italy sports Gardaland. Spain joins the continent's minimal offerings with Port Aventura and Terra Mitica. The Dutch De Efteling spent the last decade "Americanizing" its facilities.

Only the United Kingdom has more than a smattering "pleasure beaches" and "worlds of adventure". A recently mooted Dracula theme park in Romania was shot down by irate citizens and an overweening bureaucracy. "New Europe" is no better than "Old Europe" when it comes to entrepreneurship.

In both market penetration and spending per visitor, Europe is at least a decade behind the USA. Indeed, the eerie paucity of theme parks is symptomatic of the generally moribund, rigid and hyper-regulated economies of the European Union. The continent has less than half America's number of parks per 10 million denizens and one third its visits per head per year.

Only 20 major European attractions garner more than 1 million in annual attendance. Another 50 or so attract less than 1 million patrons. With revenues of c. $2 billion, Europe's parks combined amount to one third the sector in the USA and underperform many parks in Asia as well.

European firms are still woefully primitive when it comes to marketing and educating their public. According to the Economic Research Associates, a consultancy, venture capital is rare and usually squandered by developers on wages and other "soft", non-productive costs. Management is inexperienced and peripatetic.

In Asia, theme parks are considered the magic pill. Japan has Disney World and the Tokyo DisneySea Park. Disney is slated to open a giant franchise in Hong Kong in 2005. Mainland China is eyeing the experiment favorably. Universal Studios countered by inaugurating a themed playground in Osaka in 2001 and by embarking on three feasibility studies in China.

From Jakarta, Indonesia (the Taman Ria amusement park) to Vietnam - everyone is climbing on the bandwagon. There seems to be a dearth of American interest in Europe despite its far higher purchasing power and the existence of a single business address - the European Commission.

Theme parks are multifarious businesses. They provide work to thousand of small suppliers in a virtuous ripple effect. Hosting and gaming experts, marketers, managers, on-site employees, suppliers of logistics, food retailers and caterers, entertainers - all benefit mightily from the presence of such grounds. The park's brand is often parlayed into trinkets, toys, clothes and souvenirs sold by locals to tourists, both domestic and foreign.

Destination travel is a growth sector.

The International Association of Amusement Parks and Attractions, a trade group, reported that worldwide park attendance was up one quarter between 1991-2001 to 319 million people. During this decade, revenues perked up by 50 percent to almost $10 billion annually. This was largely due to a rise in per capita spending within the grounds from $23 to $30. Returns on - usually massive - investments are impressive even in saturated markets such as the United States.

The profitability of theme parks frequently balances losses spawned by more glamorous bits of entertainment groups. Amusement grounds - themed or not - are astoundingly immune to geopolitical upheavals. Attendance in Disney's US parks declined by only c. 5 percent during the 1991 Gulf War. Even September 11 failed to dent it measurably.

EuroDisney is partly to blame for the scarcity of themed parks in Europe. For many years it was perceived, quite correctly, as an insatiable white elephant gulping rivers of red ink. Reality moved on but impressions - fostered by smug pundits - lasted. Wary investors and governments throughout the Old Continent confined themselves to the mostly family-operated "garden parks" and "carnival grounds" built during the 1960s and 1970s.

The truth is that Disney's Parisian adventure is flourishing. The entertainment behemoth is planning to invest c. $540 million in Walt Disney Studios, an annex of the French outfit. This is projected to add 5 million visitors to the current 12.

Another satisfied investor is Six Flags. The operator recently expanded to Mexico and Europe where it runs the six sites of the former Walibi Parks and Movie world, an erstwhile Warner Bros. property in Germany. It soon added a Spanish Movie World to its portfolio. Non-US operations already account for 15 percent of its sales.

But these are the exceptions that prove the rule. Europe is staid and serious. It prefers indigenous high-brow culture to American low-brow imports. Or so the French would have us all believe.

Torture

On January 16, 2003, the European Court of Human Rights agreed - more than two years after the applications have been filed - to hear six cases filed by Chechens against Russia. The claimants accuse the Russian military of torture and indiscriminate killings. The Court has ruled in the past against the Russian Federation and awarded assorted plaintiffs thousands of euros per case in compensation.

As awareness of human rights increased, as their definition expanded and as new, often authoritarian polities, resorted to torture and repression - human rights advocates and non-governmental organizations proliferated. It has become a business in its own right: lawyers, consultants, psychologists, therapists, law enforcement agencies, scholars and pundits tirelessly peddle books, seminars, conferences, therapy sessions for victims, court appearances and other services.

Human rights activists target mainly countries and multinationals.

In June 2001, the International Labor Rights Fund filed a lawsuit on behalf of 11 villagers against the American oil behemoth, ExxonMobile, for "abetting" abuses in Aceh, Indonesia. They alleged that the company provided the army with equipment for digging mass graves and helped in the construction of interrogation and torture centers.

In November 2002, the law firm of Cohen, Milstein, Hausfeld & Toll joined other American and South African law firms in filing a complaint that "seeks to hold businesses responsible for aiding and abetting the apartheid regime in South Africa ... forced labor, genocide, extrajudicial killing, torture, sexual assault, and unlawful detention".

Among the accused: "IBM and ICL which provided the computers that enabled South Africa to ... control the black South African population. Car manufacturers provided the armored vehicles that were used to patrol the townships. Arms manufacturers violated the embargoes on sales to South Africa, as did the oil companies. The banks provided the funding that enabled South Africa to expand its police and security apparatus."

Charges were leveled against Unocal in Myanmar and dozens of other multinationals. In September 2002, Berger & Montague filed a class action complaint against Royal Dutch Petroleum and Shell Transport. The oil giants are charged with "purchasing ammunition and using ... helicopters and boats and providing logistical support for 'Operation Restore Order in Ogoniland'" which was designed, according to the law firm, to "terrorize the civilian population into ending peaceful protests against Shell's environmentally unsound oil exploration and extraction activities".

The defendants in all these court cases strongly deny any wrongdoing.

But this is merely one facet of the torture business.

Torture implements are produced - mostly in the West - and sold openly, frequently to nasty regimes in developing countries and even through the Internet. Hi-tech devices abound: sophisticated electroconvulsive stun guns, painful restraints, truth serums, chemicals such as pepper gas. Export licensing is universally minimal and non-intrusive and completely ignores the technical specifications of the goods (for instance, whether they could be lethal, or merely inflict pain).

Amnesty International and the UK-based Omega Foundation, found more than 150 manufacturers of stun guns in the USA alone. They face tough competition from Germany (30 companies), Taiwan (19), France (14), South Korea (13), China (12), South Africa (nine), Israel (eight), Mexico (six), Poland (four), Russia (four), Brazil (three), Spain (three) and the Czech Republic (two).

Many torture implements pass through "off-shore" supply networks in Austria, Canada, Indonesia, Kuwait, Lebanon, Lithuania, Macedonia, Albania, Russia, Israel, the Philippines, Romania and Turkey. This helps European

Union based companies circumvent legal bans at home. The US government has traditionally turned a blind eye to the international trading of such gadgets.

American high-voltage electro-shock stun shields turned up in Turkey, stun guns in Indonesia, and electro-shock batons and shields, and dart-firing taser guns in torture-prone Saudi Arabia. American firms are the dominant manufacturers of stun belts. Explains Dennis Kaufman, President of Stun Tech Inc, a US manufacturer of this innovation: "Electricity speaks every language known to man. No translation necessary. Everybody is afraid of electricity, and rightfully so." (Quoted by Amnesty International).

The Omega Foundation and Amnesty claim that 49 US companies are also major suppliers of mechanical restraints, including leg-irons and thumbcuffs. But they are not alone. Other suppliers are found in Germany (8), France (5), China (3), Taiwan (3), South Africa (2), Spain (2), the UK (2) and South Korea (1).

Not surprisingly, the Commerce Department doesn't keep tab on this category of exports.

Nor is the money sloshing around negligible. Records kept under the export control commodity number A985 show that Saudi Arabia alone spent in the United States more than $1 million a year between 1997-2000 merely on stun guns. Venezuela's bill for shock batons and such reached $3.7 million in the same period. Other clients included Hong Kong, Taiwan, Mexico and - surprisingly - Bulgaria. Egypt's notoriously brutal services - already well-equipped - spent a mere $40,000.

The United States is not the only culprit. The European Commission, according to an Amnesty International report titled "Stopping the Torture Trade" and published in 2001:

"Gave a quality award to a Taiwanese electro-shock baton, but when challenged could not cite evidence as to independent safety tests for such a baton or whether member states of the European Union (EU) had been consulted. Most EU states have banned the use of such weapons at home, but French and German companies are still allowed to supply them to other countries."

Torture expertise is widely proffered by former soldiers, agents of the security services made redundant, retired policemen and even rogue medical doctors. China, Israel, South Africa, France, Russia, the United kingdom and the United States are founts of such useful knowledge and its propagators.

How rooted torture is was revealed in September 1996 when the US Department of Defense admitted that "intelligence training manuals" were used in the Federally sponsored School of the Americas - one of 150 such facilities - between 1982 and 1991.The manuals, written in Spanish and used to train thousands of Latin American security agents, "advocated execution, torture, beatings and blackmail", says Amnesty International.

Where there is demand there is supply. Rather than ignore the discomfiting subject, governments would do well to legalize and supervise it. Alan Dershowitz, a prominent American criminal defense attorney, proposed, in an op-ed article in the Los Angeles Times, published November 8, 2001, to legalize torture in extreme cases and to have judges issue "torture warrants". This may be a radical departure from the human rights tradition of the civilized world. But dispensing export carefully reviewed licenses for dual-use implements is a different matter altogether - and long overdue.

Trade, International

In August 2002, the WTO sided with the EU against the US and authorized the former to impose 100 percent duties on a list of American products. This would cost American manufacturers more than $4 billion - ten times the the highest punitive award ever granted by the WTO.

The Europeans seek to abolish an American export subsidy known as the "foreign sales corporation". They are unlikely to impose the sanctions any time soon, though. The US has already tentatively acted to remove the illegal subvention.

As the EU sees it, the US administration seems to have taken a sharp U-turn from free trade rhetoric to unprecedented protectionism - and back to free trade with the Trade Promotion Authority the President was granted last month. America imposed quotas on steel imports - and then exempted many European mills. It passed a huge farm support bill - but pursues the phasing out of agricultural subsidies worldwide. It applied timber and lumber quotas while signing a flurry of bilateral free trade agreements and participating in the the Doha round of multilateral trade negotiations. This inconsistency may be at the root of trans-Atlantic trade frictions.

Dan Horovitz is a partner in the City (of London) law-firm Theodore Goddard, established a century ago. He is responsible for the firm's Brussels office and leads its international - EU and WTO - trade and competition practice. He represents international clientele - governments and business - before the EU administration and its courts in Brussels and Luxembourg, as well as the dispute settlement body (DSB) of the WTO in Geneva.

He says:

"It often seems that the US Administration wishes to satisfy domestic constituencies and their colloquial political interest more than it cares to comply with US international obligations, including those stemming from the WTO Agreements. This has been attributed to two main reasons.

First, the leading global, 'sole superpower', role played by the US which enables it to pursue its self-interest while being largely oblivious to other constraints. Second, since the US economy is much more dependent on its own 'home market' than on exports, the US is less sensitive to what other players in other markets think of its positions.

The EU is far more 'outward looking' and largely dependant on export markets. Moreover, because of economic, political and historical reasons, the EU is traditionally perceived as more caring and responsive to foreign interests. Yet, the EU, much like the US, can sometimes be cynical about its WTO obligations, although the practice shows that in such instances the EU often resorts to one-sided interpretation of the existing rules rather to their violation.

In realpolitik terms, disregarding the interests of US partners would not facilitate the US Administration's task to safeguard the interests of US businesses abroad. Consider steel. US steel companies have important interests in certain central and east European steel enterprises. Thus, US Steel, for instance, controls the successful Slovak Kosice mill and is also reportedly eyeing Polish and Czech mills. Slovak steel exports are in fact American exports."

The Doha round of multilateral trade negotiations is supposed to tackle hypersensitive issues - such as agricultural subsidies and textiles - massively promoted by domestic lobbies in both the US and the EU. Traditional trade remedies, such as anti-dumping measures - regularly deployed by the USA and, increasingly, by other governments - are also on the table. A lot depends on collaboration between the EU and the USA.

The Uruguay round, which led to the establishment of the WTO, is considered by many governments and activists in developing countries to have been skewed to reflect the interests of the rich, industrialized, West. Horovitz predicts that "the negotiations would require much more time to complete than officially anticipated. The unfortunate example of Seattle comes into mind. The fiasco there did not alter the agenda of the global trading community. It only delayed the agreement on its terms."

The Doha round is different, he avers.

"Developing countries already account for a majority of WTO membership. (In) the new round, the votes of the developing countries will be decisive. They will thus have a golden opportunity to translate their votes into tangible advantages.

Moreover, China, which recently acceded to the WTO, is likely to defend the cause of the developing world. China already accounts for about one fifth of world trade and the developed world is expected to listen carefully to its views."

Still, it seems that trade policy on both shores of the pond is reactive, not proactive. It is shaped by the need to placate special interest groups, especially in election years. Horovitz disagrees:

"One must make a clear distinction between those EU measures (policy and legislation) which form part of its first-priority areas (e.g. enlargement, institutional aspects, global trade interests) and those which are of a 'routine' or day-to-day caretaking importance (certain trade remedy cases, minor health concerns).

With regards to the former, decisions follow a careful examination with results which are typically well-balanced and responsible. The latter may indeed seem sometimes to be haphazard or ill-considered. The worst examples are certain anti-dumping measures.

Still, important EU legislation cannot be truly described as haphazard. On the contrary, the preparations and consultations among the member states and within them - and then also amongst interest groups across different member states - are rather thorough. Important new legislation is taken very seriously by all involved."

Opponents of Brussels often point to its butter mountains and rivers of milk - the outcomes, they claim, of the misguided Common Agricultural Policy, the madcap CAP. Farmers across the European Union needlessly receive billions of dollars annually in subsidies. EU Countries like France, with a large - and politically influential - agricultural sector, have traditionally obstructed all attempts to reform the CAP.

The EU's enlargement to the east - encompassing at the very least Poland, Hungary, and the Czech Republic - would usher in millions of additional farmers. Even under the current phase-in schedules, CAP stands to apply to these newcomers within a decade. The cost to the EU could prove ruinous.

Horovitz: "I believe that the moment of truth is fast approaching. Initiatives to liberalise the CAP have been aired. Moreover, EU decision makers understand that, come enlargement, the EU would not be able to keep the same level of protection.

Furthermore, particularly in view of WTO priorities and the need to satisfy developing countries who must find outlets for their agricultural products in order to undertake the liberalisation of their less-developed industrial sector, the EU (as well as the US and others) realise that they have to tackle this problem head-on. Agriculture will clearly be one of the toughest issues of the new round."

In the meantime, trade wars proliferate. While the Americans often resort to classic trade barriers - such as quotas - the Europeans hamper imports more subtly. They tend to apply non-quantitative trade barriers.

The refusal to admit American genetically modified food into Europe - though it reflects real concerns of European consumers and health authorities - may well be merely a protectionist ploy. The French erected barriers against

American culture products, especially films, citing concerns for their domestic culture industries and the preservation of their language and heritage.

Horovitz admits that "both real concern and real protectionism play a role. As a lawyer dealing with such cases, I can sometimes see that the EU regulator seriously believes that he is protecting EU consumers".

"Luckily, in today's WTO world, regulators cannot hide behind health or technical reasons and get away with a trade restriction, however genuine their intentions are. In many cases, the WTO's 'sanitary and phytosanitary' or 'technical barriers' provisions require WTO Members to base their restrictions on objectively established norms. Failure to respect such norms can lead to a WTO violation and risk retaliatory measures. Problems arise when clear-cut objective norms cannot be easily obtained. These are the cases you tend to hear about most."

Bilateral trade often serves as either carrot or stick in international relations. Trade sanctions, trade preferences, and trade concessions are liberally employed by both the USA and the EU.

Horovitz: "Trade concessions indeed form part of the 'carrot and stick' political game. These are often very welcome by their beneficiaries even if, at times, they refuse to pay the political price. EU - Israel trade relations are a typical example.

Israel was the first (and so far the only) Middle Eastern country to enjoy full free trade for its industrial products with the EU. Its first free trade agreement was concluded in 1975. It is a well documented fact that the opportunity given to Israeli industry to reach economies of scale through free access to the large European market was the most important factor in allowing certain industry sectors to attain the dominant market share they enjoy today.

The Europeans sought political leverage through this agreement. They always wanted to have a better say in Middle East politics, which requires Israeli consent."

Trade Unions

The AFL-CIO (the result of a merger, exactly 50 years ago, between the American Federation of Labour and the Congress of Industrial Organizations) is America's largest trade unions umbrella organization. When it splintered in July 2005, it merited barely a mention in the international media. Thus far have fallen the fortunes of organized labor.

The rebels include the 3.1 million members of the Service Employees International Union (SEIU) and the International Brotherhood of Teamsters. Another 2 million, in smaller syndicates, may join them soon - practically halving the AFL-CIO's strength of 13 million.

Add to that the decline in membership - 800,000 in the last decade alone - and the picture is grim indeed. A mere 8% of workers in private firms and one eighth of the overall labor force in the USA are unionized - a whopping drop of two thirds since the 1950s.

The malcontents complain that the bulk of members' dues - the AFL-CIO's annual budget is $125 million - is being wasted on lobbying politicians and schmoozing with the powers that be, rather than on member recruitment and support of industrial action (read: strikes).

The picture is equally dismal elsewhere.

Self Defense started as a Polish farmers' trade union a decade ago. It leveraged its populist and activist message to capture 20 percent of the electorate. But in June 2002 it failed to bring Poland to a halt in protest against liberals in the central bank and iniquitous bureaucrats in Brussels. In the last elections in Poland it won 10 percent of the votes and 53 seats.

When the Belarusian Federation of Trade Unions convoked a rally against the government's bungled economic policies at the end of March 2002, less than 1000 people turned up. Restrictions imposed by the often violent authorities coupled with sabotage by pro-government unions assured the dismal flop.

Public sector trade unions in Macedonia have been more successful in extracting concessions from the government in election years, though, usually, not before they embark on a nation-wide strikes timed to coincide with ill-fated visits of the IMF mission. Despite strident warnings from the itinerant delegates of global finance, the minimum wage is then raised heftily as are salaries in the public sector. The unions are about to strike again in an effort to extend the settlement to other state functionaries.

Romanian union members took the streets on May 30, 2002 threatening to emulate Argentina's mass protests and shouting ominous anti-government and anti-IMF slogans. The government buckled under and agreed to raise the minimum wage by 70 percent within 12 months - as an opening gambit in the forthcoming round of bargaining. Industrial action in Romania in the past often ended in bloodshed and its governments are mindful of it. An agreement was signed with the prime minister on June 11, 2002.

On June 20, 2002 Spain's trade unions went on a general strike, contesting the prime minister's advanced plans to reform both hiring and firing laws and unemployment benefits. With both job protection and social safety nets threatened, the unions' success was less than striking. Only socialist dominated regions and cities responded and demonstrations flared up in only a couple of places.

The murder of a - second - government advisor on labor legislation in March 2002 has stiffened the Italian authorities' resolve to amend, however marginally, provisions pertaining to the reinstatement of "unfairly sacked" employees. Two small trade unions - CISL and UIL - have signed an agreement with the government in June 2002, ditching a common front with CGIL, by far the largest syndicate with 5.4 million members. CGIL called for regional strikes through July 11, 2002 followed by a general strike in September and October 2002. It also challenged the amendments to the law in the Constitutional Court. All these initiatives petered out.

In mid 2002, Solidarity called upon the Polish administration to withdraw its amendments to the labor code and to allow it to negotiate with employers the voluntary expunging of anti-labor clauses. In what they called a "historic manifestation", Solidarity teamed up with erstwhile rival left-wing union to demonstrate in front of the Ministry of Labor. About 400 people showed up.

The one country bucking the trend may be Tony Blair's United Kingdom. It has adopted a minimum wage and forces employers to bargain collectively with unions if most of their employees want them to. The number of such "recognition" agreements, according to "The Economist", tripled between 2000 and 2001, to 470. Union membership in the service sector and among women is rising.

Working days lost to strikes in Britain doubled from 1997, to almost 500,000 in 2000 and 2001. Although a far cry from the likes of Ireland, Spain, France, and Italy - it is a worrisome trend. Interesting to note that many of the strikes are the result of performance-related wage gaps opening up among workers following botched privatizations (e.g., the railways, the post office). Bellicose, fogeyish, trade unions leverage the discontent bred by mismanagement to their advantage.

Failure to mobilize workers, half-hearted activism, acquiescence with policies implemented by right-wing governments, transformation into political parties, growing populism and anti-Europeanism - these are the hallmarks of these social movements in search of a cause.

As more and more workers join the ranks of the middle class, own shares and real estate, participate in management through stakeholder councils, go entrepreneurial or self-employed, join the mostly non-unionized service sector, compete with non-unionized and thus more competitive workers in their own country or globally, become temporary and contract workers, or lose their jobs - union membership plummets.

Outsourcing and off-shoring of jobs to non-unionized countries doesn't help either. Companies now openly resort to discriminatory practices last seen in the 1920s - refusing to hire and firing union activists. Politicians ride the wave: two recently elected Republican governors, in Missouri and Indiana, scrapped long-standing collective bargaining deals the minute they settled into office (2004).

The ignominious implosion of Communism and socialism throughout Europe tainted the trade union movement, often linked to both. Membership was halved in Britain in the lat two decades. Union membership among the young in heavily unionized Sweden slumped to 47 percent in 2001 - from 62 percent in 1995.

The failure of trade unions the world over to modernize only exacerbates this inexorable decline. The structure of a traditional trade union often reflected the configuration of the enterprise it had to tackle - hierarchical, centralized, top-down. But rigorously stratified corporations went the way of central planning.

Business resembles self-assembling ad-hoc networks, or a guerilla force - rather than the bottom heavy and elephantine organization of the early 20th century, when most unions were formed. Individual workers adapted to the ever-changing requirements of ever-shifting markets by increasing their mobility and adaptability and by immersing themselves in life-long education and training.

Consider the two ends of the spectrum: agency, freelance, and fixed-term contract employees (or even illegal aliens) and executives. Both are peripatetic. Workplace-orientated trade unionism cannot cater to their needs because they rarely stay put and because their skills are transferable.

The UK's Economic and Social research Council Future of Work Programme, launched in 1998, studied the role of trade unions in the rapidly changing landscape of labor. In Working Paper no. 7 titled "Beyond the Enterprise? Trade Unions and the Representation of Contingent Workers" published in 2001 by the Cardiff Business School, the authors say:

"The empirical pattern revealed by the research is complex ... We also encountered situations where unions had made use of enterprise unionism to represent contingent workers. For example, enterprise collective agreements may be used to regulate the numbers of contingent workers employed together with their terms and conditions ... Departure from the enterprise model was most apparent within unions that organize freelance workers. The latter are mobile workers and unions adapt to their mobility by reliance on non-enterprise forms of representation. Amongst agency and fixed-term contract workers, however, there is more emphasis on integration of the needs of these workers in the dominant, enterprise model of union representation. In part, this reflects the fact that agency and contract workers can develop a long-term employment relationship ..."

Trade unions are adapting by modifying their recruitment methods. Unions solicit members in employment bureaus, temp agencies, job fairs. They offer "customized packages" of workplace-independent benefits and services dispensed by paid, roving, union officials, or sub-contractors. Many unions re-organized along geographical - rather than sectoral or enterprise-wide - lines.

Syndicates are in the throes of appropriating functions from both the public and the private sector. Some unions offer job placement services, training, requalification, and skill acquisition classes, legal aid, help in setting up a business, seminars and courses on anything from assertiveness to the art of negotiating.

In some countries, unions, having failed to negotiate with multiple employers in different sectors all at once, resorted to - mostly failed - attempts to unilaterally dictate to employers the employment terms of temporary, freelance, and contract workers. This was done, for example, by publishing fee schedules. Others negotiated enterprise agreements with labor supply firms, thus circumventing the employers.

Unions have always tried to sway legislation by lobbying, making political contributions, and endorsing political candidates - as they have this past week Gerhard Schroeder who is up for re-election in Germany come September. The unions' ability to mobilize the vote makes them a formidable force even in relatively non-unionized countries, such as the USA.

Recognizing their importance as a social institution, government or employer-financed unions still exist even in Western and better governed countries, such as Greece. In the former colonies of the British Empire, trade unions have to be approved by a registrar.

Unions act as think tanks, advocacy groups, and pressure groups rolled into one. They try to further job protection wherever possible - though the task is becoming increasingly untenable. Even old-fashioned unions put the media to good use in exerting pressure over their recalcitrant governments.

Some scholars urge the unions to diversify and embrace work-related issues of minorities, the disabled, gays and lesbians, or the old. Egged on by the ILO International Programme on the Elimination of Child Labour (IPEC), Nepal's three main trade unions have targeted child labor in their country. They issued a code of conduct applicable to all their members. This is an example of the convergence of trade unions and NGOs. Syndicates are recasting themselves as labor non-governmental organizations.

Britain's once belligerent 6.8 million members strong umbrella Trade Unions Congress (TUC) now talks about a partnership with employers and labor-input in management decision making. German-style institutionalized consultations with employees regarding labor matters and crucial business decisions are already enshrined in EU directives.

The unions are trying to modernize in form as well.

In Britain, trade unions put technology to good use. The Web sites of the TUC's member unions provide online membership application forms, information packs, and discussion of social and cultural issues. Jane Taylor, Information Manager at the Communications Workers Union, writing in 2002 for the online research guides community, FreePint.com, commented about the new openness of the revamped unions:

"More and more unions are providing online access to their internal and external documents. Some only

provide access to their journals, but others put a full range of their documents online. These are often the most interesting as they tend to be responses to government proposals, briefings on changes in employment legislation and briefings around the issues facing their members, whether they be teachers or postal workers."

But Web sites are insufficient weapons against the twin tsunamis of technological change and globalization. Unions often blame the latter - and its representatives, the WTO, the IMF, and the World Bank - of retarding workers' rights by imposing austerity measures on crumbling countries.

The ILO Bureau for Workers' Activities (ACTRAV) organized, in September 2001, a get together between union activists and representatives of international financial institutions. The IMF's much vaunted poverty reduction strategy which calls for consultations with all social stakeholders, trade unions included, as a precondition for new lending, was derided by the Rwanda representative. Quoted in the ILO's December 2001 issue of the "World of Work", he complained:

"One day I was called to meet a representative of the Bretton Woods Institution, but only during breakfast in a big hotel in Kigali! I would have preferred to have him meet the inhabitants too. He would have seen homeless people, sick people, starving people. He would have seen that while the financial institutions produce tons of pages of reports, poor people continue to die by the thousands."

Others grumbled that the IMF had a strange way of "consulting" them - they were invited to listen to a monologue regarding the policies of the Fund and then dismissed. The usual criticism prevailed:

"When one knows that in Africa an employee feeds five or six people, how can the Bretton Woods Institutions speak of a reduction of poverty by requiring the layoff of 25 per cent of civil servants? ... And when the IMF demands that Bulgaria reduce salaries even more, when they are already so low, one cannot speak of a measure aiming to reduce poverty ... In this country at war (Colombia), where unionists are being assassinated, where workers live in fear for their lives, the IMF has just requested the government to show more flexibility on the labour market! Where will that lead?"

Even the ILO joined the chorus accusing the IMF of violating the ILO's core conventions by arguing against collective bargaining and the provision of social protection. The delegates also demanded a labor-related input in all WTO deliberations.

The landscape of labor unionism is subject to tectonic shifts. But unionism need not conform to its image of archaic obsolescence. UNI and Ver.di are examples of what can be achieved when a timely message is combined with sprightly management methods and more than a modicum of spin doctoring.

United Network International (UNI) held its first World Congress in September 2001 in Berlin. It is the outcome of a synergetic merger between IT, telecom, print, and media-entertainment unions. All told, UNI boasts 800 member unions in over 140 countries. It represents a break with both exclusively national and rigid sectoral unions.

It is a "global union" - a cross-country, cross-sector body of representatives. Its natural counterparts are multinationals and IFI's. It already signed agreements with OTE, Carrefour, and Telefonica - three global telecom firms. Ten such umbrella organizations exist under the auspices of the Brussels-based International Confederation of Free Trade Unions (ICFTU).

The 3 million members strong Ver.di is the outcome of a March 2001 merger of five German labor syndicates. It is a services only union in a country where professionals prefer to belong to less proletarian "associations", the modern equivalents of medieval guilds. Its muscle, though, is a response to the perceived threat of "transnational capital".

Yet, at the bottom of it all is the single member, the worker, who pays his or her dues and expects in return protection, better pay, better work conditions, larger benefits, and, above all, a sense of belonging and purpose. Referring to a ceremony to commemorate 20 years of Solidarity in Poland, a disgruntled former dissident welder poured his heart to the ILO's "World of Work":

"There are no workers at this feast, just men in coats and ties. Nothing remains of Solidarity except its name. It has lost its essence, they have betrayed and forgotten us."

This betrayal, the bourgeoisification and gentrification of trade union functionaries and erstwhile rebels, the cozying up to the powers that be, the bribes implicit in swapping the shop floor for the air conditioned offices and minibar-equipped limousines, the infusion of trade unionism with nationalistic or populist agendas - these corrupting compromises, expediencies, amenities and tranquilizers may constitute the real danger to the continued existence of the labor movement.

Transition (from Communism to Capitalism)

The implosion of communism was often presented - not least by Francis Fukuyama in his celebrated "The end of History" - as the incontrovertible victory of economic liberalism over Marxism. In truth, the battle raged for seven decades between two strands of socialism.

Social democracy was conceived in the 19th century as a benign alternative to the revolutionary belligerence of Marx and Engels. It sparred with communism - the virulent and authoritarian species of socialism that Marxism has mutated into. European history between 1946-1989 was not a clash of diametrically opposed ideologies - but an internecine war between two competing interpretations of the same doctrine.

Both contestants boasted a single market - the European Union and COMECON, respectively. In both the state was heavily involved in the economy and owned a sizable chunk of the means of production, though in the Soviet Union and its satellites, the state was the economy.

Both sported well-developed, entrenched and all-pervasive welfarism. Both east and west were stiflingly bureaucratic, statist, profoundly illiberal and comprehensively regulated. Crucially, the west was economically successful and democratic while Russia evolved into a paranoid nightmare of inefficiency and gloom. Hence its demise.

When communism crumbled, all of Europe - east and west - experienced a protracted and agonizing transition. Privatization, deregulation, competition and liberalization swept across both parts of the continent. The irony is that central and east Europe's adaptation was more farfetched and alacritous than the west's.

The tax burden - a measure of the state's immersion in the economy - still equals more than two fifths of gross domestic product in all members of the European Union. The countries in transition - from Russia to Bulgaria and from Estonia to Hungary - are way more economically liberal today than France, Germany and even Britain - let alone the nations of Scandinavia.

An increasingly united Europe has opted for "capitalism with a human face" - the democratic isotope of socialism (sometimes with a touch of corporatism). But it now faces the challenge of the Anglo-Saxon variety of the free market. Nowhere is this ideological altercation more evident than in the countries formerly behind the iron curtain.

Long before Enron and World.com, the tech bubble and Wall Street's accounting frauds and pernicious conflicts of interest - transition has exposed the raw and vulnerable nerves running through the foundations of Anglo-Saxon capitalism. Eastern Europe is a monument to the folly of unmitigated and unbridled freemarketry.

Transition has given economists a rare chance to study capitalism and economic policies from scratch. What's more important - free markets, institutions, education, democracy, or capital? Central and east Europe became a giant lab in which to peruse policies pertaining to criminality, private property ownership, entrepreneurship, privatization, income distribution, employment, inflation and social welfare.

Superficially, the debate revolved around the scientific rigor and usefulness - or lack thereof - of the "Washington Consensus". Opposing monetary and fiscal policies, free trade versus protectionism, capital controls and convertibility - these occupied the minds and writings of all manner of economic and development "experts" in the first decade after the fall of the Berlin Wall.

Yet, deep underneath, transition - perhaps because it was so thoroughly botched - taught us unforgettable lessons about markets and the way they work, namely that "objective", "mechanical" capitalism is a mirage.

Perhaps the most important moral is that, like all other economic processes - transition is, mostly, in the mind. Successful capitalism requires education and experience. The blind in east Europe were led by the one-eyed. Capitalism was presented - especially by Western protagonists of "shock therapy" - as a deus ex machina, a panacea, guaranteed to transport the region's derelict economies and destitute people to the kitschy glamour of the tacky soap operas that flooded their television screens.

Bedazzled by the alleged omnipotence and omniscience of the "invisible hand", no one predicted the utter meltdown that ensued: the mass unemployment, the ubiquitous poverty, the glaring abyss between new rich and always poor, or the skyrocketing prices even as income plummeted. Nor were the good parts of the new economic regime understood or explained: private property, personal profit, incentives.

The dangers of transition were flippantly ignored and the peoples of central and eastern Europe were treated as mere guinea pigs by eager Western economists on fat retainers. Crime was allowed to hijack important parts of the post-communist economic agenda, such as the privatization of state assets. Kleptocracies subsumed the newborn states. Social safety nets crumbled.

In their vainglorious attempt to pose as accurate and, thus, "respectable", scientists, economists refused to admit that capitalism is not merely a compendium of algorithms and formulas - but mainly a state of mind. It is an all-encompassing, holistic, worldview, a set of values, a code of conduct, a list of goals, aspirations, fantasies and preferences and a catalog of moral do's and don'ts. This is where transition, micromanaged by these "experts" failed.

The mere exposure to free markets was supposed to unleash innovation and entrepreneurship in the long-oppressed populations of east Europe. When this recipe bombed, the West tried to engender a stable, share-holding, business-owning, middle class by financing small size enterprises. It then proceeded to strengthen and transform indigenous institutions. None of it worked. Transition had no grassroots support and its prescriptive - and painful - nature caused wide resentment and obstruction.

The process of transition informed us that markets, left to their own devices, unregulated and unharnessed, yield market failures, anomies, crime and the misallocation of economic resources. The invisible hand must be firmly clasped and guided by functioning and impartial institutions, an ingrained culture of entrepreneurship and fair play, classes of stakeholders, checks and balances and good governance on all levels.

Wealth, behavioral standards, initiative, risk seeking - do not always "trickle down". To get rid of central planning - more central planning is required. The state must counteract numerous market failures , provide some public goods, establish and run institutions, tutor everyone, baby-sit venture capitalists, enhance innovation, enforce laws and standards, maintain safety, attract foreign investment, cope with unemployment and, at times, establish and operate markets for goods and services. This omnipresence runs against the grain of Anglo-Saxon liberalism.

Moreover, such an expanded role of the state sits uncomfortably with complete political liberty. That capitalism is inextricably linked to democracy is a well-meaning fallacy - or a convenient pretext for geopolitical power grabs. East Europe's transition stalled partly due to political anarchy. China's transition, by comparison, is spectacular - inflated figures notwithstanding - because it chose a gradual approach to liberalization: first economic, then political.

Last but not least, pure, "American", capitalism and pure Marxism have more in common than either would care to admit. Both are utopian. Both are materialistic. Both are doctrinaire. Both believe that "it's a jungle out there". Both seek social mobility through control of the means of production. Both claim to be egalitarian forms of social engineering and are civilizing, millennial, universal, missionary pseudo-religions.

The denizens of the nether regions of central and eastern Europe have been the victims of successive economic utopias. They fear and suspect ideological purity. They have been conditioned by the authoritarian breed of socialism they endured, really little more than an overblown conspiracy theory, a persecutory delusion which invariably led to Stalinesque paranoid backlashes. Indeed, Stalin was more representative of communism than any other leader before or after him.

The Economist summed this semipternal mass hysteria neatly thus:

"The core idea that economic structure determines everything has been especially pernicious ... The idea that ... rights have a deeper moral underpinning is an illusion. Morality itself is an illusion., just another weapon of the ruling class. As Gyorgy Lukasc put it, 'Communist ethics makes it the highest duty to act wickedly ... This is the greatest sacrifice revolution asks from us.' Human agency is null: we are mere dupes of 'the system', until we repudiate it outright. What goes for ethics also goes for history, literature, the rest of the humanities and the social sciences. The 'late Marxist' sees them all ... not as subjects for disinterested intellectual inquiry but as forms of social control."

Many in Europe feel that the above paragraph might as well have been written about Anglo-Saxon capitalism. Reduced to bare-bones materialism, it is amoral, if not immoral. It upholds natural selection instead of ethics, prefers money to values, wealth formation to social solidarity.

Predators everywhere - Russian oligarchs, central European cronies, Balkan kleptocrats, east European managers - find this gratifying. All others regard capitalism as yet another rigid and unforgiving creed, this time imposed from Washington by the IMF and multinationals rather as communism was enjoined from Moscow by the Kremlin.

With eight of the former communist countries now new members of the European Union - albeit second rate ones - transition is entering is most fascinating phase. Exposed hitherto to American teachings and practices, the new members are forced to adhere to a whole different rule book - all 82,000 pages of it.

European "capitalism" is really a hybrid of the socialist and liberal teachings of the 19th century. It emphasizes consensus, community, solidarity, equality, stability and continuity. It places these values above profitability, entrepreneurship, competition, individualism, mobility, size, litigation and the use of force. Europeans firmly believe that the workings of the market should be tampered with and that it is the responsibility of the state to see to it that no one gets left behind or trampled upon.

European stakeholder capitalism is paternalistic and inclusive. Employees, employers, the government, communities and suppliers are partners in the decision making process or privies to it. Relics of past models of the market economy still abound in this continent: industrial policy, Keynesian government spending, development aid, export and production subsidies, trade protectionism, the state-sanctioned support of nascent and infant industries. Mild corporatism is rife and manifest in central wage bargaining.

For some countries - notably Estonia - joining the EU has translated into a de-liberalized and re-regulated future. Others find the EU's brand of the market a comfortable and dimly familiar middle ground between America's harsh prescriptions and communism's delusional model. The EU's faceless and Kafkaesque bureaucracy in Brussels - Moscow revisited - should prove to be a relief compared to the IMF's ruffians.

The EU is evolving into a land empire, albeit glacially. The polities of central and eastern Europe were always constituents of empires - reluctantly or by choice. In some ways they are better suited to form an "ever closer union" than the more veteran members.

Question: What have been the most successful approaches to attracting direct foreign investments: offering prospective investors tax breaks and similar benefits, or improving the overall investment climate of the country?

Empirical research has demonstrated that investors are not lured by tax breaks and monetary or fiscal investment incentives. They will take advantage of existing schemes (and ask for more, pitting one country against another). But these will never be the determining factors in their decision making. They are much more likely to be swayed by the level of protection of property rights, degree of corruption, transparency, state of the physical infrastructure, education and knowledge of foreign languages and "mission critical skills", geographical position and proximity to markets and culture and mentality.

Question: What have been successful techniques for countries to improve their previously negative investment image?

The politicians of the country need to be seen to be transparently, non-corruptly encouraging business, liberalizing and protecting the property rights of investors. One real, transparent (for instance through international tender) privatization; one case where the government supported a foreigner against a local; one politician severely punished for corruption and nepotism; one fearless news medium – change a country's image.

Question: Should there be restrictions on repatriation of foreign investment capital (such restrictions could prevent an investment panic, but at the same time they negatively affect investor's confidence)?

Short term and long term capital flows are two disparate phenomena with very little in common. The former is speculative and technical in nature and has very little to do with fundamental realities. The latter is investment oriented and committed to the increasing of the welfare and wealth of its new domicile. It is, therefore, wrong to talk about "global capital flows". There are investments (including even long term portfolio investments and venture capital) – and there is speculative, "hot" money. While "hot money" is very useful as a lubricant on the wheels of liquid capital markets in rich countries – it can be destructive in less liquid, immature economies or in economies in transition.

The two phenomena should be accorded a different treatment. While long term capital flows should be completely liberalized, encouraged and welcomed – the short term, "hot money" type should be controlled and even discouraged. The introduction of fiscally-oriented capital controls (as Chile has implemented) is one possibility. The less attractive Malaysian model springs to mind. It is less attractive because it penalizes both the short term and the long term financial players. But it is clear that an important and integral part of the new International Financial Architecture MUST be the control of speculative money in pursuit of ever higher yields. There is nothing inherently wrong with high yields – but the capital markets provide yields connected to economic depression and to price collapses through the mechanism of short selling and through the usage of certain derivatives. This aspect of things must be neutered or at least countered.

Question: What approach has been most useful in best serving the needs of small businesses: through private business support firms, business associations, or by government agencies?

It depends where. In Israel (until the beginning of the 90s), South Korea and Japan (until 1997) – the state provided the necessary direction and support. In the USA – the private sector invented its own enormously successful support structures (such as venture capital funds). The right approach depends on the characteristics of the country in question: how entrepreneurial are its citizens, how accessible are credits and microcredits to SMEs, how benign are the bankruptcy laws (which always reflect a social ethos), how good is its physical infrastructure, how educated are its citizens and so on.

Question: How might collective action problems among numerous and dispersed small and medium entrepreneurs best be dealt with?

It is a strange question to ask in the age of cross-Atlantic transportation, telecommunication and computer networks (such as the Internet). Geographical dispersion is absolutely irrelevant. The problem is in the diverging self-interests of the various players. The more numerous they are, the more niche-orientated, the smaller – the lesser the common denominator. A proof of this fragmentation is the declining power of cartels – trade unions, on the one hand and business trusts, monopolies and cartels, on the other hand. The question is not whether this can be overcome but whether it SHOULD be overcome. Such diversity of interests is the lifeblood of the modern market economy which is based on conflicts and disagreements as much as it is based on the ability to ultimately compromise and reach a consensus.

What needs to be done centrally is public relations and education. People, politicians, big corporations need to be taught the value and advantages of small business, of entrepreneurship and intrapreneurship. And new ways to support this sector need to be constantly devised.

Question: How might access of small business to start-up capital and other resources best be facilitated?

The traditional banks all over the world failed at maintaining the balancing act between risk and reward. The result was a mega shift to the capital markets. Stock exchanges for trading the shares of small and technology companies sprang all over the world (NASDAQ in the USA, the former USM in London, the Neuemarkt in

Germany and so on). Investment and venture capital funds became the second most important source quantitatively. They not only funded budding entrepreneurs but also coached them and saw them through the excruciating and dangerous research and development phases.

But these are rich world solutions.

An important development is the invention of "third world solutions" such as microcredits granted to the agrarian or textile sectors, mainly to women and which involve the whole community.

Question: Women start one-third of new businesses in the region: now can this contribution to economic growth be further stimulated?

By providing them with the conditions to work and exercise their entrepreneurial skills. By establishing day care centres for their children. By providing microcredits (women have proven to be inordinately reliable borrowers). By giving them tax credits. By allowing or encouraging flexitime or part time work or work from home. By recognizing the home as the domicile of business (especially through the appropriate tax laws). By equalizing their legal rights and their pay. By protecting them from sexual or gender harassment.

Transport Projects, Financing of

The role of government in facilitating transport projects is inevitable. But governments are monopolists and largely cannot be trusted with the efficient allocation of resources, not to mention the problem of corruption. So, the less the state is involved the better off everyone is.

Transport has gone a full circle. Until the beginning of the 17th century it was largely privately financed. The state took over until the last two decades of the twentieth century. And now there is a revival of the involvement of the private sector in financing infrastructure. Additionally, transport has become a commodity and is securitized, as we shall see.

All social (or public) goods carry social costs and bring on negative externalities (such as environmental damage). Embedded in every public good there is a moral hazard - others bear a disproportionate part of the costs while the perpetrators go "free". This is why accurate statistics, forecasting and cost benefit analysis systems are a must. I am not talking only about cost coverage calculations but also about finding ways to impose on the users of transport infrastructure the real costs of their actions. This is known today as "user pays" charging schemes. But to do so, the state needs to know what ARE these costs. This is one way of forcing the private sector to participate in the financing of infrastructure.

But we are digressing. Allow me to return to more conventional methods.

Transport infrastructure is financed today mostly by the state. Governments usually assume bilateral or multilateral debt from commercial banks, through the international bond markets - but, most often, from institutions such as the World Bank and regional development banks through the EBRD. I have already indicated my aversion to this method of financing. The money is sure to be spent either inefficiently or corruptly or both. Yet hitherto both the financial scope of most of these projects, their regional and international repercussions and the need to adhere to statal planning - inhibited most forms of alternative financing.

Recent developments in private sector financing allow for reasonable solutions to this age-old dilemma. These solutions are widely experimented with in dozens of countries, many of them poorer and less stable than Macedonia.

The most widespread and accepted private sector financing method is the Build-Operate-Transfer (BOT) system. The state grants a 15-35 years concession to a private construction and engineering consortium of firms backed by ample financial resources (the contractors). The private firms build the infrastructure project, operate it for the concession period at the end of which they transfer it to the state without compensation. All the income during the operating period goes to the contractors. If the period of concession is sufficiently long - the contractors have an interest to observe high standards of quality in order to minimize maintenance costs. The state (sometimes through "golden shares") maintains a say in certain operational aspects (such as tariffs of usage).

The BOT approach has spawned off a host of variants. There is BOO - the Build, Own and Operate (classic) version. Then there is Build, sell to a financial institution or an investor, Lease it back from the new owner and Operate (BLO). There is also BLOT - like BLO but with a transfer of the asset to the state at the end of a long, pre-determined period. The Sopang Airport in Malaysia was constructed on a Build-Sell (to a group of banks)-Lease-Operate basis.

Lately, private entrepreneurs have begun to tap the international equity and debt markets to raise financing for transport projects. A case in point is the financing of the M2 Motorway in Australia. Both shares representing ownership in the assets and bonds representing an interest in its future stream of income are sold to investors through investment banks, portfolio managers and then through the international stock and bond markets.

This approach is a remote off-shoot of MUNIS. These are municipal bonds issued by local authorities to finances specific transport infrastructure, such as a toll-way. The income from the project goes to cover the interest and principal payments of the bonds. Such bonds are issued either directly to investors and portfolio managers or through the stock exchange were they are freely traded. The interests of the investors are (supposed to be) protected by custodian banks and trustees. Most of these bonds are backed by long term letters of credit and the interest income is tax free. State Route 91, the Riverside Freeway in California, was fully financed by municipal bonds. Munis have caught on with many countries, including countries in transition.

Last but not least, private enterprises are allowed to own their own infrastructure. Firms can own a railway section and even trains ("Own Your Wagons" schemes) providing they finance them. In many countries, construction licences are conditioned on participation in infrastructure costs.

Macedonia's infrastructure is decrepit. Maintenance is bad. Planning is absent. Corruption is rampant. The only hope is to remove as much as we can from the process of planning and constructing transport infrastructure from the hands of the state. Maybe this will even attract the billion dollars under our mattresses and carpets.

Trust

Economics acquired its dismal reputation by pretending to be an exact science rather than a branch of mass psychology. In truth it is a narrative struggling to describe the aggregate behavior of humans. It seeks to cloak its uncertainties and shifting fashions with mathematical formulae and elaborate econometric computerized models.

So much is certain, though - that people operate within markets, free or regulated, patchy or organized. They attach numerical (and emotional) values to their inputs (work, capital) and to their possessions (assets, natural endowments). They communicate these values to each other by sending out signals known as prices.

Yet, this entire edifice - the market and its price mechanism - critically depends on trust. If people do not trust each other, or the economic "envelope" within which they interact - economic activity gradually grinds to a halt. There is a strong correlation between the general level of trust and the extent and intensity of economic activity.

Trust is not a monolithic quantity. There are a few categories of economic trust. Some forms of trust are akin to a public good and are closely related to governmental action or inaction, the reputation of the state and its institutions, and its pronounced agenda. Other types of trust are the outcomes of kinship, ethnic origin, personal standing and goodwill, corporate brands and other data generated by individuals, households, and firms.

I. Trust in the playing field

To transact, people have to maintain faith in a relevant economic horizon and in the immutability of the economic playing field or "envelope". Put less obscurely, a few hidden assumptions underlie the continued economic activity of market players.

They assume, for instance, that the market will continue to exist for the foreseeable future in its current form. That it will remain inert - unhindered by externalities like government intervention, geopolitical upheavals, crises, abrupt changes in accounting policies and tax laws, hyperinflation, institutional and structural reform and other market-deflecting events and processes.

They further assume that their price signals will not be distorted or thwarted on a consistent basis thus skewing the efficient and rational allocation of risks and rewards. Insider trading, stock manipulation, monopolies, hoarding - all tend to consistently but unpredictably distort price signals and, thus, deter market participation.

Market players take for granted the existence and continuous operation of institutions - financial intermediaries, law enforcement agencies, courts. It is important to note that market players prefer continuity and certainty to evolution, however gradual and ultimately beneficial. A venal bureaucrat is a known quantity and can be tackled effectively. A period of transition to good and equitable governance can be more stifling than any level of corruption and malfeasance. This is why economic activity drops sharply whenever institutions are reformed.

II. Trust in other players

Market players assume that other players are (generally) rational, that they have intentions, that they intend to maximize their benefits and that they are likely to act on their intentions in a legal (or rule-based), rational manner.

III. Trust in market liquidity

Market players assume that other players possess or have access to the liquid means they need in order to act on their intentions and obligations. They know, from personal experience, that idle capital tends to dwindle and that the only way to, perhaps, maintain or increase it is to transact with others, directly or through intermediaries, such as banks.

IV. Trust in others' knowledge and ability

Market players assume that other players possess or have access to the intellectual property, technology, and knowledge they need in order to realize their intentions and obligations. This implicitly presupposes that all other market players are physically, mentally, legally and financially able and willing to act their parts as stipulated, for instance, in contracts they sign.

The emotional dimensions of contracting are often neglected in economics. Players assume that their counterparts maintain a realistic and stable sense of self-worth based on intimate knowledge of their own strengths and weaknesses. Market participants are presumed to harbor realistic expectations, commensurate with their skills and accomplishments. Allowance is made for exaggeration, disinformation, even outright deception - but these are supposed to be marginal phenomena.

When trust breaks down - often the result of an external or internal systemic shock - people react expectedly. The number of voluntary interactions and transactions decreases sharply. With a collapsed investment horizon, individuals and firms become corrupt in an effort to shortcut their way into economic benefits, not knowing how long will the system survive. Criminal activity increases.

People compensate with fantasies and grandiose delusions for their growing sense of uncertainty, helplessness, and fears. This is a self-reinforcing mechanism, a vicious cycle which results in under-confidence and a fluctuating self esteem. They develop psychological defence mechanisms.

Cognitive dissonance ("I really choose to be poor rather than heartless"), pathological envy (seeks to deprive others and thus gain emotional reward), rigidity ("I am like that, my family or ethnic group has been like that for generations, there is nothing I can do"), passive-aggressive behavior (obstructing the work flow, absenteeism, stealing from the employer, adhering strictly to arcane regulations) - are all reactions to a breakdown in one or more of the four aforementioned types of trust. Furthermore, people in a trust crisis are unable to postpone gratification. They often become frustrated, aggressive, and deceitful if denied. They resort to reckless behavior and stopgap economic activities.

In economic environments with compromised and impaired trust, loyalty decreases and mobility increases. People switch jobs, renege on obligations, fail to repay debts, relocate often. Concepts like exclusivity, the sanctity of contracts, workplace loyalty, or a career path -

all get eroded. As a result, little is invested in the future, in the acquisition of skills, in long term savings. Short-termism and bottom line mentality rule.

The outcomes of a crisis of trust are, usually, catastrophic:

Economic activity is much reduced, human capital is corroded and wasted, brain drain increases, illegal and extra-legal activities rise, society is polarized between haves and haves-not, interethnic and inter-racial tensions increase. To rebuild trust in such circumstances is a daunting task. The loss of trust is contagious and, finally, it infects every institution and profession in the land. It is the stuff revolutions are made of.

Turkey, Economy of

On November 15, 2002 Horst Kohler, the Managing Director of the IMF, acknowledged that, despite a "strong implementation" of the IMF program, Turkey's financing gap may have increased by up to an additional $10 billion. He tenuously and untenably attributed this massive failure of the IMF to the September 11 events. He intended to recommend to the Fund a new (the fourth since 1998) stand-by arrangement to be negotiated in Ankara in December. Many regarded this as an American-inspired prize in recognition of Turkey's pivotal role in the anti-terror global coalition.

Its much criticized obstruction of a settlement in Cyprus and its oft-derided sabotage of the creation of the European ex-NATO Rapid Deployment Force were all but forgotten. Issues like its poor human rights record (bombastic sounding constitutional amendments notwithstanding), the suppression of the Kurdish minority, the pernicious role in state affairs (and in criminal affairs) of its military, police, and bloated bureaucracy, and its rising Islamist sentiment were relegated to the backburner. The Copenhagen criteria for the commencement of membership talks with Turkey have been effectively suspended.

Emboldened by new stature, Bulent Ecevit, the Turkish prime minister, threatened the EU with annexation of the Turkish Republic of Northern Cyprus (TRNC) should the Greek populated south become a full member. Turks overwhelmingly long to belong to the EU but such grandstanding does their cause no good. Ecevit's diatribe was intended for internal consumption by the virulently nationalist allies in his shaky left-right coalition.

A widening financing gap was only the latest in a series of bad news. That same week, Balfour Beatty of the UK and Impregilo of Italy pulled out of the controversial $1.6 billion Ilisu hydro-electric dam - together with the export credit guarantees their governments were supposed to offer. They cited human rights and environmental considerations. The Turkish government vowed to press ahead with this flagship project, but its strained finances cast it in doubt. Turkey was forced to internationally issue the equivalent of almost a billion US dollars (partly in Euros) in 5 year bonds (with a yield of over 11%) in the last 30 days alone.

It all started at the end of last year. A banking meltdown in November was narrowly averted with $7.5 billion in IMF funds. The government, unable to repay its monstrous domestic debt, resorted to eroding it (to 80% of GDP) and to preventing a run on the fast dilapidating lira through a debilitating devaluation in February. Foreign investors fled its collapsing capital markets and drew $5 billion, c. 25% of Turkey's foreign exchange reserves, on February 19th alone. Important privatizations failed to attract a single bidder. The stock exchange rose by a dizzying 650% until March 2000 and then crushed by 63% in a few days and the current account worsened by 3% of GDP. Yields on one month treasury bills shot up to 144%, overnight inter-bank rates touched 9000% briefly.

Structural reform stalled and the Prime Minister and the President publicly fell out over suspiciously under-investigated corruption charges. Industrial production crumbled by 9.2% in the year to September and GDP shrank by more than 9% (though it is expected to recover next year). At least 600,000 workers lost their jobs (adding 3% to the official 6% unemployment rate and to an equal number of unemployed). The Turkish lira halved against the US dollar. Turbulence-prone Turkey experiences now its worst recession in 60 years.

The inevitable IMF cum World Bank rescue package signed in May (initially at $15.7 billion) was coupled with (partly successful) pressure to reform the banks, phase out farm subsidies, and introduce market based regulation and competition through accelerated privatization. Turkey's central bank has adopted inflation targeting. Political appointments to Turk Telekom have been reversed. Over-generous wage settlements have been checked. State as well as private banks have been recapitalized, merged, or closed and a dragnet scheme of deposit insurance has been introduced. More than $7 billion of short term state obligations were swapped in June for much longer maturities (though some of the new bonds were linked to the exchange rate of the US dollar). Still, the IMF's projection of a mere 5.5% decline in GDP looks inane.

And government bond auctions continue to end with crippling yields (a real interest rate of 18% - or more than 90% nominally in October).

But this externally imposed ambulatory regime failed to gain the support of opportunistic, populist, and venal Turkish politicians, or of the Turkish people. The private sector oriented technocrat (formerly with the World Bank) in charge of implementing the reforms, the Minister of Economy, Kemal Dervis, was continually sniped at and scapegoated. And though one of the IMF's most vocal critics was sacked in July (an event followed by the release of a delayed IMF loan tranche) - many call for early elections of which the likes of Tansu Ciller and Suleyman Demirel (two discredited politicians) or the thinly veiled Islamist Justice and Development Party may yet benefit. The distrust of the current government translates to a mistrust of its economic policies and to the exacerbation and prolongation of the economic crisis.

Turkey's economy is a hybrid of modern industry (29%), trade, and services (56%) with primitive agriculture (40% of the workforce but only 15% of GDP), of state ownership (mainly of infrastructure and industry) with a thriving and vibrant private sector (mainly textiles). Income inequality is great and GDP per capita is c. $2000 in current exchange rates. Despite the fact that it enjoys a robust investment rate of 25% of GNP and a merchandise trade which amounts to 50% of its GNP - Turkey was rated a poor 86 in the 1999 UNDP Human Development Index. Adult female illiteracy is higher than Albania's (at 25%), and infant mortality (38 per 1000) is almost African. Less than 35% of the roads are paved.

More than a million Turks work abroad and their remittances are of crucial importance to the foreign exchange reserves of the country and to its economy. More than 40% of the government's budget is used to defray the domestic debt. This leads to consistent fiscal deficits of 10% of GDP (though the budget sports a primary surplus). Turkey has consistently been on the verge of hyperinflation, with double digit inflation the norm (though recently it dropped below 40%).

Yet, Turkey's fate is determined not in Ankara or Brussels, but in Washington. Should the coalition attack Iraq, or isolate Syria, or fail to coerce Israel (Turkey's improbable ally in the region) to accommodate Palestinian needs - Turkey will be the first and foremost to suffer the consequences. An oil-rich and trouble stirring Kurdish state in Iraq, a water dispute with Syria, a wave of Islamist anti-Israeli zeal - could all undo a year's worth of economic overhaul. The military is likely to re-assert itself in any such crisis and the EU will keep mum, averse to jeopardizing the US-led grand coalition.

Moreover, the likes of Iraq are Turkey's neighbors and natural trade partners. It has a full time Ambassador in Baghdad, another border crossing is being negotiated, and dozens of Turkish business delegations visit Iraq (Turkey's erstwhile second largest trade partner) regularly. "The Economist" quotes Turkey as saying that "it has forfeited over $40 billion in trade because of the UN's continuing sanctions against Iraq." Naturally, the US is no too thrilled about Turkey's gravitation towards its arch enemy.

IFI's like the IMF and the World Bank are bound to play an inordinate and much resented role in Turkey's affairs in the foreseeable future. The World Bank, for instance, has pledged in excess of $5 billion and disbursed more than $2 billion. But most of this money goes towards disaster relief or support of IMF programs - and not to long term development projects. Ordinary Turks do not benefit from the World Bank's activities and believe, however erroneously, that they directly harmed by the IMF policies. Should Turkey also find itself the victim of US geopolitics, a wave of xenophobia and a backlash against liberalism and market economy might well ensue.

In emphasizing its "special relationship" with Turkey, the United States conveniently overlooked the fact - confirmed yet again by a recent Pew Global Attitudes Project survey - that 84 percent of Turks view America "unfavorably".

According to the Anadolu news agency, the Chairman of the Union of Chambers and Commodity Exchanges in Turkey, Rifat Hisarciklioglu, cajoled his countrymen on Monday to rid themselves of their dependence on "foreign" assistance - common euphemism for handouts from America and, as the Turks firmly believe, its long arm, the International Monetary Fund.

A country's foreign policy stature, he averred, is conferred by its domestic product. Somewhat implausibly, he pegged Turkey's war-related damages this year at $16.2 billion and between $70-150 in the following decade. It will have to resort to more expensive alternative sources of oil. Tourism, its second largest foreign exchange earner, will wither.

If true, Turkish refusal to be used by U.S. troops as a launching pad for a second, northern, Iraqi front - was nothing short of suicidal.

Turkey could have ended up with $30 billion in sorely needed aid and loan guarantees - now reduced, perhaps, to a mere $8.5 billion in commercial debt in return for overflight rights. Moreover, future IMF aid and even disbursements from an existing standby agreement are in jeopardy.

Last year, at the behest of the United States, Turkey received another dollop of $17 billion in multilateral funds to shore up its ailing economy. According to the Washington Post, it already owes the Fund five times the ordinary borrowing limit under the lending agency's rules.

The country's finances are in dire straits. Its foreign debt catapulted from $50 billion in the wake of the first Gulf war - to more than $130 billion in the run-up to the second. The government's economic policies are still founded on the defunct assumption that U.S. aid will be allotted, despite Turkey's denial of service.

Inflation, at more than 25 percent, is rising as are real interest rates - at 30 percent above inflation - and an already unsustainable $95 billion in domestic public debt, a sizable chunk of it extremely short term. Financial markets and the currency are plummeting. The yield on Turkish bonds is a stratospheric 70-80 percent. An incredible three quarters of the budget are earmarked for debt repayments.

The country should service $80 billion in obligations in the remainder of this year. Not surprisingly, Standard and

Poor's is contemplating a lowering of Turkey's country rating, currently below investment grade at B1. Fitch went ahead and reduced Turkey's rank to B minus with a negative outlook to boot - akin to destitute and near-default Moldova.

According to Stratfor, the strategic forecasting consultancy, risk premiums on Turkish treasuries leaped 90-122 basis points on March 17 alone - to 9.5 percent above comparable U.S. bonds. This spread narrowed by 0.85 percent the following day when Turkey came up with the offer to allow U.S. planes to make use of its air space.

Closer integration with the European Union, warned EU enlargement commissioner, Günter Verheugen, will be adversely affected by any unilateral Turkish move in north Iraq. The acrimonious breakdown of reunification talks between the Greek and Turkish-sponsored parties in Cyprus did not help either.

Turkey has been allocated $1.1 billion by the EU as pre-accession aid. Unruly behavior on its part may endanger this carrot as well. To complicate matters further, America may drop its staunch political and pecuniary support for the Baku-Ceyhan Main Export oil Pipeline (MEP).

Nor is the domestic situation less ominous.

The new, hitherto popular, prime minister, Recep Tayyip Erdogan, vowed on Sunday to "carefully and diligently" implement the IMF's agonizing austerity program which calls for spending cuts of $2 billion by the end of the month, the privatization of the tobacco and alcohol monopolies and tax reform. The 2003 budget envisages a primary surplus of 6.5 percent of gross national product. It aims to raise revenues by $5 billion and cut expenditure by $3 billion.

Such prescriptions ill-fit with promises to help the poor and fiscally boost growth. But a mid-April loan tranche of $1.6 billion - of the $3.5 billion left to be disbursed - is dependent on strict adherence. Nor is a new agreement with the IMF in the offing without considerable U.S. pressure or its implicit guarantee, both now unlikely.

The threat of dispatching troops to northern Iraq is Turkey's last, desperate, card in a depleted deck. To avoid this cataclysmic scenario, the United States may yet, teeth gnashing, revive the moribund economic aid package it has seethingly withdrawn. The alternative is an Argentina-style default with a shock wave cruising through a volatile and ignitable Middle East - or a military dictatorship in Ankara.

It is ironic that relations between Turkey and Israel have never been better. The former is ruled by yet another Islamic government - though constrained by secular-minded generals. The latter is increasingly nationalistic-Messianic and theocratic - though its newly elected Prime Minister, a former army general, Ariel Sharon, has just put together a largely secular coalition government.

Each year, more than 300,000 Israelis spend their vacation - and more than a quarter of a billion dollars - in scenic and affordable Turkish resorts. A drought-stricken Israel revived a decade-old plan to buy from Turkey up to 400 million cubic meters a year, instead of expensively desalinating sea water.

Israeli land use, hydrological and agricultural experts roam the Texas-sized country. The parties - with a combined gross domestic product of $300 billion - have inked close to thirty agreements and protocols since 1991. Everything, from double taxation to joint development and manufacturing of missiles, has been covered.

Buoyed by a free trade agreement in force since 1997, bilateral trade exceeded $1.5 billion last year, excluding clandestine sales of arms and weapons technologies. According to the Turkish Ambassador to the United States, "Turkish exports to Israel consist mainly of manufactured goods, foodstuffs and grain, while Israel's main export items to Turkey are chemical products, plastics, computers and irrigation and telecommunications systems technologies."

A sizable portion of Turkey's $3-5 billion in annual spending on the modernization of its armed forces is rumored to end in Israeli pockets. This is part of a 25-year plan launched in 1997 and estimated to be worth a total of $150 billion. Israeli contractors are refurbishing ageing Turkish fighter planes and other weapons systems at a total cost exceeding $2 billion hitherto.

Last May, the Israeli Military Industries and Elbit secured a $688 million contract to upgrade 170 M-60A1 tanks. There are at least another 800 pieces in the pipeline. Small arms, unmanned aerial vehicles and rockets originating in Israel make only part of a long shopping list. Israeli pilots regularly train in Turkey. Joint military exercises and intelligence sharing are frequent. The Israeli backdoor allows friendly American administrations to circumvent a rarely Turkophile Congress.

The American-Israel Public Action Committee (AIPAC), the Jewish Institute for National Security Affairs (JINSA) and, more generally, the almighty Jewish lobby in Washington, often support Turkish causes on the Hill. Three years ago, for example, Jews helped quash a resolution commemorating the Armenian genocide perpetrated by Turkish forces during the first world war.

This exercise in hypocrisy did not endear the Jewish community or Israel to either Armenians or to European Union cardholding Greeks who have long permitted Palestinian terrorists to operate from the Greek part of Cyprus with impunity. The friend of my enemy is my enemy and Israel is clearly Turkey's Jewish friend.

But Israeli hopes that Turkey will reciprocate by serving as a conduit to Arab regimes in the Middle East proved to be ill-founded. Only one tenth of Turkish trade is with its neighbors near and far. Turkey's leverage is further limited by its chronic economic distress and its offensive designs to monopolize waterways shared by adjacent countries.

Though Moslem, like the Iranians, Turkey is not an Arab nation. It counts Syria, Iraq and Iran as potential enemies and competitors for scarce water resources - as does Israel. The recent rebuff by its parliament of America's request to station troops on Turkish soil notwithstanding, the country is defiantly pro-American against a backdrop of anti-Western virulence.

Turkey aspires to join the European Union because it regards itself as an island of civilization in an ocean of backwardness and destitution. This counter-regional orientation is another thing it has in common with the

Jewish state. In an effort to differentiate themselves, both polities were early adopters of economic trends such as deregulation, equities, venture capital, entrepreneurship, privatization and hi-tech.

Turkey was the first Moslem state to recognize an ominously isolated Israel in 1949. Both Israel and Turkey are democracies though they are implicated in systemic human rights violations on a massive scale. The political class of both is incestuously enmeshed with the military.

The two countries face terrorism on a daily basis and feel threatened by the rise of militant Islam, by the spread of weapons of mass destruction - though Israel is hitherto the only regional nuclear power - and by global networks like al-Qaida.

In his travelogue, "Eastward to Tartary", published in 2001, Robert Kaplan notes:

"Turkey's more friendly position toward Israel was the result of several factors. (Turkey) became tired of diplomatic initiatives that failed to induce the Arabs to end their support of the Kurdish Workers' party, which was responsible for the insurgency in southeastern Turkey. The Turks felt, too, that the Jews could help them with their Greek problem (via the Jewish lobby) ... (The Turks realized) they might never gain full admittance to the European Union. Thus, they required another alliance."

This confluence of interests and predicaments does not render Israel the darling of the Turkish street, though. Turks, addicted to conspiracy theories, fully believe that the second Iraq war is being instigated by the Israelis.

They also decry the way Israel manhandles the Palestinian uprising. Flag-burning demonstrations are common occurrences in Ankara and Istanbul. Suleyman Demirel, Turkey's former president, nearly paid with his life for the entente cordiale when a deranged pharmacist tried to assassinate him in 1996.

Turkey's power behind the throne and future prime minister, Recep Tayyip Erdogan, called Israel's Ariel Sharon a terrorist. The previous prime minister called Israel's behavior in the occupied territories "genocide" - hastening to reverse himself when faced with the possible consequences of his Freudian slip.

Indeed, the looming conflict in Iraq may well be the watershed of the Turkish-Israeli love fest. Turkey is growing increasingly religious and more pro-Arab by the year. The further the United States - Israel's sponsor and unwavering ally - pushes into the region, the less aligned are its interests with Turkey's.

Consider the Kurdish question. Turkey is committed to preventing, if need be by force of arms, the emergence of independent Kurdish polity in Iraq. It would also wish to secure oil-rich northern Iraq as a Turkish protectorate. But the Kurds - America's long-standing and long-suffering collaborators - are the United States' "Northern Alliance" in Iraq. It cannot abandon them for both military and moral considerations.

But even in the absence of such blatant conflicts of interests, Turkey's shift is inevitable, a matter of geography as destiny.

Turkey continues to ignore the Arab world at its peril. Regional conflicts fail to respect international borders - as the country is discovering, faced with the damaging Iraqi spillover. Until 1998, Syria, another restive neighbor, actively aided and abetted the rebellious Kurds. It may yet resume its meddling if Israel, its bitter enemy, is neutered through a peace accord. The dispute over precious water sources is embedded in Turkish-Syrian topography and is, therefore, permanent.

It may have been in recognition of these facts that Abdullah Gul, Turkey's prime minister, embarked on a tour of Arab capitals in January. Simultaneously, the Turkish Trade Minister, Korsad Touzman, led a delegation of 150 businessmen in a two day visit to Baghdad to discuss trade issues. Turkey claims to have sustained damages in excess of $30 billion in the 1991 Gulf War - a measure of its regional integration.

Turkey has also recently begun considering the sale of water in the framework of the "Manavgat Project for Peace" to Egypt, Jordan and even Libya. Turkey's foreign minister, Bashar Yakis, is a Turkish diplomat who knows Arabic and had served in Damascus, Riyadh and Cairo.

Turkey's Occidental orientation has proven to be counterproductive. As the European Union grows more fractured and indecisive and the United States more overweening and unilaterally belligerent, Turkey will have to give up its fantasies - bred by the country's post-Ottoman founding father, Kemal Ataturk - of becoming an inalienable part of Western civilization.

Both Turkey and Israel will, in due time, be forced to accept - however reluctantly - that they are barely mid-sized, mostly Asiatic, regional powers and that their future - geopolitical and military, if not economic - lies in the Middle East, not in the Midwest. Turkey could then serve as a goodwill mediator between erstwhile enemies and Israel as a regional engine of growth.

Until they do, both countries are major founts of regional instability, often deliberately and gleefully so.

Israeli engineering firms, for instance, are heavily involved in the design and implementation of the regionally controversial Southeast Anatolian Project (GAP), intended to block Turkish water from reaching Syria and Iraq. Additionally, protestations to the contrary aside, the thrust of Israel's burgeoning military cooperation with Turkey is, plausibly, anti-Arab.

Turkish security officials confirmed to the English-language daily, Turkish Daily News, in March last year, that Turkey worked with Israel to counter the Hezbollah in Lebanon. As early as 1998, Turkey threatened war with Syria - and mobilized troops to back up its warnings - explicitly relying on the always-present Israeli "second front". The Egyptian government's mouthpiece, the daily al-Ahram, called this emerging de-facto alliance "the true axis of evil".

Israel's massive army, its nuclear weapons, its policies in the West Bank and Gaza, its influence on right-wing American decision-makers and legislators - provoke the very same threats they are intended to forestall, including terrorism, the coalescence of hostile axes and alliances and the pursuit of weapons of mass destruction by regional thugs.

Turkey's disdain for everything Arab, its diversion of the Tigris, Asi and Euphrates rivers, its arms race, its suppression of the Kurds and its military-tainted democracy have led it, more than once, to the verge of open warfare. Such a conflict may not be containable. In 1995, Syria granted Greece the right to use its air bases and air space, thus explicitly dragging NATO and the European Union into the fray.

It is, therefore, the interest of the West to disabuse Turkey of its grandiosity and to convince Israel to choose peace. As September 11 and its aftermath have painfully demonstrated, no conflict in the Middle East is merely regional.

U-V-W

Ukraine, Economy of

Reading the Western media, one would think that Ukraine's main products are grotesquely corrupt politicians, grey hued, drab, and polluted cities, and mysteriously deceased investigative journalists and erstwhile state functionaries.

When another journalist was found dead in Odessa on New Year's Eve 2002, both the Prosecutor General and the Ukrainian Parliamentary Committee for Fighting Organized Crime and Corruption have accused the entire Ukrainian Cabinet of Ministers of collusion in shady dealings with Kazakhoil, the Kazakh national oil monopoly.

The "Orange Revolution" in October-November 2004 the disorderly, though popular, transfer of power from one group within the "Dniepropetrovsk family", headed by Leonid Kuchma and his henchman to another faction, headed by the volatile and incompatible Viktor Yushchenko and Yulia Timoshenko led to more deaths in unexplained circumstances.

Both Yushchenko and Timoshenko had served in senior positions (as prime minister, for instance) in the ancien regime and, therefore, may have skeletons in their cupboards. The spate of "suicides" committed by former and knowledgeable functionaries came as no surprise - both parties, outgoing and incoming, have a vested interest in suppressing embarrassing revelations.

From December 2001 onwards, the Legsi (the Lehman Brothers Eurasia Group Stability Index) kept warning against a deterioration in Ukraine's social stability, owing to fiercely resisted austerity measures.

Until recently, things were not auspicious on the international front as well. During the Balkan hostilities between Macedonians and Albanians in 2001, Ukraine supplied Macedonia with attack helicopters and other weaponry over the strident objections of the State Department. Its strategy of ever closer union with Russia and China was in ruins following the sudden shift in Putin's geopolitical predilections after the September 11 attacks. And to spite the EU (which forced Poland to impose strict controls on its porous border with Ukraine) - "starting from 1 January 2002, Kyrgyz citizens, like the citizens of Azerbaijan, Armenia, Kazakhstan, Tajikistan and Uzbekistan, may enter, leave and pass through Ukraine without visas" as the Kyiv based UNIAN news agency jubilantly announced on January 4th, 2002.

Its parliament having failed to pass a government sponsored law against the unlicensed production of CD ROM's (piracy) - the Ukraine was subjected on January 2, 2002 to much postponed US imposed stiff trade sanctions (estimated to cost it $500 million per year). The employees of Ukraine's largest CD maker, Rostock Records, demonstrated opposite the US embassy against the sanctions, denouncing them as "economic terrorism". The International Federation of Phonographic Industry (IFPI) countered by saying that "Ukraine is the largest exporter of pirated CDs to Europe, with tens of millions of high quality illegal copies shipped each year to markets throughout Europe and as far away as South America."

At any rate, following its blatant intervention in the political machinations which led to the Orange Revolution in October-November 2004, anti-American sentiments are running higher than usual in the eastern, Russophile parts of the country.

Ukrainian discontent is further exacerbated by the American continued threat to slap tariffs on steel imports despite a last minute agreement signed in 2001 with the EU and other major steel manufacturing countries to curb worldwide production. Ukraine has agreed to cut its output by 11 million tons annually (out of a total reduction of 97.5 million tons). Depressed prices for gallium (used mainly in the recession-struck mobile phones industry) have gravely affected Ukraine's only alumina producer (Mykolaevsky Hlynozyomny Zavod) which has just quintupled its capacity to 10 tons.

Ukraine is optimally located between Central Europe and Russia. It is the largest polity in East Europe and the second largest country is Europe (almost the size of Texas). It is rich in natural endowments, though hopelessly polluted (Chernobyl is in the Ukraine) and deforested. In the former USSR, it provided 25% of all agricultural produce. The Soviet mining and oil industries relied on Ukrainian heavy industry for their equipment. The literacy rate in Ukraine is 100% and many are polyglot.

Yet, these Ukrainian riches were squandered in the decade following independence. Dependence on energy and a reform effort thwarted by entrenched Communist era stalwarts led to a 60% drop in GDP compared to 1991 (the year of its independence). Frenetic money printing resulted in hyperinflation in 1993. Inflation has still not been subdued and has topped 26% as late as 2000.

More than 50% of the population are under the official, starvation level, poverty line. Though only 5.3% are registered as unemployed, both underemployment and hidden unemployment are rampant. Mercurial and default prone Russia is still Ukraine's main trade partner (c. 30% of its international trade). Each of Ukraine's 49 million citizens owes $200 to foreign creditors - the equivalent of 30% of GDP per capita. Public debt has doubled to c. 50% of GDP in the four years to 2000. Worse still, Ukraine is increasingly used as a drug smuggling route and drugs growing area for the CIS. Synthetic drugs are manufactured in the Ukraine and smuggled to the countries of Western Europe.

Ukraine is a major target for Russian investors, especially from the energy sector. Putin appointed Victor Chernomyrdin, a political heavyweight - a former Prime Minister and, more importantly, a former chairman of Gazprom, the Russian energy behemoth - as Russia's ambassador in Kyiv. Ukrainians are not against Russian investment - but they are averse to the political strings it comes attached to. They also resent the bargain basement prices at which their most valued assets are "privatized" to these old-new "foreign" investors. Inevitably, they ask themselves "cui bono" - who benefits personally from these questionable transactions. The answer is not too hard to guess - but guessing has proven to be a dangerous occupation. At least one muck-raking journalist has been (literally) beheaded and a senior politician (now prime minister in the new regime) jailed for trying to reform the energy sector.

Inevitably, Ukraine is socially and politically strained. Its western parts are fiercely nationalistic and West oriented. Its eastern parts lean more towards Russia and are USSR-nostalgic. But this apparent schism is no bad thing. It provides Ukrainians with a secure foothold in both worlds - and no one seriously considers secession.

Unnoticed by many, Ukraine is undergoing a seismic shift which may result in an economic revival of Chinese proportions.

When Viktor Yushchenko, the popular Prime Minister and darling of the West was brutally ousted in May 2001 by the authoritarian President, Kuchma (himself hailed as a daring reformer by the IMF when elected in 1994), everyone predicted a calamity. Yet, Yushchenko moved since then to the centre in what appears to be an implicit reconciliation with the president.

His replacement, Anatoly Kinakh, surprised everyone by proving to be an efficient and modernizing technocrat. Ukrainian bonds returned to investors more than 60% net in 2001-2, making them the best emerging markets investment by far. Its capital markets are gradually being internationalized. The much maligned Kuchma introduced a sweeping anti-money laundering decree (later to become law). Ukraine (since its 1998-2000 series of de facto defaults following the financial meltdown in Russia) is now a model debtor. In August 2000 it has even re-paid the IMF $100 million.

Possibly emboldened by his re-election in 1999, Kuchma seemed to be making real efforts to streamline the government (which anyhow consumes a mere 18% of GDP), cut red tape, consolidate the government's fiscal stance (Ukraine had small budget deficits, excluding privatization receipts, in 1999-2001), become a WTO member, and create a legal environment conducive to private enterprise and entrepreneurship.

A new Land Code - passed by a surprising ad hoc parliamentary alliance and providing for the (limited) private ownership of land - took effect on January 2, 2002. Payment discipline in the critical energy sector was enforced, the agriculture sector was revamped, non cash revenue offsets and cronyist tax exemptions were entirely eliminated, government arrears (including pensions) were substantially reduced (though new arrears have again accumulated thereafter), a privatization law was finally introduced, and municipal finance was rationalized.

The government's contractionary fiscal rectitude (a new Budget Code was enacted and tax collection improved) was balanced by the central bank's (NBU) expansionary monetary policy aimed at increasing its dangerously dilapidated foreign exchange reserves (c. $2.4 billion in 2001) and spurring growth in the real sector. Rising demand for money and the propitious existence of a thriving informal (cash) economy prevented the resurgence of inflationary pressures - though inflation has picked up in December 2001, forcing the central bank to tighten in 2002 (it disputes the government's official figure of 6.1% inflation for 2001).

In 2000 the economy grew for the first time (by 6%). Growth was export driven and industrial output increased by 13%. The global recession has hurt Ukraine's export prospects but even so, it grew by 4-5% in 2001. It continued to expand by 2-4% each year in 2002-2004.

With a labour cost of 30 cents per hour, Ukraine attracts the interest of manufacturers in the US, in Central Europe, and even in Russia. Strong import growth may swing it back to a current account deficit (in a surplus of c. 5% of GDP in 2001, as it has been in the previous 2 years). Fiscal shenanigans ahead of the March 2002 and October 2004 elections (and the horse trading which inevitably followed) had ratcheted up the predicted inflation rate of 9-12% - but the appreciation of the hryvna is set to continue.

The economy is surprisingly modern. Only 24% are employed in agriculture (and they produce a mere 12% of GDP). More than double that is produced by industry (26% of GDP) and a whopping 62% of GDP is generated in services (in which only 44% of the labour force are employed).

On December 2001, S&P upgraded Ukraine's currency risk rating (both foreign and domestic) to "B" with a "Stable" long term outlook. On the pro side, S&P cited financial stability, partly the result of a rationalized and rescheduled foreign debt structure. On the con side, it cited the usual litany of corruption, weak legislature, problems with privatization and with structural reform and malignant oligarchs. These flaws being noted, it did upgrade Ukraine's rating - as did Fitch, Moody's and Japan's Rating and Investment Information Agency. The price of Ukraine's (mainly dollar denominated) Eurobonds appreciated dramatically on institutional buying immediately following the announcement.

Ukraine's image as bereft of Foreign Direct Investment is false. Moreover, c. 80% of all FDI in Ukraine is Western - not Russian. USA investors compete with Russian (cum

"Cypriot") investors - each holding 17% of the total stock of FDI (c. $4.5 billion in early 2002).

Moreover, Ukraine is now in good standing with the IMF (after a difficult 2001 in which the IMF virtually suspended all communication with Ukraine due to falsified data provided by the NBU). It has signed in 1998 a $2.6 billion arrangement (of which $1.6 billion are used). Another tranche of c. $380 million was approved in September 2001. The IMF singled out the banking, energy, and agriculture sectors as in need of continued, pervasive, reforms.

The World Bank has committed close to $3 billion (and disbursed $2.2 billion) to projects in Ukraine (mostly in the energy, mining, agriculture, finance, and private sectors) since 1992. The latest Country Assistance Strategy documents for Ukraine (2001-2003 and 2004-6) are unusual in that they seek to circumvent the hopelessly venal and discredited administration and work directly with the public, business, and NGO's towards building a civil society and its attendant institutions. "The strategy seeks to move Ukraine closer to the European Union standards, fostering environmentally-sustainable development" - says the Bank. though it hastens to emphasize the success the government had in implementing its reforms.

As of June 2001, the EBRD (which has a mixed track record in Ukraine) has approved 45 projects in Ukraine (34 of which in the private sector) worth 1.2 billion euro. This excludes the construction of a highly controversial and politically inspired nuclear power plant.

Ukraine has gone so low in the world that its fortunes can only improve. It is poised for a modest economic comeback as its mediating geographic position between centre and east comes into play with EU enlargement. Kuchma was eased out by the very oligarchs he nurtured. They now constitute an element in a broad based coalition for reform. Having sated their appetite for loot they now seek respectability and access to capital markets and credits in the West. They want a functioning country and a larger cake. Kuchma is a figurehead of a disfigured past. In the long run, a Putin style robotic reformer is likely to succeed him. When it happens, Ukraine may yet become the region's first economic tiger.

The "Orange Revolution" in October-November 2004 was a coup d'etat. It was a disorderly, though popular, transfer of power from one group within the "Dniepropetrovsk clan", headed by Leonid Kuchma and his henchman to another faction, headed by the volatile and incompatible Viktor Yushchenko and Yulia Timoshenko.

Both figures had served in senior positions (as prime minister, for instance) in the ancien regime and, therefore, may have skeletons in their cupboards. A spate of "suicides" committed by former and knowledgeable functionaries came as no surprise - both parties, outgoing and incoming, have a vested interest in suppressing embarrassing revelations.

Still, Ukraine's long-predicted economic revival is at hand. After a long hiatus, both the International Monetary Fund and the World Bank are expected to make new commitments in their forthcoming visits this year. As correctly observed by the former Finance Minister Mykola Azarov, Ukraine needs at least $600 to 800 million in fresh funds. Debt repayments amounted to $1.6 billion in both 2003 and 2004. Ukraine is even considering a bond issue.

Concurrently, as it did in 2003, NATO is likely to stage in Ukraine a massive one week long military exercise under the aegis of the "Partnership for Peace" - its collaborative program with the countries of East and Southeast Europe. It will involve army units from Armenia, Austria, Azerbaijan, Bulgaria, Germany, Georgia, Italy, Canada, Kyrgyzstan, Lithuania, Moldova, Norway, Poland, Romania, France, Ukraine, Uzbekistan and the United States.

But Ukraine was embraced by the international community long before the Orange Revolution. It is instructive to follow the rising temperatures that led to the thaw. It seems that in Ukraine's case carrots did the trick - not sticks, a lesson worth remembering in the forthcoming confrontation with Iran.

This, therefore, is an overview of the two years leading to Ukraine's 2004 presidential elections.

The USA already cancelled in 2003 financial sanctions it had earlier imposed on Ukraine on the recommendation of the Financial Action Task Force. Ukraine is no longer a center of money laundering, said the international watchdog. It was be removed from the agency's blacklist last year and joined the EGMONT group of the financial intelligence units of 69 countries.

There were other signs of thawing. A 16-month ban on $11 million in U.S. poultry imports was terminated in April 2003 with the signing of a revised veterinary certificate protocol. Simultaneously, Ukrainian officials held talks with their European Union counterparts to integrate the two space programs. Ukraine has expertise in launch vehicles, satellites and payloads. And Volkswagen inked a letter of intent in 2003 regarding the assembly of its Passat, Golf, Bora and Polo models in Ukraine.

According to Radio Free Europe/Radio Liberty, in March 2003, the EU offered Russia, Ukraine, and Moldova - its future neighbors following enlargement - "preferential trade terms, expanded transport, energy, and telecommunication links, and the possibility of visa-free travel to the EU." The door to future accession was left ajar, though the inclusion of North African nations in the "New Neighborhood Policy" bodes ill for Ukraine's future membership.

Long-stalled negotiations between Ukraine and the European Bank for Reconstruction and Development over the $215 million financing of two much-disputed nuclear power plants to replace the smoldering Chernobyl reactor were mysteriously restarted in April 2003 and successfully concluded the year after, to the chagrin of many environmentalists. The Bank's President, Jean Lemierre, promised at the time positive results by summer - despite environmental concerns and studies, financed by the EBRD itself, which cast in doubt the project's feasibility.

Quoted by Interfax-Ukraine, then Foreign Ministry spokesman Markijan Lubkivskyy, announced in early April 2003, that "the U.S. may subcontract Ukrainian companies (for postwar reconstruction in Iraq), particularly those that have experience in working with firms in the Persian Gulf."

There were good news from the East as well.

Turkmenistan and Russia started negotiating with Ukraine - a major gas importer - a tripartite 25 year agreement to exploit and export Turkmen natural gas with prices frozen throughout at current levels, well below the market. In return, Ukraine is supposed to co-finance the construction of a $1 billion, 1070 kilometer long, 30 to 40 billion cubic meters a year, pipeline, mostly on Kazakh territory, along the shores of the energy-rich Caspian Sea.

Inevitably, not all was rosy.

In contravention of all prior measures of liberalization, President Leonid Kuchma administratively halved grain exports to 1 million tons a month, due to a weak harvest in the first quarter of 2003 and rising domestic grain prices. The Crimean agricultural ministry announced at the time that one is seven hectares of winter crops - mostly barley - are lost due to the harsh weather.

This is half the average ratio in other parts of Ukraine. According to AgWeb.com, "the country's milling wheat crop (in 2003) may be only 10 million metric tons to 12 MMT, down sharply from 22 MMT in 2002 and 26 MMT in 2001". Domestic consumption, at 7 million tons, now equals inventories.

The country - formerly Europe's breadbasket - still lacks modern infrastructure and grain storage facilities. Its extempore export policy is muddled. Agricultural imports are surging. Ukraine bought 70,000 tons of - mainly Brazilian - sugar in February 2003 alone.

In the worst of Stalinist traditions, the former Deputy Prime Minister for Agriculture Leonid Kozachenko, a reformer, was promptly arrested by Kuchma's security apparatus for "bribery and tax evasion". Grain merchants, foreign investors and multinationals included, were placed under official scrutiny.

In an unusually strongly worded letter to Ukraine's then Ambassador to the United States Kostyantyn Hryshchenko, President of Ukraine-US Business Council, Kempton B. Jenkins wrote:

"We hope that this effort to turn back the clock to Soviet-style management of Ukraine's critical sector will soon disappear and allow Ukraine's dramatic march to productivity and prosperity to resume."

Nor has Ukraine forsaken its erstwhile clients, frowned upon by an increasingly assertive United States. According to IRNA, the Iranian news agency, a Ukrainian delegation visited Iran in April 2003 to discuss the construction of Antonov An-140 aircraft. Later that week, Pakistan and Ukraine negotiated a free trade agreement.

Standard and Poor's, the international rating agency, concluded, in a report it released the same month, that "despite some early successes, the political environment in Ukraine remains difficult and financing uncertainties continue".

The Sovietologist John Armstrong dubbed the Ukrainians the Russians' "smaller brothers". This is no longer true. Unlike Russia, Ukraine aspires to NATO membership but is far less pro-American. It seeks Russian investments but is wary of the imperial intentions of its neighbor. Despite

Russian coaxing, Ukraine hasn't even joined the Eurasian Economic Community, a pet project of the Russia-dominated Commonwealth of Independent States.

In the meantime, Ukraine is bleeding both its least-skilled, menial workers - and its most highly educated brains. Ukrainians are welcome nowhere and abused everywhere. Israel deported 300 illegal Ukrainian aliens in 2003 alone. Others - notably Turkey, Hungary, Poland, Slovakia, and Italy - followed suit.

Ukraine's then ombudswoman Nina Karpachova pegs the number of economic exiles at between 2 and 7 million. At least 5 million - one fifth of the workforce - seek seasonal employment abroad. Remittances amount to between $2 and $3 billion a year.

One quarter of all Ukrainians barely survive under the wretched poverty line. Official unemployment - at 11 percent - underestimates the problem by half. A low birth rate conspires with elevated mortality to produce a self-induced demographic genocide.

Capital flight is on the rise and equals half the foreign direct investment in the economy. Then Governor of the National Bank, Sergiy Tyhypko, estimated in February 2003 that as much as $ 2.27 billion fled Ukraine in 2002 - compared to $898 million in 2001 and $385 million in 2000. This is the reflection of a thriving informal economy, half the size of its formal counterpart, by some measures.

Appearances aside, ubiquitous corruption, tottering banks, clannish institutions, compromised leadership, illicit deals and barely contained xenophobia are entrenched in

Ukraine's criminalized economy. As the 2004 presidential elections neared, the oligarchs augmented their war chests abroad. Kuchma failed to postpone the elections to 2006 or 2007. The opposition aggressively opposed such chicanery. Despite the Orange Revolution, or maybe because of it, Ukraine may be in for a bumpy ride ahead.

Unemployment and Labor

There is a connection between economic growth and unemployment. There is a connection between growth and inflation. Therefore, commonsense (and financial theory) goes, there must be a connection between inflation and unemployment. A special measure of this connection is the Non Accelerating Inflation Rate of Unemployment (NAIRU). Supposedly, this is the rate of unemployment which still does not influence inflation. If unemployment goes below NAIRU, inflationary pressures begin to exert themselves.

This is closely linked to the other concepts, those of "structural", "frictional" and "conjectural or cyclical" unemployment types.

Some unemployment, the theory, goes is frictional. It is the inevitable result of a few processes:

1. ***Labour Mobility*** – People move from one job to another, either because they are fired or because they seek to improve their lot. In the intervening period between leaving an old workplace and finding another, they are unemployed.

2. ***Labour Force Expansion*** – Every year there are new entrants to the labour market. Generations

mature and are ripe to be part of the labour force. Until they find their first job – these new participants are unemployed.

3. ***Seasonal and Part Time Employment*** – Some professions are seasonal by their nature (a hotel in a resort hotel, for instance). These workers join the ranks of the unemployed at certain times and desert them seasonally. Other workers prefer to work part time or in the "Grey" or "Black" economy. They go unreported or report themselves as unemployed, thus distorting the true picture of unemployment.

The frictional type of unemployment is a sign of economic health. It indicates a dynamic economy in fast development. It is a sign of labour mobility, of labour flexibility (part time solutions and flexitime) and of labour adaptability. This cannot be said about the second, more insidious, type, the structural unemployment. It is this kind of unemployment which really bothers governments and worries social planners. It has long term psychological and social effects and limits both economic growth and social cohesion. It is also the most difficult to battle.

Usually, it is the result of ingrained, long term and structural processes and changes in the economy and cannot be fought with artificial one-time measure (employment initiated by the state or fiscal stimulus intended to encourage employment). Among the factors which create it:

1. ***Technological change*** – new professions are created, old ones lose their lustre and, ultimately,

their place in the economy. New professions, connected to new technologies, emerge. Some workers can be retrained but even this takes time (in which they might, technically, be defined as unemployed). Others cannot be retrained and they join the ranks of the long term unemployed, swelling structural unemployment.

2. ***Changes in Consumer Preferences*** – Fashions change, mass consumption patterns alter, emphases on certain goods and services shift. Today's hot item is tomorrow's dead one. Whole industries can and are effected by these tectonic shifts.

3. ***Globalization and Cross Border Labour Mobility*** – Labour mobility is intentionally encouraged, the world over. Economic unions and trade pacts include social or labour chapters. The most notable example is NAFTA which created hundreds of thousands of new jobs in Mexico and in the USA. As companies go multinational, as production processes become global, as services and goods are exported and imported within a rising tide of international trade, as international brands develop – the biggest restructuring of labour markets is taking place across the globe in rich and poor countries alike. Consider the clear erosion of the power of the trade unions or the cheap labour available in Central and Eastern Europe and in parts of Southeast Asia. These cause jobs (even skilled ones) to be reallocated across political borders.

4. ***Skill Acquisition Failure*** – People who failed to acquire the minimum education necessary to participate in today's workforce (secondary high school) are doomed to be permanently unemployed or part time employed. School dropouts form a large part of the structural unemployment in many countries. In countries which are in the process of shifting from one economic system to another, even those with the right formal education are made redundant and useless by the new paradigm. Think about a professor of economy who studied and taught Marxist economy from the wrong textbooks – he is quite useless in a capitalist market economy and might find himself unemployed despite his high education.

The last, benign, type of unemployment is the cyclical one. It is the result of the natural business cycle (at least natural to capitalism) and of the ebb and tide of aggregate demand for workers which is a result of these cycles. This is considered to be an unavoidable side effect of market economy. The pain of the laid off workers can be ameliorated (through the introduction of unemployment benefits) but the solution comes from sorting out the cycle itself and not by attacking the unemployment issue in an isolated artificial manner.

The "Natural Rate of Employment" takes into account that frictional and structural employment must exist. What is left is really the full employment rate. This is highly misleading. First, economists are forced to rely on government data which, normally, tend to underestimate and understate the problem. For example: the statistics ignore "discouraged workers" (those who despaired and stopped looking for work). A second, more philosophical issue, is that, as opposed to frictional unemployment, which is a welcome sign, structural unemployment is not and must be fiercely fought by the state. But Economy give Politics a legitimacy to ignore structural unemployment as a part of life.

But the third problem is the most pressing: what is the "natural" rate of unemployment and how should it be determined? This is where NAIRU came in: the natural rate of unemployment could be construed as that rate of unemployment which prevented bad economic effects, such as inflation. In the USA this was estimated to be 5-6%. But this estimate was based on a long history of labour and inflation statistics. History proved the wrong guide in this case: the world has changed. Globalization, technological innovation, growing free international trade, growth in productivity, electronic money, the massive move to the "Third Wave" (Information and knowledge) industries – all this meant that inflationary pressures could be exported or absorbed and the employment could go much higher without fostering them. This became part of a new paradigm in economy which proclaimed the death of the business cycle and of the inflationary boom-bust phases. Though exaggerated and probably untrue, the "New Paradigm" did predict that productivity will grow, inflation will remain subdued, unemployment will decrease drastically and the prices of financial assets will explode – all simultaneously (which was considered hitherto impossible). The unemployment rate in the USA has stayed well below 5% and there are still no sign of inflation. This is remarkable (though probably short lived. Inflation will pick up there and the world over starting in 1998).

And what about Macedonia? It is one of a group of countries in transition that suffered an unprecedented series of external shocks separation from a Federation, the loss of virtually all export markets, economic siege, monetary instability, a collapse of the financial system, and, lately, interethnic tensions. Small wonder that it endured an outlandish (official) rate of unemployment (more than one third of the active workforce). Granted, the real unemployment rate is probably lower (many workers in the black economy go unreported) – still, these are daunting figures.

Is this a structural or frictional or cyclical unemployment? It is tempting to say that it is structural. It seems to be the result of trying to adapt to a brave new world: new technologies, new determinants of survival, new market mechanisms, the need for a set of completely new skills and new consumer preferences. But a closer analysis will yield a different picture: most of the unemployment in Macedonia (and in countries in transition in general) is cyclical and frictional. It is the result of massive layoffs which, in themselves, are the results of efficiency and productivity drives. It is not that the workforce is ill adapted to cope with the new, post-transition situation. The composition of skills is well balanced, the education, in some respects, better than in the West, labour mobility is enforced by the cruelty of the new labour markets, the pay is low and is likely to remain so (wage pressures don't go well with high unemployment). The workforce has adapted wondrously.

The failures belong to the management levels and, above all, to the political echelons. Unwilling to adapt, eager to make a quick (personal) buck, entrenched in cosy offices and old ways of thinking, more interested in their perks that in anything else, not educated in the new ways of the markets – they led themselves and their workers (=their voters) to the unemployment swamp. This unfortunate condition was avoidable.

There is no reason to assume that structural unemployment in Macedonia should be much higher than in Germany. The relative sizes and richness of the two economies is not relevant to this discussion. What is relevant is that labour in Macedonia is by far more mobile than in Germany, that it is paid much less, that it is, therefore, relatively more productive, that it is better educated, that both countries suffered external shocks (Germany the unification, Macedonia the transition), that both countries are macro-economically stable, that Macedonia has real natural and human endowments. By certain measures and theoretic formulas, the structural unemployment in Macedonia should be circa 9%, the frictional unemployment (the business cycle is turning up strongly so cyclical unemployment is bound to go down) contributing another 5%. The natural unemployment rate is, therefore, circa 15%.

Moreover, Macedonia is in the rare and enviable position of not having to worry about inflation or wage pressures. Even much higher employment will not create wage pressures. Only the most skilled workers will possess the ability to dictate their own wages and, even then, we are talking about ridiculous wages in Western terms. There is so much competition for every vacancy ("an employers' market") that the likelihood of demanding (and getting) higher wages (and, thus, generating inflationary pressures is all but non-existent). So NAIRU in Macedonian terms is an abstract notion with no applicability. Every additional percent of permanent employment in the West entails 2-3 as much in economic (GDP) growth. Macedonia has to grow by 10% and more annually to reduce the level of unemployment to 15% in 5 years (taking additions to the workforce into account). This is doable: Macedonia starts from such a low base that it would take little effort to achieve this kind of growth (to add 300 million USD to the GDP annually=3 months exports at today's rate).

But this rate of unemployment can be achieved only with the right policy decisions on the state level – and the right management cadre to take advantage of these decisions and of the thrilling new vistas of the global market scene. It is here that Macedonia is lacking – it is here that it should concentrate its efforts.

Communism abolished official unemployment. It had no place in the dictatorship of the proletariat, where all means of production were commonly owned. Underemployment was rife, though. Many workers did little else besides punching cards on their way in and out.

For a long time, it seemed as though Japan succeeded where communism failed. Its unemployment rate was eerily low. It has since climbed to exceed the United States' at 5.6%. As was the case in Central and Eastern Europe, the glowing figures hid a disheartening reality of underemployment, inefficiency, and incestuous relationships between manufacturers, suppliers, the government, and financial institutions.

The landscape of labour has rarely undergone more all-pervasive and thorough changes than in the last decade. With the Cold War over, the world is in the throes of an unprecedented economic transition. The confluence of new, disruptive technologies, the collapse of non-capitalistic modes of production, the evaporation of non-market economies, mass migration (between 7.5% - in France - and 15% - in Switzerland - of European populations), and a debilitating brain drain - altered the patterns of employment and unemployment irreversibly and globally.

In this series of articles, I study this tectonic shift: employment and unemployment, brain drain and migration, entrepreneurship and workaholism, the role of trade unions, and the future of work and retirement.

I. The True Picture

According to the ILO ("World Employment Report - 2001"), more than 1 billion people - one third of the global workforce - are either unemployed or underemployed. Even hitherto "stable" countries have seen their situation worsen as they failed to fully adjust to a world of labour mobility, competitiveness, and globalization.

Unemployment in Poland may well be over 18% - in Argentina, perhaps 25%. In many countries, unemployment is so entrenched that no amount of aid and development seem to affect it. This is the case in countries as diverse as Macedonia (35% unemployment) and Zimbabwe (a whopping 60%). The much heralded improvements in the OECD countries were both marginal (long term unemployment declined from 35% of the total to 31%) and reversible (unemployment is vigorously regaining lost ground in Germany and France, for instance).

Official global unemployment increased by 20 million people (to 160 million) between the nadir of the Asian crisis in 1997 and 2001. The situation has much deteriorated since. The ILO estimates that the world economy has to run (i.e., continue to expand as it has done in the roaring 1990's) - in order to stay put (i.e., absorb 500 million workers likely to be added to the global labour force until 2010). How can this be achieved with China unwinding its state sector (which employs 13% of its workforce) - is not clear. Add to this stubbornly high birth rates (esp. in Africa) and a steady decline in government hiring al over the world - and the picture may be grimmer than advertised.

But the rate of unemployment is not a direct and exclusive result of growth or the lack thereof. It is influenced by government policies, market forces (including external shocks), the business cycle, discrimination, and investment - including by the private sector - in human capital.

The problem with devising effective ways of coping with unemployment is that no one knows the true picture. Taking into account internal, rural-to-urban, migration patterns and the growth of the private sector (it now employs 5% of the labour force) - China may have a real unemployment rate of 9.5% (compared to the official figure of 3.1%). Egypt's official rate is 8% -but it masks vast over-employment in the public sector. Lebanon's is 9% - due to a one-time reconstruction bonanza, financed by the billionaire-turned-politician, Hariri. Algeria's unemployed easily amount to half the work force - yet, the published rate is 29%. In numerous countries - from Brazil to Sri Lanka - many people are mainly employed in casual work.

The average unemployment rate in Central and Eastern Europe is 14% - but it is double that (more than 30%) among the young (compared to 15% for West European youths). The average is misleading, though. In Georgia the rate is 70% - in the Czech Republic 16%.

Even in the OECD, the tidal wave of part-time workers, short term contracts, outsourcing, sub-contracting, and self-employment - renders most figures rough approximations. Part time work is now 20% of the OECD workforce (German attempts to reverse the trend notwithstanding). Temporary work and self-employment constitute another 12% each. No one knows for sure how many illegal economic migrants are there - but there are tens of millions of legal ones.

II. The Facts

IIa. Labour Mobility

"Mobility", "globalization", "flextime" - media imagery leads us to believe that we move around more often, and change (less secure) jobs more frequently. It is not so. By many measures, the world is less globalized today than it was a century ago. Contrary to popular perceptions, job tenure (in the first 8 years of employment) has not declined, nor did labour mobility increase (according to findings published by the NBER and CEPR). Firms' hiring and firing practices are more flexible but this is because "sarariman" jobs are out of fashion and many workers (80% of them, according to the Employment Policy Foundation) prefer casual work with temporary contracts.

Workers keep moving, as they always have, among firms and between sectors. But they are still reluctant to relocate, let alone emigrate. The subjective perception of job insecurity is high, even after the most prosperous decade in recent history. Witness the sparse movement of labour among members of the EU, despite the existence, on paper, of a single labour market. Still, rising systemic unemployment everywhere serves to increase both the efficiency and productivity of workers and to moderate their wage claims.

IIb. Collective Bargaining

Studies linked collective bargaining to an increased wage level, decreased hiring and more rigid labour markets. But unionized labour has greatly contracted in almost all OECD countries. Why has unemployment remained so persistently high?

In France and the Netherlands collective agreements were applied to non-unionized labour (close to four fifth of the actually employed in the latter). Employment increases only where both union membership and coverage by collective agreements are down (USA, UK, New Zealand, Australia).

There are different models of wage bargaining. In the USA and Canada agreements are sometimes signed at the firm or even individual plant level. Throughout Scandinavia (though this may be changing in Norway and Denmark now that centre-right parties have won the elections), a single national agreement prevails. There is no clear trend, though. Britain, New Zealand and Sweden decentralized their collective bargaining processes while Norway and Portugal are still centralized.

Both types of bargaining - centralized and decentralized - tend to moderate wage demands. Centralized bargaining forces union leaders to consider the welfare of the entire workforce. Either of the pure models seems preferable to a hybrid system. The worst results are obtained with national bargaining for specific industries. Hybrid-bargaining Europe saw its unemployment soar from 3 to 11% in the last 25 years. Pure-bargaining USA maintained a low unemployment rate of 5-6% during the same quarter century.

IIc. Unemployment Benefits

Blanchard and Wolfers studied 8 market rigidities in 20 countries (including the EU, USA, Canada, and Japan) between the years 1960-96. The unemployment rate in an imaginary composite of all the studied countries should have risen by 7.2% in this period. But unemployment increased by twice as much in countries with strict employment protection laws compared to countries with laxer labour legislation.

Unemployment in the country with the most generous unemployment benefits grew five times more than in the most parsimonious one. It grew our times faster in countries with centralized wage bargaining than in countries with utterly decentralized bargaining. Labour market rigidities all amplify the effects of asymmetrical shocks - which bodes ill for the eurozone.

Other studies (e.g., the 1994 OECD one year study, the more substantial DiTella-MacCullouch study) seem to support these findings. The transition from a rigid to a flexible labour market does not yield immediate results because it increases labour force participation. But the unemployment rate is favorably affected later.

IId. Minimum Wages

In the USA, the minimum wage is 35% of the median wage (in France it is 60%, in Britain - 45%, and in the Netherlands it is declining). When wages are downward-flexible - more lowly skilled jobs are created. A 1% rise in the minimum wage reduces the probability of finding such a job by 2-2.5% in both America and France, according to the NBER (Lemieux and Margolis).

The proponents of minimum wages say they reduce poverty and increase the equality of wealth distribution. Their opponents (such as Peter Tulip of the Federal Reserve) blame them for job destruction, mainly by raising the NAIRU. The OECD's position is that wage regulation cannot remedy poverty. As "The Economist" succinctly puts it, "few low paid workers live in low-income households and few low-income households include low paid workers. (Thus), the benefits of the minimum wage, such as they are, largely bypass the poor."

Again, it is important to realize that unemployment is not universal - it is concentrated among the young, the old, the under-educated, the unskilled, and the geographically disadvantaged. One in eight of all workers under the age of 25 in the USA are unemployed, more than twice the national average (the figure in France is one in four). A 10% rise in the minimum wage - regardless of its level - reduces teenage employment by 2-4%, calculates the OECD.

Many countries (USA, UK, France) introduced "training wages" - actually, minimum wage exemptions for the young. But even this sub-minimum wages still represent a high percentage of mean youth earnings (53% in the USA and 72% in France) and thus have an inhibiting effect on youth employment.

Minimum wages do reduce inequality by altering the income distribution and by equalizing wages across ages and genders - but they have no effect on inequality and poverty reduction, insists the OECD. "The Economist" quotes these figures (in 1998):

"In American households with less than half the median household income, only 33% of adults have a low-paid job. (compared to 13% in the Netherlands and 5% in the UK). In most poor households no one is employed in a regular job. Many low earners, on the other hand, have well-paid partners, or affluent parents ... Only 33% of those Americans who earn less than two-thirds of the median wage live in families whose income is less than half the national median. (In the UK the figure is 10% and in Ireland - 3%). Over a 5-year period, only 25% of low paid Americans are in a poor family at some point; in Britain 10% are."

Thus, minimum wages seem to hurt poor families with teenagers (by making teenage employment unattractive) while benefiting mainly the middle class.

Still, the absolute level of the minimum wage seems to be far more important that its level relative to the average or median wage. Hungary's unemployment went down, from 9% to 6%, while its minimum wage went up (in real terms) by 72% in 1998-2001. During the same four year period, its economy grew by an enviable 5% a year, real wages skyrocketed (by 17%), and its inflation dropped to 7% (from 16%).

IIe. Structural Unemployment

Most unemployment in Europe is structural (as high as 8.9% in Germany, according to a 1999 IMF study). It is the ossified result of decades of centralized wage bargaining, strict job protection laws, and over-generous employment benefits. The IMF puts structural unemployment in Europe at 9%. This is compared to the USA's 5% and the UK's 6% (down from 9%). The remedies, though well known, are politically unpalatable: flexible wages, mobile labour, the right fiscal policy, labour market deregulation, and limiting jobless benefits.

Some hesitant steps have been taken by the governments of Germany and France (cut jobless benefits and turned a blind eye to temporary and part-time work), by Italy (decoupled benefits from inflation), and by Belgium, Spain and France (reduced the minimum wage payable to young people).

But piecemeal reform is worse than no reform at all. In an IMF Staff Paper, Coe and Snower describe the Spanish attempt to introduce fixed term labour contracts. It established two de facto classes of workers - the temporary vs. the permanently employed - and, thus, reduced labour market flexibility by granting increased bargaining power to the latter. France introduced a truncated, 35-hours, working week. Other countries imposed a freeze on hiring with the aim of workforce attrition through retirement. Yet, these "remedies" also led to an increase in the bargaining power of the remaining workers and to commensurate increases in real wages.

IIf. Unemployment and Inflation

Another common misperception is that there is some trade off between unemployment and inflation. Both Friedman and Phelps attacked this simplistic notion. Unemployment seems to have a "natural" (equilibrium) rate, which is determined by the structure and operation of the labour market and is consistent with stable inflation (NAIRU - Non Accelerating Inflation Rate of Unemployment).

NAIRU is not cast in stone. Employment subsidies, for instance, make low skilled workers employable and lower NAIRU. So do unilateral transfers which raise incomes. According to Phelps, big drops in unemployment need not greatly increase permanent inflation. Stiglitz calculated that America's NAIRU may have dropped by 1.5% due to increased competition in the markets for jobs and goods. These findings are supported by other prominent economists. Stiglitz concluded that NAIRU, in itself, is meaningless. It is the gap between the estimated NAIRU and the actual rate of unemployment that is a good predictor of inflation.

IIg. The Rhineland Model, the Poldermodel, and Other European Ideas

The Anglo-Saxon variant of capitalism is intended to maximize value for shareholders (often at the expense of all other stakeholders).

The Rhineland model likes to think of itself as "capitalism with a human face". It calls for an economy of consensus among stakeholders (shareholders, management, workers, government, banks, other creditors, suppliers, etc.).

Netherlands, too, has an advisory Social and Economic Council. Another institution, the Labour Foundation is a social partnership between employees and employers. Both are relics of a corporatist past.

But the Netherlands saw its unemployment rate decline from 17% to less than 2% while ignoring both models and inventing the "Poldermodel", a Third Way. Wim Duisenberg, the Dutch Banker (currently Governor of the European Central Bank), quoted in an extensive analysis of the Poldermodel prepared for "The Economist" by Frits Bolkstein (a former Dutch minister for foreign trade), attributed this success to four elements:

1. Improving state finances;
2. Pruning social security and other benefits and transfers;
3. Flexible labour markets;
4. A Stable exchange rate.

According to Thomas Mayer and Laurent Grillet-Aubert ("The New Dutch Model"), the "Dutch Miracle" traces its beginnings to 1982 and the Wassenaar Agreement in which employers' organizations and trade unions settled on wage moderation and job creation, mainly through decentralization of wage bargaining. The government contributed tax cuts to the deal (these served to compensate for forgone wage increases). These cuts generated a fiscal stimulus and prevented a contraction in demand as a result of wage moderation. Additionally, both social security payments and the minimum wage were restricted. Wage increases were no longer matched by corresponding increases in minimum social benefits. Working hours, hiring, firing and collective bargaining were all incorporated in a deregulated labour market.

Small and medium size businesses costly regulation was relaxed. Generous social security and unemployment benefits (a disincentive to find work) were scaled back. Sickness benefits, vacation periods, maternal leave and unemployment benefits were substantially adjusted.

The Netherlands did not shy from initiating public works projects, though on a much smaller scale than France, for instance. The latter financed these projects by raising taxes and by increasing its budget deficit. The Dutch preferred to rely on the free market.

Long term (more than 12 months) unemployment in Europe constitutes 30% of the total. About half the entire workforce under the age of 24 is unemployed in Spain - and about one quarter in France and in Italy. Germany, Austria and Denmark escaped this fate only by instituting compulsory apprenticeship. But the young unemployed form the tough and immutable kernel of long-term unemployment. This is because a tug of war, a basic conflict of interest, exists between the "haves" and "have-nots". The employed wish to defend their monopoly and form "labour cartels". This is especially true in dirigiste Europe.

While, in the USA, according to McKinsey, 85% of all service jobs created between 1990-5 paid more than the average salary - this was not the case in Europe. Add to this European labour immobility - and a stable geographical distribution of unemployment emerges.

The Dutch model sought to counter all these rigidities. In a report about "The Politics of Unemployment" dated April 1997, "The Economist" admiringly enumerated these steps:

- The Dutch reduced social security contributions from 20% (1989) to 7.9% and they halved the income tax rate to 7% (1994).
- They allowed part time workers to be paid less than full timers, doing the same job.
- They abandoned sectoral central bargaining in favor of decentralized national bargaining.
- They cut sickness benefits, unemployment insurance (benefits) and disability insurance payments (by 10% in 1991 alone - from 80% to 70%).
- They made it harder to qualify for unemployment (from 1995 no benefits were paid to those who chose to remain unemployed).
- The burden of supporting the sick was shifted to the employer / firm. In 1996, the employer was responsible to pay for the first year of sickness benefits.

Even the Dutch model is not an unmitigated success, though. More than 13% of the population are on disability benefits. Only 74% of the economically active population is in the workforce - one third of them in part time jobs.

But compare the Dutch experience to France's, for instance.

The Loi Robien exempted companies from some social security contributions for 7 years, if they agree to put workers on part time work instead of laying them off.

Firms promptly abused the law and restructured themselves at the government's expense.

The next initiative was to reduce the working week to 35 hours. This was based on the "Lump of Labour Fallacy" - the idea that there is a fixed quantity of work and that reducing the working week from 39 to 35 hours will create more jobs.

In Spain, hiring workers is unattractive because firing them is cost-prohibitive. The government - faced with more than 22% unemployment in the mid-90's - let more than 25% of all workers go on part time contracts with less job protection, by 2001.

Still, no one knows to authoritatively answer the following substantial questions, despite the emergence of almost universally applied UN-sponsored Standard National Job Classifications:

How many are employed and not reported or registered? How many are registered as unemployed but really have a job or are self-employed? How many are part time workers - as opposed to full time workers? How many are officially employed - but de facto unemployed or underemployed? How many are on "indefinite" vacations, on leave without pay, on reduced pay, etc.?

Many countries have a vested interest to obscure the real landscape of their destitution - either in order to prevent social unrest, or in order to extract disproportionate international aid. In a few countries, limited amnesties were offered by the state for employers' violations of worker registration. Firms were given a few, penalty-free, weeks to register all their workers. Afterwards, labour inspectors were supposed to embark on sampling raids and penalize the non-compliers, if need be by closing down the offending business. The results were dismal.

In most countries, the unemployed must register with the Employment Bureau once a month, whether they receive their benefits, or not. Non-compliance automatically triggers the loss of benefits. In other countries, household surveys were carried out - in addition to claimant counts and labour force surveys, which deal with the structure of the workforce, its geographical distribution, the pay structure, and employment time probabilities.

Yet, none of these measures proved successful as long as government policies - the core problem - remained the same. Faced with this trenchant and socially corroding scourge - governments have lately been experimenting with a variety of options.

III. The Solutions

IIIa. Tweaking Unemployment Benefits

Unemployment benefits provide a strong disincentive to work and, if too generous, may become self-perpetuating. Ideally, unemployment benefits should be means tested and limited in time, should decrease gradually and should be withheld from school dropouts, those who never held a job, and, arguably, as is the case in some countries, women after childbearing. In the USA, unemployment benefits are not available to farm workers, domestic servants, the briefly employed, government workers and the self- employed.

Copious research demonstrates that, to be effective, unemployment benefits should not exceed short-term sickness benefits (as they do in Canada, Denmark, and the Netherlands). Optimally, they should be lower (as they are in Greece, Germany and Hungary). Where sickness benefits are earnings-related, unemployment benefits should be flat (as is the case in Bulgaria and Italy). In Australia and New Zealand, both sickness benefits and unemployment benefits are means tested. Unemployment benefits should not be higher than 40% of one's net average monthly wage (the "replacement rate").

Most unemployment benefits are limited in time. In Bulgaria, to 13 weeks, in Israel, Hungary, Italy and the Netherlands to 6 months and in France, Germany, Luxemburg and the United Kingdom - to 12 months. Only Belgium offered time-unlimited unemployment benefits. In most countries, once unemployment benefits end - social welfare payments commence, though they are much lower (to encourage people to find work).

In many countries in transition (e.g., in Macedonia), the unemployed are eligible to receive health and pension benefits upon registration. This - besides being an enormous drain of state finances - encourages people to register as unemployed even if they are not and distorts the true picture.

Some countries, mainly in Central Europe, attempt to provide lump sum block grants to municipalities and to allow them to determine eligibility, to run their own employment-enhancement programs, and to establish job training and child care centers. Workers made redundant can choose to either receive a lump sum or be eligible for unemployment benefits.

A third approach involves the formation of private unemployment, disability, and life, or health insurance and savings plans to supplement or even replace the benefits offered by the relevant state agencies.

An intriguing solution is the municipal "voucher communities" of unemployed workers, who trade goods and services among themselves (in the UK, in Australia, and in Canada). They use a form of "internal money" - a voucher. Thus, an unemployed electrician exchanges his services with an unemployed teacher who, in return tutors the electrician's off-spring. The unemployed are allowed to use voucher money to pay for certain public goods and services (such as health and education). Voucher money cannot be redeemed or converted to real money - so it has no inflationary or fiscal effects, though it does increase the purchasing power of the unemployed.

IIIb. Enhancing Employability

In most such schemes, the state participates in the wage costs of newly hired formerly unemployed workers - more with every year the person remains employed. Employers usually undertake to continue to employ the worker after the state subsidy is over. Another ploy is linking the size of investment incentives (including tax holidays) to the potential increase in employment deriving from an investment project. Using these methods, Israel succeeded to absorb more than 400,000 working age immigrants from Russia in the space of 5 years (1989-1994) - while reducing its unemployment rate.

IIIc. Encouraging Labour Mobility

Workers are encouraged to respond promptly and positively to employment signals, even if it means relocating. In many countries, a worker is obliged to accept any job on offer in a radius of 100 km from the worker's place of residence on pain of losing his or her unemployment benefits. Many governments (e.g., Israel, Yugoslavia, Russia, Canada, Australia) offer the relocating worker financial and logistical assistance as well as monetary and non-monetary incentives.

The EU is considering to introduce standard fixed term labour contracts. They would reduce the insupportable costs and simplify the red tape now involved in hiring and firing. The only country to buck the trend is Germany. It is looking to equate the rights of part time workers and full time ones. Similar ideas are debated in Britain. In France and most countries in Central and Eastern Europe, to dismiss a worker, the employer has to show that it has restricted hiring, applied workforce attrition, and reduced overall overtime. The EU's "social chapters" - now on of every member's law books - provides sacked employees with recourse to domestic and European courts against their employers. In other parts of the world, the two parties are subject to conciliation, mediation, or arbitration.

IIId. Reforming the Minimum Wage

Minimum wage hinders the formation of new workplaces - and yet almost all countries have it. Both the USA and the UK have just increased it. Many are considering a scaled minimum wage, age-related, means tested, and skills-dependent.

IIIe. Administrative Measures: Early Retirement

A favorite of post-communist countries in transition, early retirement was liberally applied in order to get rid of "technologically-redundant" workers and thus trim under-employment.

Romania, for instance, offered its workers a handsome up-front payment combined with unemployment benefits. A special Early Retirement Fund was created by setting aside receipts from the privatization of state assets and from dividends received by the state from its various shareholdings.

IIIf. Administrative Measures: Reduction of Working Hours

France has recently implemented the second phase of its transition to a 35 hours working week, making it obligatory for medium and small businesses. It is considered by many economist to be a wasteful measure, based on the "lump of labour" fallacy.

IIIg. Administrative Measures: Public Works

The Civilian Conservation Corps (CCC) was established in the USA in 1932. It offered work for young and unmarried men. They planted trees, erected flood barriers, put out forest fires, and constructed forest roads and trails. They lived in semi-military work camps, were provided with food rations and a modest monthly cash allowance, medical care, and other necessities.

At its apex, the CCC employed 500,000 people - and 3 million people throughout its existence. It was part of a major "public works" drive known as "The New Deal". This Keynesian tradition continues in many countries -

from deflationary Japan to racially imbalanced South Africa - to this very day. Such workers are usually paid a salary equal to their unemployment benefits (Workfare).

The Encyclopedia Britannica has this to say about public works:

"The weakness in the proposal to use disguised unemployment for the construction of social overhead capital projects arises from inadequate consideration of the problem of providing necessary subsistence funds to maintain the workers during the long waiting period before the projects yield consumable output. This can be managed somehow for small-scale local community projects when workers are maintained in situ by their relatives - but not when workers move away. The only way to raise subsistence funds is to encourage voluntary savings and expansion of marketable surplus of food purchased with these savings."

Public works financed by grants or soft loans do serve as an interim "unemployment sink" - a countercyclical buffer against wild upswings in unemployment - but, for all we know, they may simply be displacing existing employment at great cost to the public purse.

IIIh. Administrative Measures: Public Education and Dissemination of Information

Employment Bureaus throughout the world - spurred on by stiff competition from the private sector - have transformed themselves from mere registries to active (and computerized) labour exchanges. Many also strive to educate workers, retrain them, and enhance their employability through the acquisition of new skills. The unemployed are taught how to prepare a professional bio, a business plan, a marketing plan, feasibility studies, credit applications and interview skills.

Employment Bureaus now organize job clubs, labour exchanges and employment fairs.

IIIi. National Employment Contract

Many countries - especially in Latin America and in Central and Eastern Europe - have signed "National Employment Contracts" between government, trade unions, employers (represented by the Chamber of Commerce), and Central Bank.

In this neo-corporatist approach, employers usually guarantee the formation of new work places against a freeze on employee compensation, the exclusion of part time labour from collective bargaining, and added flexibility on minimum wages, job security, hiring and firing procedures, social and unemployment benefits, indexation of wages and benefits, the right to strike, and wage increases (increasingly linked to productivity gains).

Trade unions, in return, are granted effective control of the shop floor - issues like unemployment insurance, employment protection, early retirement, working hours, old age pensions, health insurance, housing, taxation, public sector employment, vocational training, and regional aid and subsidies to declining and infant industries.

In Sweden and Germany there is co-determination. Workers are represented even in non-wage related matters (such as the work organization).

Wages and unemployment benefits are perceived as complementary economic stabilizers. Many countries instituted an "Incomes Policy" intended to ensure that employers, pressurized by unions, do not raise wages and prices. In Sweden, for instance, both labour and management organizations are responsible to maintain price stability. The government can intervene in the negotiations and even threaten a wage freeze, or wage AND price controls. In Holland the courts can set wages.

Another possibility is a Guaranteed Wage Plan - Employers assure minimum annual employment or minimum annual wages or both to tenured employees. In return, firms and trade unions forego seniority (LIFO, last in first out, firing the newly hired first) and the employer is given a free hand in hiring and firing employees, regardless of tenure.

IIIj. Labour Disputes Settlement

Most modern collective agreements require compulsory dispute settlement through mediation and arbitration with clear grievance procedures. Possibilities include conciliation (a third party brings management and labour together to try and solve the problems by themselves), mediation (a third party makes nonbinding suggestions to the parties), arbitration (a third party makes final, binding decisions), or Peer Review Panels - where management and labour rule together on grievances.

IIIk. Non-conventional Modes of Work

Work is no longer the straightforward affair it used to be.

In Denmark, a worker can take a special leave. He receives 80% of the maximum unemployment benefits as well as uninterrupted continuity in his social security rights. But he has to use the time for job training, a sabbatical, further education, a parental leave, to take old people (old parents or other relatives), or the terminally ill. This is also the case in Belgium (though only for up to 2 months). These activities are thought of as substitutes for social outlays.

In Britain, part time and full time workers are entitled to the same benefits if wrongfully dismissed and in Holland, the pension funds grant pensions to part time workers. In many countries, night, shift and weekend workers are granted special treatment by law and by collective contract (for instance, exemption from social benefits contributions).

Most OECD countries now encourage (or tolerate) part-time, flextime, from home, seasonal, casual, and job sharing work. Two people sharing the same job as well as shift workers are allowed to choose to be treated, for tax purposes and for the purposes of unemployment benefits, either as one person or as two persons. In Bulgaria, Macedonia, and a host of other post-communist countries, a national part time employment program (called in Macedonia the "Mladinska Zadruga") encourages employers to hire the unemployed on a short term, part time basis.

IIIl. Full Employment Budgets

The national accounts of many countries now produce a full employment budget. It adjusts the budget deficit or surplus in relation to effects of deviations from full or normal unemployment. Thus, a simple balanced budget could be actually contractionary. A simple deficit may, actually, be a surplus on a full employment basis and government policies can be contractionary despite positive borrowing.

IIIm. Apprenticeship, Training, Retraining and Re-Qualification

In France, Germany, the UK, the USA, and many other countries, sub-minimum wages are paid to participants in apprenticeship and training programs. Most of the unemployed can be retrained, regardless of age and level of education. This surprising result has emerged from many studies.

The massive retraining and re-qualification programs required by the technological upheavals of the last few decades are often undertaken in collaboration with the private sector. The government trains, re-trains, or re-qualifies the unemployed - and firms in the private sector undertake to employ them for a minimal period of time afterwards. It is a partnership, with the government acting as educational sub-contractor for the business sector (with emphasis on the needs of small to medium enterprises) and a catalyst of skill acquisition. Such programs include vocational training, entrepreneurship skills, management skills, and even basic literacy and numeracy. Students are often employed as instructors in return for college credits and scholarships.

IIIn. Entrepreneurship and Small Businesses

Small businesses are the engine of growth and job creation in all modern economies. Even the governments of rich countries encourage innovative credit schemes (such as micro-credits) and facilities (such as business incubators), tax credits, and preference to small businesses in government procurement.

Unification, German

The May 22, 2005 elections in North Rhine-Westphalia (with 18 million inhabitants, Germany's most populous state) are expected to determine the fate of Chancellor Gerhard Schroeder, his party, the Social Democrats, SPD (which ruled the state in the last four decades), and his coalition with the Greens. The SPD-Greens are projected to lose to the uninspiring coalition of Christian Democrats (CDU) and Free Democrats. The state is buffeted by the crumbling of traditional industries such as mining and heavy industry

The run up to this election is reminiscent of another - the pivotal elections in Saxony-Anhalt in April 21, 2002. Germany is again in bad shape: high unemployment (12% and rising), exploding public debt, rising crime, collapsing healthcare and education systems.

The vote in the east German Land of Saxony-Anhalt (3 million inhabitants, 8000 sq. miles) was followed with bated breath by assorted South Koreans. The merger of West and East Germany in the wake of the implosion of communism in 1990 is considered to be a test case. Can two political entities separated by ideology, economic doctrine and performance, wealth, political structure, mentality, and history - become one successfully?

The answer was a resounding no only 4 years before. An openly xenophobic right wing party, financed by an eccentric Munich-based publisher-millionaire, garnered 13 percent of the votes in the 1998 bellwether elections in Saxony-Anhalt. These usually precede nationwide parliamentary elections to the Bundestag by 5 months.

Saxony-Anhalt used to be second in industrial production only to the Ruhr. Its chemical factories (120,000 workers) and engineering firms (80,000 employees) were among the most advanced in the world. It still notes with pride that the first color film ever was shot and developed in Wolfen. East Germany, the ostensible industrial powerhouse of the Soviet Bloc, placed Saxony-Anhalt on a pedestal.

Yet, by 1998, one of every four working adults was unemployed. Another 100,000 participated in make-believe and stopgap retraining schemes and public works. A decisive majority of Saxony-Anhalt's young never experienced a day's work. Its bloated, inefficient, and technologically retarded industries crumbled as they faced the powerhouses of West Germany.

Klaus Schucht, Saxony-Anhalt's then minister of economics since 1994 - a former Treuhand privatization expert and Chairman of Ruhrkohle AG (coal industry) - supervised the agonized disintegration of its smokestacks. Salaries in the public sector (e.g., teachers) were cut by up to 20 percent in return for job security. Welfare rolls swelled, 15,000 people became homeless by 1996, unemployment reached monstrous proportions (28 percent) in company towns like Bittersfeld. Yet dwindling tax receipts forced the government to implement four consecutive austerity plans, each harsher than its predecessor.

Inevitably, the voters trounced the nationally-ruling CDU. With 22 percent of the votes, they came almost equal with the PDS - the former (and reformed) vicious communists. The minority SPD-Greens government of Saxony-Anhalt (with tacit PDS support) was unaffected, though people rated its performance 0.2 on a scale of -5 to +5. Only the racist DVU benefited, as it linked mass unemployment to the ubiquity of foreigners, the self-enrichment of an old-new elite of turncoats, and an all-pervasive social crisis. The "Magdeburg Model" of compassionate reform the eastern way - failed.

The "World Socialist Web Site" quoted the DVU's campaign slogans with terrified fascination:

"German money for German jobs", "Jobs for Germans first", "This time - make your vote a protest", "Corrupt politicians, greedy parliamentarians, European Union bigwigs, asylum fraudsters", "If the bosses won't invest, then the state must fund new jobs." The DVU denounced Kohl for being "the main culprit" for the "collapse of our economy."

Not everything was bleak, though. In an article published in November 1999 ("Coming Together, Ten Years on"), "The Economist" described a prospering Hanseatic town in Saxony-Anhalt. It attributed the relative prosperity of the Ossies to Wessies returning to reclaim their property, or to invest, "tempted by cheap labour, a chance to ignore red tape, and fat government incentives to invest in the former east".

Wessies and Ossies still clash in mutual suspicion and envy, the mental barriers are still there, alienation and estrangement as well as crime are rampant, pensions and salaries are lower, unemployment is (much) higher, and the "blossoming landscape" promised by the CDU has shriveled - but the railway to Berlin was being re-opened and the town is full of shopping malls and glittering banks, observed "The Economist".

Yet, this is true only in the "interface" zone between east and west. Further inland, the picture is grim indeed. And, in Saxony-Anhalt, it is the grimmest. At the time of the elections, unemployment was still a devastating 21 percent (January 2002 figures), double the national average and more than in any other eastern Land. Its GDP grew by 0.6 percent in 2000, underperforming national growth (though both the manufacturing and services sectors outperformed the German average). The construction industry contracted by 10 percent in the 12 months to April 2001.

Chancellor Gerhard Schroeder has spent a good part of January 2002 cajoling Bombardier, the Canadian rail equipment maker, not to end production at its Halle factory (900 workers). The German government agreed, in return, to buy from Bombardier several undeveloped land tracts. It is rumored that Bombardier was also promised lucrative state contracts immediately after the September elections.

The almighty trade union IG Metal has pressured BMW into investing 1 billion euros in a new car plant in Leipzig (with supplies coming from Saxony-Anhalt). BMW complied but made it clear that it expects the state of Saxony-Anhalt to underwrite a third of its investment.

Of 11 billion euros slated for capital expenditures in Saxony-Anhalt's decrepit infrastructure - more than 7 billion are transfers from the federal government and the European Union. Saxony-Anhalt, at 25 percent, has double the rate of investment in the Lander of West Germany (though its investment rate declined to 20% by 2004). Only 60 percent of its 8 billion euros strong budget relies on tax revenues - the rest comes from transfers. Transfers - mainly social benefits - constitute almost half the state's operating expenditures.

Even so, Saxony-Anhalt ran a debilitating budget deficit (9 percent), mostly financed with 3 billion euros of fresh borrowing per year. It renowned for its lavish road shows, trying to market its bonds to international investors. It expects to have zero net borrowing in 2006 - but the mountain of total outstanding debt (76% of which is negotiable) will weigh on this impoverished state for a long time to come. Moreover, it has a reputation in financial markets as being dangerously exposed to credit derivatives in a desperate attempt to reduce its effective interest rate to 5%.

The federal government has rejected calls by the Lander to guarantee their bonds by intermingling state and federal obligations in auctioned "packages". A conceptually similar mixed package of 1.75 billion euros in three year notes issued by seven states ("Lander jumbo") - the 12th of its kind - was sold in January 2002 at a mere 0.22% above the federal benchmark. The Lander owe 350 billion euros between them. Even a marginal improvement in interest rate translates to hundreds of millions of euros in annual savings. Saxony-Anhalt (rated the lowest among the Lander, at AA-) spearheads this campaign.

In an interview to Bloomberg, its finance minister, Heinrich Aller, said:

" 'Different credit ratings for the states and the federal government make no sense' ... He said there is no risk to the government in guaranteeing the states as they are 'too big' and 'too public' to default on payments. Eichel (the German minister of finance) is concerned that centralized bond sales could cause the government's borrowing costs to rise ... The government is reluctant to act as guarantor for states on interest and debt repayments (said Deputy Finance Minister of Germany Karl Diller)."

But many are betting that, in an effort to impose fiscal discipline on the oft-errant Lander, the federal government may yet agree to joint issuance of bonds subject to clear limitations on regional budget deficits (a "national stability pact"). Should this happen, Germany's rating is likely be downgraded but Saxony-Anhalt would stand to benefit, its borrowing and debt service costs cut considerably by its enhanced credit rating.

This could be one of the goodies the SPD has in store for the eastern states, under the umbrella of its "Towards the Future" economic program. Schroeder unrealistically promises to equalize wage levels between east and west by 2007. Investors in the eastern parts will be entitled to even more generous incentives. Job creation schemes (worth 10 billion euros annually) will abound.

On a Sunday in mid-March 2002, the SPD held a special (and unprecedented) conclave of SPD associations in the eastern states in Magdeburg. It is a measure of desperation. Despite some recent anti-eastern steps by the CDU and CSU (e.g., contesting cross-subsidies in Germany's health insurance funds which benefit the Ossies) - discontent with the SPD and its lackluster performance was rife. The CDU succeeded to shift the emphasis from unilateral transfers to the east (a whopping trillion euros since 1990) to the formation of new businesses, the promotion of R&D in universities, and the enhancement of business-critical infrastructure.

The SPD never really swept Saxony-Anhalt off its feet. Hoppner, the prime minister at the time, headed a minority government, the outcome of narrowly averted defeats in both 1994 and 1998. He did his populist best to reflect east German disenchantment and longing for a spurious past of tight-knit communities and low crime rates. But in doing so he played into the hands of the PDS whose rise is now inevitable. It has been the SPD's silent partner all along and thus legitimized and rehabilitated. Its comeback is part of a trend all over Central and Eastern Europe. But apart from the PDS, it would be wrong to read too much into the state elections in April as far as the future alignment of national politics is concerned.

Perhaps more importantly, the elections in Saxony-Anhalt were a referendum about the unification of Germany. Has it really been a failure, good intentions and a trillion euros notwithstanding? Is future Germany an entity permanently fractured along the old fault lines of rich vs. poor and east vs. west? Does the solution consist of throwing more money at the problem or is a fundamental re-think called for? Above all, will it ever get better? The unemployed, welfare-dependent, and humiliated denizens of Saxony-Anhalt don't believe so. They feel second class and East Germany is retroactively idealized in a perverted form of nostalgia. Germany - and the world with it - have been losing its faith as well. The experiment may have failed after all. South Korea is again watching closely.

Unification, German and Korean

In July-August 2002, the north and south rumps of an erstwhile unified Korea have agreed to reconvene, at North Korea's rare request, cabinet-level talks severed the year before. Only 6 weeks before that, on June 29, 2002 vessels of these two countries clashed to lethal effect in the Yellow Sea - an incident for which the North now, startlingly, expressed its regrets.

The South's indefatigable unification ministry concluded the three-days negotiations on August 14, a day before both polities celebrate the end of the brutal Japanese occupation. North Korea also consented to participate in the 14th Asian Games, held in September 2002 in Busan in South Korea. It even partook in a friendly football match with the South.

Noble prizewinner South Korean president at the time, Kim Dae Jung launched his "sunshine policy" - a Korean Ostpolitik - towards the famished and decrepit North in June 2000, when he met the "Dear Leader", Kim Jon Il. This led to precious little hitherto. A few members of families divided by the war in 1950-3 were finally allowed to briefly reunite. North Korea gorged on South Korean and Japanese grain and extorted cash from visitors to the much adored Mount Geumgang.

UPI was among the first to report a discernible shift to market principles in the North. This was coupled with thawing relations with the West, notably the United States. Both the Japanese foreign minister and America's secretary of state conversed with their North Korean counterpart during the ASEAN regional forum in Brunei in early August 2002. The North even requested talks with the US-led United Command it so decries.

These breakthroughs were followed by frequently interrupted rounds of negotiations between the United States and North Korea, in the presence of 4 observer nations (among them Russia and China). North Korea admitted, in the process, to owning nuclear weapons and extorted additional economic benefits from its southern neighbor. The United States demands unilateral and unconditional nuclear disarmament and accuses the North Korean "tyranny" of illegal proliferation of nuclear materiel and technology.

But, otherwise, the North remains as recalcitrant and belligerent as ever. The prospects of Korean unification are best gauged in Panmunjom, scene of the armistice that ended the Korean war, where a South Korean rail line ends abruptly. The North has yet to construct the few miles to Kaesong within its territory. North Korea's Committee for the Peaceful Reunification of the Fatherland continues its vitriolic diatribes against South and West alike.

Unification is not a straightforward matter not only geopolitically or politically - but also, and, perhaps, mainly, economically.

In a Northeast Asia Peace and Security Network Special Report dated August 1999 and titled "Modeling Korean Unification", the authors, among them Marcus Noland, a leading authority on the subject, recommended a customs union between the two Koreas as a way to ameliorate northern famine and generate a peace dividend through military demobilization.

The authors believe that unification will affect South Korea's "composition of output, the distribution of income, and the rate of economic growth". Should capital flow in from the rest of the world, the won is likely to appreciate and the "nontraded goods sectors could expand at the expense of the traded goods sectors".

It would take at least a decade for northern incomes to reach 55 percent of southern ones.

"The amount of capital investment necessary to raise Northern per capita incomes to 60 percent those of the South would actually drive the rate of return on capital in the North below that in the South. However, it would be possible to attain the 60 percent target without such equalization of the rate of return in the two parts of Korea under high-end estimates of the speed of technological convergence. This suggests that either the rate of technological convergence would have to be very rapid (say, 12 percent annually), or restriction on migration from the North to the South would have to be imposed on a semi-permanent basis."

South Korea itself is likely to be as transformed by unification as the north. Cheap migrant labour from the across the erstwhile border will tilt the balance between income from capital and income from labor in favor of the former. As northerners occupy low-skill jobs, southerners are bound to monopolize the high end of the labor market. Income inequality will widen.

Noland believes that the cost of unification can be limited. It is hard to see how, though. Inter-Korean trade leapt 21 percent year-over-year to a meager $130 million in the first four months of 2002 - including $51 million in "non-trade" items, such a food grants.

The North maintained a trade surplus of $51 million with the South in these 120 days, excluding humanitarian assistance and Southern gifts. It exported to the South agricultural products, fish, and textiles and imported from it machinery, chemicals, and processed textiles. A mere 62 companies - of a total of 188 - worked on a "processing-on-commission" basis, elsewhere a very common practice in least developed countries.

The World Bank sounds more realistic when it pegs the overall cost at 5-6 times South Korea's GDP, or $2-3 trillion. Noland notes that between $300-600 billion over ten years would be needed to raise North Korean income levels to 60 percent of the Southern average and to prevent ruinous mass migration from North to South. Young-sun Lee, another scholar, concurs with the high end of Noland's estimate.

The historical irony is that the North, until 1950, has been the industrial powerhouse of the united Korea. Mining, heavy industry, and science were all concentrated in the north. The south was home to agriculture and light, family-owned, industry. Despite American carpet bombing which pulverized its manufacturing base, the North grew faster than the south throughout the 1950's and 1960's - albeit partly thanks to Chinese and Russian monetary infusions.

But while the south - with double the north's population - leapt from an average GDP per capita of $90 in the mid-60's to almost $9000 in 1999 - the north crept to one tenth, some say one twentieth, this figure in 2001. And while

North Korea's foreign trade is a measly $2 billion - the South trades almost $300 billion in goods and services. After China and Japan, South Korea is the North's largest trading partner.

The harrowing stories of fatal famine in the North are a commonplace by now. Even by its official - and, thus, false - figures, the North admits to a quarter of a million deaths by starvation. The figure may be 10 times as high. Energy shortages mean that factories are working at 10-15 percent capacity, reported "The Economist" in August 2002.

Though far more suave, the South may be pursuing a passive-aggressive tack of its own. Unification is likely to be a better avoided prohibitively expensive and economically destabilizing affair. An apt parallel would be with Yemen, whose Marxist and destitute south united with the far more prosperous and open north only to yield a devastating civil war two years later. But the Koreans optimistically prefer to compare their situation to pre-unification Germany.

A decade and $1 trillion in subsidies later, not counting $2.6 billion in annual handouts from the European Union - east Germany is still woefully trailing its west. According to figures published by The Frankfurter Allgemeine Zeitung, the growth rate and productivity of the east - the German mezzogiorno - is a mere 70 percent of the western Lander. The east contributes one tenth of German GDP with one fifth of the population. A quarter of a million jobs have evaporated between 1998 and 2002 alone.

Unemployment, at 17.8 percent in June, 2002 is the highest since 1990. The tax base is shrinking as the dreary region is drained of its populace. Three years ago, Germany has extended federal aid to the east - financed by a much-resented 5 percent surtax - by another 20 years.

This massive failure is a hot topic in every election campaign in Germany. BMW has been courted, cajoled, and bribed with copious tax breaks to open a new factory in Leipzig. Volkswagen's decision to launch a positively minor plant in Dresden was hailed as a breakthrough.

On a visit to Seoul in 2002, German Nobel laureate Gunter Grass cautiously suggested that unification may follow a long period of engagement. He hoped, he said, that Korea will not repeat the mistakes that his country committed - the exorbitant taxes and the human dislocation. He bemoaned the lack of cultural and artistic exchanges between the Koreas.

But Korean unification may pose more than belletristic predicaments.

Another German, Otto Graf Lambsdorff, compared the Korean experience to the German one in a guest column in the "Korea Herald":

"The (economic) conditions in Korea ... (are) more difficult than those in Germany around the time of its reunification ... In relation to the West German population, the East German population was much smaller than the respective proportions of North to South Koreans ... The discrepancy regarding the level of economic development is much larger between South and North Korea than it was between West and East Germany ... It is sometimes overlooked that in the case of East Germany about one-third of the economic production was delivered by a private and cooperative sector ... Furthermore, in contrast to the ... isolation (of North Korea), (East Germany) participated actively and with a certain degree of success in international economic exchanges."

He noted that it took Germany 20 years to unite after the first east-west summit in 1970. But the parallels end there. By being absorbed in West Germany, the east gained immediate access to the European Union. There is no Asian equivalent of a common market. Moreover, the North Korean market is geared to support a bloated military and to produce weapons, especially missiles. Demobilization may prove to be a thorny issue economically as well as politically.

In Korea's case the very term "unification" may be misleading. According to a "Korea Times" commentary by Dr. Park Eung-kyuk of Hanyang University, the South aims at an EU-like confederation while the North counters with a loose federation.

Is there anything these two disparate polities can learn from the German experience?

The first serious effort to answer this question was made in 1993 by an expert group chaired by former German chancellor, Helmut Schmidt. Its conclusions and policy recommendations reverberate through subsequent scholarship and commentary. In July 2002, the Frankfurter Allgemeine Zeitung, neatly summed up the error-ridden unification process thus:

"At unification, many western companies viewed the East as a new export market, a consumer land. Instead of investing in production sites there, they funneled goods and services to a consumption-starved public armed with a cash windfall from the currency exchange."

The Kohl-mandated exchange rate of 1 ostmark to 1 deutschmark rather than the previous and more realistic rate of 4:1 had grave repercussions. To avoid inflation, the Bundesbank was forced to raise interest rates and induce a recession.

The paper continues:

"Eastern goods were priced out of the market as manufacturing cost quadrupled overnight. The country's chief export market, the former Soviet bloc, also went bankrupt. Local consumers bought western goods. No revenue flowed back to the East, touching off a mass exodus of labor that reduced the workforce by one-third in three years."

In a book titled "Avoiding the Apocalypse" and published in 2001 by the Institute for International Economics, Marcus Noland disputes this scenario. The culprit was wage policy, not the exchange rate. On the contrary, the transfer of wealth to the east through the exchange rate mechanism eased its problem of lack of competitiveness and did not result in inflation. He even goes as far as floating an idea of dollarizing inter-Korean trade.

Driving east German wages beyond productivity - in response to labor union pressure - depressed output and may have encouraged westward migration. The sluggish rate of privatization served to perpetuate mismanagement.

The practice of property restitution impeded the assignment of clear property rights and, as a result, hampered investment. Privatization was further hobbled by the refusal to write off enterprise debt outright.

The Schmidt commission strongly differs:

"In transferring to a market economy, it is not possible to leave everything to market forces. The deficiencies of the infrastructure in the former GDR were grossly underestimated as was the environmental contamination, the lack of modern technology. The political, legal, economic, educational, and social security systems changed, including traffic rules. It is an enormous achievement for the East German population to have coped with the stress created by this veritable revolution. But it also created distrust, lack of initiative, confusion, and fear all of which should have been more effectively addressed."

The recipe which seems to enjoy a consensus among scholars and politicians alike calls for a gradual unification. Trading and investments should be followed by a currency union at a realistic exchange rate, land reform in the North, and the institution and restitution of property rights. Tourism and services establishments should be privatized first, agriculture later.

The state would have to design and implement a series of industrial policies to prevent market failures and provide public goods. Its top priorities should be infrastructure and institution building. Human capital must be augmented by the transfer of qualified personnel from the south while northerners are trained or retrained. It may be necessary to restrict immigration during a transition period.

Help and support from the international community - Korea's neighbours, the Asian Development Bank, the IMF, the World Bank, the West - would be indispensable. It is here that unification may blunder.

Many Asian countries - not least, China - may be unhappy with the idea of a united, independent, and economically prosperous Korea under Western influence. Lending to emerging economies - not to mention unification projects - has dried up and is likely to remain so for years to come. The West has its own agenda regarding the "axis of evil". Ultimately, Koreans trying to unite may be faced with an insurmountable common adversary - geopolitics.

United Nations

In March 2005, an increasingly isolationist United States appointed an outspoken critic of the United Nations, John Bolton, to serve as its Ambassador there.

Less than two years earlier, Arab nations tabled a resolution at the United Nations General Assembly condemning the U.S.-British led "invasion" and "occupation" of Iraq and calling for immediate troop withdrawal. A similar effort at the Security Council failed, doomed by the veto powers of both alleged aggressors.

This did endear the organization to the Bush administration whose hawks regard it as a superfluous leftover from the Cold War era. Rep. Ron Paul (R-Texas) even introduced legislation to withdraw from the organization altogether. Nile Gardiner, a visiting fellow at the Heritage Foundation, summed up these sentiments in Insight Magazine thus:

"I think the U.N. has been in gradual decline for many years. It failed to act spectacularly in Rwanda and did nothing about Slobodan Milosevic's brutal regime. Iraq is the latest in a long line of failures."

Admittedly, like any bureaucracy, the organization is self-perpetuating, self-serving and self-absorbed. But it - and its raft of specialized offshoots - still give back far more than they receive. In recognition of the U.N.'s crucial role, several liberal Democrats have entered legislation to create a "permanent U.N. security force" and to "voluntarily contribute" to the U.N. Population Fund.

Consider peacekeeping operations. At a total annual cost of c. $5 billion in 2002, U.N. peacekeeping missions employ close to 40,000 police and military and another 11,000 civilians from 89 countries. The budget is shoestring and more than half the pledged contributions are still outstanding. The U.N. consumes less than 0.001 percent of the world's gross domestic product. As James Paul, Executive Director of Global Policy Forum, observes:

"All UN staff, including the specialized agencies and funds, are fewer than the civil service of the City of Stockholm or the staff of McDonalds. The core UN budget is one half of one percent of the US military budget and far less than the cost of one B-2 bomber aircraft."

Even the United States Mission to the United Nations, on its Web site, seeks to debunk a few myths. Despite a massive increase in remit and operations, the organization's budget, at $2.6 billion, has remained constant since 1995. The workforce was cut by 11 percent, to 9000 employees, since 1997:

"The UN has done a great deal to increase efficiency and overall accountability. In 1994, the UN created the Office of Internal Oversight Services (OIOS) to serve as the inspector general and promote efficient management and reduce waste, fraud and abuse. During the year ended June 30, 2001, OIOS recommended $58 million in savings and recoveries for the UN and persuaded UN program managers to implement hundreds of recommendations for improving management and internal controls. OIOS investigations also led to successful convictions of UN staff and others for fraud and stealing UN funds."

Yet, bad - and expensive - habits die hard. Budget discipline is lax with no clear order of priorities. The United Nations suffers from an abundance of obsolete relics of past programs, inertly and futilely maintained by beneficiary bureaucrats. Follow-up U.N. conferences - and they tend to proliferate incontrollably - are still being held in exotic resorts, or shopping-friendly megalopolises. United Nations entities at the country level duplicate efforts and studiously avoid joint programming, common databases and pooling of resources.

The aforementioned OIOS has hitherto identified more than $200 million in waste and fraud and issued 5000 recommendations to improve efficiency, transparency and accountability. Disgusted by the flagrant squandering of scarce resources, the United States - which covers one fifth of the august establishment's pecuniary needs - accumulated more than $1.2 billion in arrears by 1999, double the debts of all other members combined.

It has since repaid the bulk of these even as it reduced its share of the United Nations' finances. It now contributes 22 percent of the regular budget, down from 25 percent and 25-27 percent of the costs of the U.N. peacekeeping forces, down from 30-31 percent.

But a row erupted in the corridors of power with regards to the proposed budget for 2004-5. Ambassador Patrick Kennedy, United States Representative for United Nations Management and Reform, called it "a step backwards". The European Union, predictably, "fully concurred" with it and urged members to increase the budget in line with the U.N.'s enhanced responsibilities.

Kofi Annan, the U.N. General Secretary since 1997, is promoting the nation-building and humanitarian credentials of his reformed outfit for the postwar reconstruction of Iraq. American President George Bush is less than keen and Prime Minister Tony Blair of Britain has moderated his pro-multilateralist rhetoric following his meetings with Bush.

Even erstwhile keen supporters of the United Nations, such as Japan, a surprising member of the "coalition of the willing", are hesitant. Japan contributes close to one fifth of the international body's regular budget. Yet, disillusioned by its inability to gain permanent membership of the Security Council despite its economic clout, Japan announced, in January 2003, its intention to cut its participation by 5 percent.

The United States seems to wish to consign the organization to the humanitarian aspects of Iraq's restoration. As early as April 2003, the U.S. Agency for International Development (USAID) granted $8 million to the U.N.'s Children's Fund (UNICEF) to pay for sanitation, healthcare and potable water schemes in Iraq as well as for micronutrients, vitamins and medicines for its malnourished and disease-stricken populace.

Succumbing to its niche typecasting, the United Nations has launched an unprecedented $2.2 billion "emergency appeal for immediate humanitarian assistance for the people of Iraq over the next six months, with $1.3 billion devoted to a massive food aid operation ... to help the displaced, refugees, children, the elderly and other especially vulnerable groups". The donor funds will augment the proceeds of the revamped (and effectively terminated) oil-for-food program, now entirely under the control of the General Secretary.

So, is the United Nations really "just a farce" and its members mostly "petty despots" as Conrad Black, the Canadian erstwhile media mogul, has it in his interviews? Or, paradoxically, has this international body been strengthened by its faithful depiction of resistant world opinion in the face of perceived Anglo-Saxon bullying? The global assembly's future largely depends on an incensed and disenchanted United States.

Unable to rely on the kindness of strangers, Annan is reaching out to new constituencies.

At the 1999 World Economic Forum in Davos, he challenged the global business community to enter a "Global Compact" with the U.N. to uphold "human rights, labour standards and environmental practices." The International Chamber of Commerce, representing 7,000 business organizations in 137 countries, picked up the gauntlet and published a joint statement at a July 1999 meeting with United Nations bigwigs.

This uneasy partnership drew severe criticisms from non-governmental organizations the world over. Corpwatch, a California-based NGO, observed acidly that "in the first 18 months of the Global Compact, we have seen a growing but secret membership, heavy influence by the International Chamber of Commerce, and a failure to publish even a single case study of sustainable practices. The Global Compact logo has been used without attribution by DaimlerChrysler, even as Global Compact officials insist that use of the general UN logo is strictly controlled. The Global Compact represents a smuggling of a business agenda into the United Nations. It should not be considered a contribution to or framework for the Johannesburg Summit."

The United Nations - like NATO and other Cold War critters - is an organization in search of a purpose. The demise of the USSR constituted a tectonic shift in international affairs. The U.N.'s inability to accommodate its institutions to the supremacy of the United States, the demography of China, the decline of Britain and France and the economic clout of Germany, India, Brazil, and Japan are symptoms of denial and delusion that are detrimental to the future of this otherwise benign and useful establishment. The war in Iraq is merely a rude wake-up call. And about time, too.

United States-China Relations

European intellectuals yearned for the mutually exclusive: an America contained and a regime-changed Iraq. The Chinese are more pragmatic - though, bound by what is left of their Marxism, they still ascribe American behavior to the irreconcilable contradictions inherent in capitalism.

The United States is impelled by its economy and values to world dominion, claimed in March 2003 an analysis titled "American Empire Steps Up Fourth Expansion" in the communist party's mouthpiece People's Daily. Expansionism is an "eternal theme" in American history and a "main line" running through its foreign policy.

The contemporary USA is actually a land-based empire, comprising the territorial fruits of previous armed conflicts with its neighbors and foes, often one and the same. The global spread of American influence through its culture, political alliances, science and multinationals is merely an extrapolation of a trend two centuries in the making.

How did a small country succeed to thus transform itself?

The paper attributes America's success to its political stability, neglecting to mention its pluralism and multi-party system, the sources of said endurance. But then, in an interesting departure from the official party line, it praises US "scientific and technological innovations and new achievements in economic development". Somewhat tautologically, it also credits America's status as an empire to its "external expansions".

The rest of the article is, alas, no better reasoned, nor better informed. American pilgrims were forced westward because "they found there was neither tile over their heads nor a speck of land under their feet (in the East Coast)". But it is the emphases that are of interest, not the shoddy workmanship.

The article clearly identifies America's (capitalistic) economy and its (liberal, pluralistic, religious and democratic) values as its competitive mainstays and founts of strength. "US unique commercial expansion spirit (combined with the) the puritan's 'concept of mission' (are its fortes)", gushes the anonymous author.

The paper distinguishes four phases of distension: "First, continental expansion stage; second, overseas expansion stage; third, the stage of global contention for hegemony; and fourth, the stage of world domination." The second, third and fourth are mainly economic, cultural and military.

In an echo of defunct Soviet and Euro-left conspiracy theories, the paper insists that expansion was "triggered by commercial capital". This capital - better known in the West as the military-industrial complex - also determines US foreign policy. Thus, the American Empire is closer to the commercially driven British Empire than to the militarily propelled Roman one.

Actually, the author thinks aloud, isn't America's reign merely the successor of Britain's? Wasn't it John Locke, a British philosopher, who said that expansion - a "natural right" - responds to domestic needs? Wasn't it Benjamin Franklin who claimed that the United States must "constantly acquire new land to open up living space" (the forerunner of the infamous German "Lebensraum")?

The author quotes James Jerome Hill, the American railway magnet, as exclaiming, during the US-Spanish War, that "If you review the commercial history, you will discover anyone who controls oriental trade will get hold of global wealth". Thus, US expansion was concerned mainly with "protecting American commercial monopoly or advantageous position". America entered the first world war only when "its free trade position was challenged", opines the red-top.

American moral values are designed to "serve commercial capital". This blending of the spiritual with the pecuniary is very disorienting. "Even the Americans themselves find it hard to distinguish which matter is expanding national interests under the banner of 'enforcing justice on behalf of Heaven' and which is propagating their ideology and concept of value on the plea of national interests."

The paper mentions the conviction, held by most Americans, that their system and values are the "best things in human society". Moreover, Americans are missionaries with a "manifest destiny" and "the duty and obligation to help other countries and nations" and to serve as the "the beacon lighting up the way for the development of other countries and nations". If all else fails, it feels justified to "force its best things on other countries by the method of Crusades".

This is a patently non-Orthodox, non-Marxist interpretation of history and of the role of the United States - the prime specimen of capitalism - in it. Economy, admits the author, plays only one part in America's ascendance. Tribute must be given to its values as well. This view of the United States - at the height of an international crisis pitting China against it - is nothing if not revolutionary.

American history is re-cast as an inevitable progression of concentric circles. At first, the United States acted as a classic colonial power, vying for real estate first with

Spain in Latin America and later with the Soviet Union all over the world. The Marshall Plan was a ploy to make Europe dependent on US largesse. The Old Continent, sneers the paper, is nothing more than "US little partner".

Now, with the demise of the USSR, bemoans the columnist, the United States exhibits "rising hegemonic airs" and does "whatever it pleased", concurrently twisting economic, cultural and military arms. Inevitably and especially after September 11, calls for an American "new empire" are on the rise. Iraq "was chosen as the first target for this new round of expansion".

But the expansionist drive has become self-defeating: "Only when the United States refrains from taking the road of pursuing global empire, can it avoid terrorists' bombs or other forms of attacks befalling on its own territory", concludes the opinion piece.

What is China up to? Were this - and similar - articles a signal encrypted in the best Cold War tradition?

Another commentary published a few days later may contain the public key. It is titled "The Paradox of American Power". The author quotes at length from "The Paradox of American Power - Why the World's Only Superpower Can't Go It Alone" written by Joseph Nye, the Dean of the John F. Kennedy School of Government at Harvard and a former Assistant Secretary of Defense:

"Hard power works through coercion, using military sticks and economic carrots to get others to do our will. Soft power works through attraction ... Our attractiveness rests on our culture, our political values and our policies by taking into account the interests of others."

As it summarizes Nye's teachings, the tone of the piece is avuncular and conciliatory, not enraged or patronizing:

"In today's world, the United States is no doubt in an advantageous position with its hard power. But ... power politics always invite resentment and the paradox of American power is that the stronger the nation grows, the weaker its influence becomes. As the saying goes, a danger to oneself results from an excess of power and an accumulation of misfortunes stems from lavish of praises and favors. He, whose power grows to such a swelling state that he strikes anybody he wants to and turns a deaf ear to others' advice, will unavoidably put himself in a straitened circumstance someday. When one indulges oneself in wars of aggression under the pretext of 'self security' will possibly get, in return, more factors of insecurity ... Military forces cannot fundamentally solve problems and war benefits no one including the war starter."

Nor are these views the preserve of the arthritic upper echelons of the precariously balanced Chinese Communist party.

In the same month, in an interview he granted to Xinhua, the Chinese news agency, Shen Jiru, chief of the Division of International Strategy of the Institute of World Economics and Politics, Chinese Academy of Social Sciences, reiterated his conviction that "the United States aims to create a unipolar world through the Iraq issue".

Mirroring the People's Daily, he did not think that the looming Iraq war can be entirely explained as a "dispute on oil or economic interests". It was, he thought, about "the future model of international order: a multipolar and democratic one, or the US strategic goal of a unipolar world". China has been encouraged by dissent in the West. It shows that the "multipolar international community" is an "inevitable" momentum of history.

Why this sudden flurry of historiosophic ruminations?

According to Stratfor, the strategic forecasting consultancy, "for Beijing, the only way to stymie the fourth phase is through promoting multilateralism; barring that, China must be prepared to confront the United States in the future, and U.S. history can give some guidance ... Thus, Beijing continues to focus on the concept of multilateralism and the legitimacy of the United Nations as the best ways to slow or even disrupt U.S. expansionism. At the same time, Beijing is preparing to face a future confrontation with the United States if necessary."

When its economy matures, China wants to become another United States. It has started emulating America two decades ago - and never ceased. Recent steps include painful privatization, restructuring of the banking system, clamping down on corruption and bad governance, paring down the central bureaucracy, revamping the military and security apparatus and creating mechanisms for smooth political transitions.

China sent a man to the moon. It invests heavily in basic science and research and development. It is moving gradually up the manufacturing food chain to higher value added industries. It is the quintessential leapfrogger, much of its cadre moving straight from the rustic to the plastic - computers, cellular phones, wireless and the like.

Ironically, it could never have made it even this far without its ostensible foe. Thousands of bright Chinese students train in the United states. American technologies, management, knowledge, capital and marketing permeate Beijing's economic fabric. Bilateral trade is flourishing. China enjoys the biggest share of the world's - in large part American - foreign direct investment flows. Should the United states disintegrate tomorrow - China would assuredly follow.

Valuation (of Stocks)

The debate rages all over Eastern and Central Europe, in countries in transition as well as in Western Europe. It raged in Britain during the 80s.

Is privatization really the robbery in disguise of state assets by a select few, cronies of the political regime? Margaret Thatcher was accused of it - and so were privatizers in developing countries. What price should state-owned companies have fetched? This question is not as simple and straightforward as it sounds.

There is a stock pricing mechanism known as the Stock Exchange. Willing buyers and willing sellers meet there to freely negotiate deals of stock purchases and sales. New information, macro-economic and micro-economic, determines the value of companies.

Greenspan testifies in the Senate, economic figures are released - and the rumour mill starts working: interest rates might go up. The stock market reacts with frenzily - it crashes. Why?

A top executive is asked how profitable will his firm be this quarter. He winks, he grins - this is interpreted by Wall Street to mean that profits will go up. The share price surges: no one wants to sell it, everyone want to buy it. The result: a sharp rise in its price. Why?

Moreover: the share price of a company of an identical size, similar financial ratios (and in the same industry) barely budges. Why not?

We say that the stocks of the two companies have different elasticity (their prices move up and down differently), probably the result of different sensitivities to changes in interest rates and in earnings estimates. But this is just to rename the problem. The question remains: Why do the shares of similar companies react differently?

Economy is a branch of psychology and wherever and whenever humans are involved, answers don't come easy. A few models have been developed and are in wide use but it is difficult to say that any of them has real predictive or even explanatory powers. Some of these models are "technical" in nature: they ignore the fundamentals of the company. Such models assume that all the relevant information is already incorporated in the price of the stock and that changes in expectations, hopes, fears and attitudes will be reflected in the prices immediately. Others are fundamental: these models rely on the company's performance and assets. The former models are applicable mostly to companies whose shares are traded publicly, in stock exchanges. They are not very useful in trying to attach a value to the stock of a private firm. The latter type (fundamental) models can be applied more broadly.

The value of a stock (a bond, a firm, real estate, or any asset) is the sum of the income (cash flow) that a reasonable investor would expect to get in the future, discounted at the appropriate rate. The discounting reflects the fact that money received in the future has lower (discounted) purchasing power than money received now. Moreover, we can invest money received now and get interest on it (which should normally equal the discount). Put differently: the discount reflects the loss in purchasing power of money deferred or the interest lost by not being able to invest the money right away. This is the time value of money.

Another problem is the uncertainty of future payments, or the risk that we will never receive them. The longer the payment period, the higher the risk, of course. A model exists which links time, the value of the stock, the cash flows expected in the future and the discount (interest) rates.

The rate that we use to discount future cash flows is the prevailing interest rate. This is partly true in stable, predictable and certain economies. But the discount rate depends on the inflation rate in the country where the firm is located (or, if a multinational, in all the countries where it operates), on the projected supply of and demand for its shares and on the aforementioned risk of non-payment. In certain places, additional factors must be taken into account (for example: country risk or foreign exchange risks).

The supply of a stock and, to a lesser extent, the demand for it determine its distribution (how many shareowners are there) and, as a result, its liquidity. Liquidity means how freely can one buy and sell it and at which quantities sought or sold do prices become rigid.

Example: if a controlling stake is sold - the buyer normally pays a "control premium". Another example: in thin markets it is easier to manipulate the price of a stock by artificially increasing the demand or decreasing the supply ("cornering" the market).

In a liquid market (no problems to buy and to sell), the discount rate is comprised of two elements: one is the risk-free rate (normally, the interest payable on government bonds), the other being the risk-related rate (the rate which reflects the risk related to the specific stock).

But what is this risk-related rate?

The most widely used model to evaluate specific risks is the Capital Asset Pricing Model (CAPM).

According to it, the discount rate is the risk-free rate plus a coefficient (called beta) multiplied by a risk premium general to all stocks (in the USA it was calculated to be 5.5%). Beta is a measure of the volatility of the return of the stock relative to that of the return of the market. A stock's Beta can be obtained by calculating the coefficient of the regression line between the weekly returns of the stock and those of the stock market during a selected period of time.

Unfortunately, different betas can be calculated by selecting different parameters (for instance, the length of the period on which the calculation is performed). Another problem is that betas change with every new datum. Professionals resort to sensitivity tests which neutralize the changes that betas undergo with time.

Still, with all its shortcomings and disputed assumptions, the CAPM should be used to determine the discount rate. But to use the discount rate we must have future cash flows to discount.

The only relatively certain cash flows are dividends paid to the shareholders. So, Dividend Discount Models (DDM) were developed.

Other models relate to the projected growth of the company (which is supposed to increase the payable dividends and to cause the stock to appreciate in value).

Still, DDM's require, as input, the ultimate value of the stock and growth models are only suitable for mature firms with a stable, low dividend growth. Two-stage models are more powerful because they combine both emphases, on dividends and on growth. This is because of the life-cycle of firms. At first, they tend to have a high and unstable dividend growth rate (the DDM tackles this adequately). As the firm matures, it is expected to have a lower and stable growth rate, suitable for the treatment of Growth Models.

But how many years of future income (from dividends) should we use in our calculations? If a firm is profitable now, is there any guarantee that it will continue to be so in the next year, or the next decade? If it does continue to be profitable - who can guarantee that its dividend policy will not change and that the same rate of dividends will continue to be distributed?

The number of periods (normally, years) selected for the calculation is called the "price to earnings (P/E) multiple". The multiple denotes by how much we multiply the (after tax) earnings of the firm to obtain its value. It depends on the industry (growth or dying), the country (stable or geopolitically perilous), on the ownership structure (family or public), on the management in place (committed or mobile), on the product (new or old technology) and a myriad of other factors. It is almost impossible to objectively quantify or formulate this process of analysis and decision making. In telecommunications, the range of numbers used for valuing stocks of a private firm is between 7 and 10, for instance. If the company is in the public domain, the number can shoot up to 20 times net earnings.

While some companies pay dividends (some even borrow to do so), others do not. So in stock valuation, dividends are not the only future incomes you would expect to get. Capital gains (profits which are the result of the appreciation in the value of the stock) also count. This is the result of expectations regarding the firm's free cash flow, in particular the free cash flow that goes to the shareholders.

There is no agreement as to what constitutes free cash flow. In general, it is the cash which a firm has after sufficiently investing in its development, research and (predetermined) growth. Cash Flow Statements have become a standard accounting requirement in the 80s (starting with the USA). Because "free" cash flow can be easily extracted from these reports, stock valuation based on free cash flow became increasingly popular and feasible. Cash flow statements are considered independent of the idiosyncratic parameters of different international environments and therefore applicable to multinationals or to national, export-orientated firms.

The free cash flow of a firm that is debt-financed solely by its shareholders belongs solely to them. Free cash flow to equity (FCFE) is:

***FCFE* = Operating Cash Flow MINUS Cash needed for meeting growth targets**

Where:

***Operating Cash Flow* = Net Income (NI) PLUS Depreciation and Amortization**

***Cash needed for meeting growth targets* = Capital Expenditures + Change in Working Capital**

***Working Capital* = Total Current Assets - Total Current Liabilities**

***Change in Working Capital* = One Year's Working Capital MINUS Previous Year's Working Capital**

The complete formula is:

FCFE = Net Income PLUS
Depreciation and Amortization MINUS
Capital Expenditures PLUS
Change in Working Capital

A leveraged firm that borrowed money from other sources (even from preferred stock holders) exhibits a different free cash flow to equity. Its CFCE must be adjusted to reflect the preferred dividends and principal repayments of debt (MINUS sign) and the proceeds from new debt and preferred stocks (PLUS sign). If its borrowings are sufficient to pay the dividends to the holders of preference shares and to service its debt - its debt to capital ratio is sound.

The FCFE of a leveraged firm is:

FCFE = Net Income PLUS
Depreciation and Amortization MINUS
Principal Repayment of Debt MINUS
Preferred Dividends PLUS
Proceeds from New Debt and Preferred MINUS
Capital Expenditures MINUS
Changes in Working Capital

A sound debt ratio means:

FCFE = Net Income MINUS
(1 - Debt Ratio)*(Capital Expenditures MINUS
Depreciation and Amortization PLUS
Change in Working Capital)

Value Added Taxes

To be justified, taxes should satisfy a few conditions:

Above all, they should encourage economic activity by providing incentives to save and to invest. Savings - transformed into investments- enhance productivity and growth of the economy as a whole.

A tax should be simple - to administer and to comply with. It should be "fair" (progressive, in professional lingo) - although no one seems to agree on what this means.

At best, it should replace other taxes, whose compliance with the above conditions is less rigorous. In this case it will, usually, lead to budget cuts and reduce the overall tax burden.

The most well known tax is the income tax. However, it fails to satisfy even one of the conditions above listed.

To start with, it is staggeringly complicated. The IRS code in the USA sprawls over more than 8,000 pages and 500 forms. This single feature makes it expensive to enforce.

Estimates are that 100 billion USD are spent annually (by both government and taxpayers) to comply with the tax, to administer it and to enforce it.

Income tax is all for consumption and against savings: it taxes income spent on consumption only once - but does so twice with income earmarked for savings (by taxing the interest on it).

Income taxes discriminate against business expenses related to the acquisition of capital assets. These cannot be deducted that same fiscal year. Rather, they have to be depreciated over an "accounting life" which is supposed to reflect the useful life of the asset. This is not the case with almost all other business expenses (labour, to name the biggest) which are deductible in full the same fiscal year expended in.

Income taxes encourage debt financing over equity financing. After all, retained earnings are taxed - while interest expenses are deductible.

We can safely say that income taxes in their current form were somewhat responsible to an increase in consumer credits and in the national debt (as manifested in the budget deficits). They also had a hand in the freefall in the saving rate in the USA (from 3.6% in the 80s to 2.1% in the 90s). And money evading the tax authorities globalised itself using means as diverse as off-shore banking and computer networking. This made taxing sophisticated, big money close to impossible.

No wonder that taxes levied on consumption rather than on income came to be regarded as an interesting alternative.

Consumption taxes are levied at the Point of Sale (POS). They are a mixed lot:

We all get in touch with Excise Taxes. These are imposed on products which are considered to be bad both for the consumer and for society. These products bring about negative externalities: smoke and lung cancer, in the case of tobacco, for instance. So, when tobacco or alcohol are thus taxed - the idea is to modify and reform our behaviour which is deemed to be damaging to society as a whole. About 7% of tax revenues in the USA come from this source - and double that in other countries.

Sales taxes have a more modest calling: to raise revenues by taxing the finished product in the retail level. Unfortunately, so many authorities have the right to impose them - that they vary greatly from one location to another. This adds to the confusion of the taxpayer (and of the retailer) and makes the tax more expensive to collect than it should have been.

Moreover, it distorts business decisions: businesses would tend to locate in places with lower sales taxes.

Sales taxes have a malignant effect on the pricing of finished goods. First, no tax credit is allowed (sales taxes paid on inputs cannot be deducted from the sales tax payable by the retailer). Secondly, the tax tends to cascade, increase the prices of goods (taxable and not, alike), affect investments in capital goods (which are not exempt). It adversely affects exports and domestic goods which compete with imports.

In short: sales taxes tend to impede growth and prevent the optimization of economic resources. Compare this with the VAT (Value Added Taxes): simple, cheap to collect, contain no implicit taxes on inputs. VAT renders the pricing structure of goods transparent. This transparency encourages economic efficiency.

VAT is used in 80 countries worldwide and in 22 out of 24 OECD countries, with the exception of the federal ones: the USA and Australia.

There are three types of VAT. They are very different from each other and the only thing common to them all is the tax base: the value added by the taxpayer.

Economic theory defines Value Added as the sum of all the wages, interest paid on capital, rents paid on property and profits. In the Addition VAT method, these four components are taxed directly. The State of Michigan in the USA uses this method since 1976. Experience shows that this method yields more predictable tax revenues and is less susceptible to business or industry cycles.

The Subtraction method, employed in Japan and a few much smaller countries, is admittedly the simplest. It taxes the difference between a taxpayer's sales and its taxed inputs. However, it becomes very complicated when the country has a few VAT rates, because the inputs have to be separated according to the various rates.

Thus, the most widely accepted system is the Credit Invoice. Businesses become unpaid tax collectors. They are responsible to get tax receipts from their suppliers (inputs). They will be credited with the VAT amounts on the receipts that they have collected, so they have a major incentive to do so. They will periodically pay the tax authorities the difference between the VAT on their sales and the VAT on their inputs, as evidenced by the receipts that they have collected. If the difference is negative - they will receive a rebate (in certain countries, directly to their bank account).

This is a breathtakingly simple concept of tax collection, which also distributes the costs of administering the tax amongst millions of businesses. In the fiscal year (FY) 1977/8 in the UK - the tax productivity (cost per 1 dollar collected) was 2%. This means that the government paid 2 cents to collect 1 dollar. But businesses paid the remaining 10 cents.

If introduced in the USA, VAT will cost only 3 billion USD (with 30,000 tax officials employed in a separate administration). To collect 1 dollar of income tax costs 0.56% in the USA. But, to collect VAT in Norway costs

0.32%, in Belgium - 1.09% and, on average, 0.68%. In short, VAT does not cost much more than income taxes to collect.

Yet, what is true for government is not necessarily so for their subjects.

The compliance cost for a business in the USA is $49. It is $53-282 in other countries.

Small businesses suffer disproportionately more than their bigger brethren. It cost them 1.94% of VAT revenue in FY 1986/7 in the UK. Rather more than big firms (0.003%!).

Compliance costs are 40 times higher for small businesses, on average. This figure masks a larger difference in retail and basic industries (80 times more), in wholesale (60 times more) and in manufacturing and utilities (45 times more).

It was inevitable to think about exempting small business from paying VAT.

If 16 out of 24 million businesses were exempted - the costs of collecting VAT will go down by 33% - while the revenues will decline by only 3%. KPMG claims that businesses with less than $50,000 annual turnover (18 out of 24 million) exempted in the USA, revenues would have declined by 1.5%. About 70% of the tax are paid by 10% of the businesses in the UK. For 69% of the businesses there (with turnover of less than 100,000 USD annually) the costs of collection exceed 60% of the revenues. For 96% of the businesses (with less than 1 million USD a year) - the costs exceed 50%. Only in the case of 30,000 companies - are the costs less than 20%. These figures do not include compliance costs (=costs borne by businesses which comply with the tax law).

No wonder that small businesses borrow money to pay that VAT bills. Many of them - though exempt - register voluntarily, to get an endless stream of rebates. This is a major handicap for the tax system and reduces its productivity considerably. In a desperate effort to cope with this law-abiding flood, tax authorities have resorted to longer periods of reporting (instead of monthly). Some of them (in the UK, for one) allow annual VAT reports.

Part of the problem is political. There is little disagreement between economists that VAT is a tax preferable to income taxes. But this statement comes with caveats: the tax must have one rate, universally applied, without sector exemptions. This is the ideal VAT.

The world being less than ideal - and populated by politicians - VATs do not come this way. They contain many rates and exemptions for categories of goods and services.

This mutilated version is called the differentiated VAT.

An ideal VAT is economically neutral - though not equitable. This means that the tax does not affect economic decisions in ways that it shouldn't. On the other hand, its burden is not equally distributed between the haves and have nots.

VAT taxes value added in each stage of the production process. It does so by levying a tax on goods and services - but what is really taxed are the means of production, labour and capital. Ultimately, shareholders of the taxpaying businesses pay the price - but most of them try to move it on to the consumer, which is where the inequity begins. A rich consumer will pay the same tax as his poorer counterpart - but the tax will constitute a smaller part of his income. This is the best definition yet found for regressivity.

On the face of it - and for a very long time - VAT served as a prime example of regressive, unfair taxation.

For a very long time, that is until the development and propagation of the Life Cycle Theories. The main idea in all these theories was that consumption was not based on annual, current income only. Rather, it took into consideration future flows of income (income expectations). People tended to be constant in their level of spending (in different periods in their lives) - even as their annual income vacillated. With the exception of millionaires and billionaires, people spent most of their income in their lifetime.

VAT was, therefore, a just and equal tax. If income equalled consumption in the long run, VAT was a form of income tax, levied incrementally, with every purchase. It reflected a taxpayer's ability to pay (=to consume). It was a wealth tax. As such, it necessitated the reduction in other taxes. Taxing money spent on consumption was taxing money already taxed once (as income). This was classic double taxation - a situation which had to be remedied.

But, in any case, VAT was a proportional tax when related to a lifetime's income - rather than a regressive tax when compared to annual income. Because consumption was a parameter more stable than income - VAT made for a more stable and predictable tax.

Still, old convictions die hard. To appease social lobbies everywhere, politicians came up with solutions which were unanimously rejected by economists.

The most prevalent was exempting a basket of "poor people's goods" from VAT.

This gave rise to a series of intricate questions:

If food, for instance, was exempted (and it always is) - was this not a subsidy given to rich people as well? Don't rich people eat?

Moreover, who will decide what is or isn't food? Is caviar food? What about health food? It was obviously going to be very hard to reach social consensus.

If tax on these products were zeroed - taxes on other products would have had to go up to maintain the same revenue. And so they did. In most countries VAT is levied on less than 45% of the GDP - and is reckoned to be twice as high as it should be.

Some sought to correct this situation by subjecting services to VAT but this proved onerous and impossible to implement in certain sectors of the economy (banking and insurance, to name two).

Others suggested to dedicate VAT generated revenues to progressivity enhancing programs. But this would have entailed the imposition of additional taxes to cover the shortfall.

It is universally thought, that the best method to "compensate" the poor for their regressive plight is to directly transfer money to them from the budget or to give them vouchers (or tax credits) which they can use to get discounts in education, medical treatment, etc. These measures will, at least, not distort economic decisions. And we, the less lucky taxpayers, will know how much we are paying for - and to whom.

This is one of the budgetary items which increase with the introduction of VAT. Research shows that there is a strong correlation between the introduction of VAT and growth in government spending. Admittedly, it is difficult to tell which led to what. Still, certain groups in the population feel that it is their natural right to be compensated for every income reducing measure - by virtue of the fact that they don't have enough of it.

But VAT is known to have some socially desirable results, as well.

To start with, VAT is a renowned fighter of the Black Economy. This illegitimate branch of economic activity consists of three elements:

1. The non official sales of legal goods (produced within the tax system);
2. The sales of illegal goods (which never were within the tax system);
3. The consumption of money not declared or disclosed to the tax authorities VAT lays its heavy paws on all three activities.

VAT is self enforced. As we said, VAT offers a powerful (money) incentive not to collaborate in tax scams. Every tax receipt means money begotten from the tax authorities.

VAT is incremental. To completely evade paying VAT on a product would require the collaboration of dozens of businesses, suppliers and manufacturers. It is much more plausible to cheat the income tax authorities. VAT is levied on each and every phase of the production cycle - it is possible to avoid it in some of these phases, but never in all of them. VAT is an all-pervasive tax.

VAT is levied on consumption. It is indifferent to the source of the money used to pay for it. Thus, it is as easily applied to "black", undeclared, money - as it is to completely legal funds.

Surely, there are incentives to avoid and to evade it. If the amount of inputs in a product is very low, the VAT on the sale will be very burdensome. A business non-registered with the VAT authorities will have a sizeable price advantage over his registered competitor.

With a differential VAT system, it is easy to declare the false sale of zero-rated goods or services to linked entities or to falsify the inputs, or both. Even computers (which compare the ratio of sales to inputs) cannot detect anything suspicious in such a scheme.

Yet, these are rare occurrences, easily detectable by cross examining information derived from several databases. All in all, VAT is the ultimate, inevitable tax.

Moreover, it is virtuous. By making consumption more expensive, it would tend to divert capital into investments and savings. At least, this is what our intuition tells us.

Research begs to differ. It demonstrates the resilience of consumers, who maintain their consumption levels in the face of mounting price pressures. They even reduce savings to do so. We say that their consumption is rigid, inelastic. Also, people do not save because it "pays better" to save than to consume. They don't save because the relative return on savings is higher on savings than on consumption. They save because they are goal oriented. They want to buy something: a car, a house, higher education for their children.

When the yield increases - they will need to save less money to get to the same target in the prescribed period of time. We could say that, to some extent, savings display negative elasticity.

Markets balance themselves through a series of intricate feedback loops and "true models" of economic activity. Take an increase in savings generated by the introduction of VAT: it is bound to be short lived. Why? because the equilibrium will be restored.

Increased savings will increase the amount of capital available and reduce the yields on this capital. A reduction in yield would, in turn, reduce the savings rate.

Moreover, narrow (differentiated, non-ideal) based VATs lead to higher rates of VAT (to generate the same revenue). This reduces the incentives to work and the amount of income available for savings.

In a very thorough research, Ken Militzer found no connection between the introduction of VAT and an increase in the rate of saving in 22 OECD countries since 1965 (VAT was first introduced in France in 1954). He also found no connection between VAT and changes in corporate (profit) and income taxes.

In Europe VAT replaced various turnover taxes so its impact on anything was fairly insignificant. It had no influence on inflation, as well. VAT apparently has two conflicting influences: it raises the general price level through a one time "price shock", on one hand. On the other hand, it contracts the economy by providing a disincentive to consume. If VAT does influence inflation - its impact will be echoed and amplified through wage indexation and the linking of transfer payments to the Consumer Price Index (CPI). In this case, maybe its effects should be sterilized from the calculations of the CPI.

But research was able to demonstrate only the potentially dangerous contracting, deflationary (stagflationary, to be exact) influences of this tax. The recommendation is surprising: the Central Bank is advised to increase the money supply to accommodate the reverberations of the introduction of this tax.

Finally, VAT is a "border adjustment" tax (under the GATT and WTO charters).

This means that VAT is rebated to the exporter and imposed on the importer.

Prima facie, this should encourage exports - and equally discourage imports.

Surprisingly, this time the intuition is right - albeit for a limited period of time.

Despite a raging debate in economic literature, it seems safe to say the following:

- VAT increases the profits of exporters and producers of import substitutes.
- VAT increases the investments in the trade sector.
- VAT increases exports and decreases imports.
- These advantages are, ultimately, partially offset by the movement of exchange rates.
- If certain sectors are not taxed - investment will flow to that sector and badly affect the trade sector and the competitiveness of the country in world markets.

Viral Marketing

The answer is: no one knows. Many self-styled "gurus" and "pundits" - authors of voluminous tomes they sell to the gullible - pretend to know. But their "expertise" is an admixture of guesswork, superstitions, anecdotal "evidence" and hearsay. The sad truth is that no methodical, long term, and systematic research has been attempted in the nascent field of e-publishing and, more broadly, digital content on the Web. So, no one knows to say for sure whether free content sells, when, or how.

There are two schools - apparently equally informed by the dearth of hard data. One is the "viral school". Its vocal proponents claim that the dissemination of free content fuels sales by creating "buzz" (word of mouth marketing driven by influential communicators). The "intellectual property" school roughly says that free content cannibalizes paid content mainly because it conditions potential consumers to expect free information. Free content also often serves as a substitute (imperfect but sufficient) to paid content.

Experience - though patchy - confusingly seems to points both ways. Views and prejudices tend to converge around this consensus: whether free content sells or not depends on a few variables. They are:

1. **The nature of the information.** People are generally willing to pay for specific or customized information, tailored to their idiosyncratic needs, provided in a timely manner, and by authorities in the field. The more general and "featureless" the information, the more reluctant people are to dip into their pockets (probably because there are many free substitutes).

2. **The nature of the audience.** The more targeted the information, the more it caters to the needs of a unique, or specific group, the more often it has to be updated ("maintained"), the less indiscriminately applicable it is, and especially if it deals with money, health, sex, or relationships - the more valuable it is and the more people are willing to pay for it. The less computer savvy users - unable to find free alternatives - are more willing to pay.

3. **Time dependent parameters.** The more the content is linked to "hot" topics, "burning" issues, trends, fads, buzzwords, and "developments" - the more likely it is to sell regardless of the availability of free alternatives.

4. **The "U" curve.** People pay for content if the free information available to them is either (a) insufficient or (b) overwhelming. People will buy a book if the author's Web site provides only a few tantalizing excerpts. But they are equally likely to buy the book if its entire full text content is available online and overwhelms them. Packaged and indexed information carries a premium over the same information in bulk. Consumer willingness to pay for content seems to decline if the amount of content provided falls between these two extremes. They feel sated and the need to acquire further information vanishes. Additionally, free content must really be free. People resent having to pay for free content, even if the currency is their personal data.

5. **Frills and bonuses.** There seems to be a weak, albeit positive link between willingness to pay for content and "members only" or "buyers only" frills, free add-ons, bonuses, and free maintenance. Free subscriptions, discount vouchers for additional products, volume discounts, add-on, or "piggyback" products - all seem to encourage sales. Qualitative free content is often perceived by consumers to be a BONUS - hence its enhancing effect on sales.

6. **Credibility.** The credibility and positive track record of both content creator and vendor are crucial factors. This is where testimonials and reviews come in. But their effect is particularly strong if the potential consumer finds himself in agreement with them. In other words, the motivating effect of a testimonial or a review is

amplified when the customer can actually browse the content and form his or her own opinion. Free content encourages a latent dialog between the potential consumer and actual consumers (through their reviews and testimonials).

7. **Money back warranties or guarantees.** These are really forms of free content. The consumer is safe in the knowledge that he can always return the already consumed content and get his money back. In other words, it is the consumer who decides whether to transform the content from free to paid by not exercising the money back guarantee.

8. **Relative pricing.** Information available on the Web is assumed to be inherently inferior and consumers expect pricing to reflect this "fact". Free content is perceived to be even more shoddy. The coupling of free ("cheap", "gimcrack") content with paid content serves to enhance the RELATIVE VALUE of the paid content (and the price people are willing to pay for it). It is like pairing a medium height person with a midget - the former would look taller by comparison.

9. **Price rigidity.** Free content reduces the price elasticity of paid content. Normally, the cheaper the content - the more it sells. But the availability of free content alters this simple function. Paid content cannot be too cheap or it will come to resemble the free alternative ("shoddy", "dubious"). But free content is also a substitute (however partial and imperfect) to paid content. Thus, paid content cannot be priced too high - or people will prefer the free alternative. Free

content, in other words, limits both the downside and the upside of the price of paid content.

There are many other factors which determine the interaction of free and paid content. Culture plays an important role as do the law and technology. But as long as the field is not subject to a research agenda the best we can do is observe, collate - and guess.

This article is, of course, free content...:o))

APPENDIX - Types of Free Content

The experiment of online content is in its infancy. Content creators, providers and aggregators fall into seven categories, though hybrids and permutations abound:

I. ***Entirely Free Content***

Unrestricted access to the entire body of content available through a central URL or database.

II. ***Registration Required***

Access to the entire body of content available through a central URL or database conditioned on providing a few personal data and being assigned - or choosing - a user ID and password. But, subject to registration, the content is entirely free, as in (I).

III. ***Time Limited Free Content - New but not Archived***

Unrestricted but time-limited access to some content available through a central URL or database. Access to new material is free and unrestricted. Access to archived material requires a subscription.

IV. ***Time Limited Free Content - Archived but not New***

Unrestricted but time-limited access to some content available through a central URL or database. Access to archived material is free and unrestricted. Access to new material requires a subscription.

V. ***Time Limited Free Content - Rotation***

Unrestricted but time-limited access to some content available through a central URL or database. Various parts of the Web site (desks, chapters, features, articles, stories, sections, etc.) become accessible at different times. Access is rotated between these sections periodically or thematically or arbitrarily.

VI. ***Teaser Content***

Unrestricted - time unlimited or time limited - access to some content (selected articles, headlines only, etc.) available through a central URL or database. Access to the rest of the content requires a subscription.

VII. ***Subscription***

Access to content subject to paid subscription or payment per item.

Vodka

Vodka is a crucial component in Russian life. And in Russian death. Alcohol-related accidents and cardiac arrests have already decimated Russian life expectancy by well over a decade during the last decade alone.

Vodka is also big business. The brand "Stolichnaya" sells $2 billion a year worldwide. Hence the interminable and inordinately bitter battle between the Russian ministry of agriculture and SPI Spirits. The latter, still partly owned by the state, is the on and off owner of the haloed brand "Stolichnaya", James Bond's favorite.

SPI's PR firm, Burson-Marsteller, posits this commercial conflict as a classic case of the violation of the property rights of hapless foreign shareholders by the avaricious and ruthless functionaries of an unreformed evil empire. They question Russia's readiness to accede to the WTO and its respect for the law.

SPI's latest press release consists of the detailed history of this harrowing tale. The brand Stolichnaya, as well as 42 others, were privatized in 1992. The firm quotes a document, bearing the official seal of the maligned ministry, which states unambiguously: "VAO Sojuzplodoimport has the right to export Russian vodka to the USA under the following trademarks: Stolichnaya, Stolichnaya Cristall, Pertsovka, Limonnnaya, Privet, Privet Orange (Apelsinovaya), Russian and Okhotnichya."

The privatization was completed in 1997 when the old SPI was sold to the new SPI Spirits. The new SPI claims to have assumed $40 million in debt and invested another $20 million to rebuild the company into "one of the world's leading vodka producers". Yet, the Russian government, as heavy handed as ever, clearly is unhappy with SPI.

It says the privatization deal was dubious and that SPI paid only $300,000 (or maybe as little as $61,000 claim other sources) for the multi-billion dollar brands, including "Stolichnaya", "Moskovskaya", and "Russkaya". The government values the brands at a far more reasonable $400 million. Other appraisers came up with a figure of $1.4 billion.

The government, in a bout of new-found legal rectitude, also insists that the seller of the brands, the defunct (state-owned) SPI, was not their legal owner. It also questions the mysterious shareholders of the new SPI - including a holding company in tax-lenient Delaware. SPI's trademarks portfolio is represented by an Australian law firm, Mallesons Stephen Jaques.

Putin himself set up a committee for the repatriation of these and other consumer brands to the state. He craves the beneficial effects the alcohol sector's tax revenues could have on the federal budget - and on its powers of patronage. A central state-owned brand-holding and distribution company was set up less than two years ago. Ever since then, the alcohol sector has been subjected to relentless state interference. SPI is not the most egregious case either.

"The Observer" mentions that SPI currently runs most of its business from inscrutable Cyprus, a favorite destination for Russian money launderers, tycoon tax evaders, and mobsters. SPI's German distributor, Plodimex, is increasingly less active - as three new off shore distribution entities (in Cyprus, the Dutch Antilles, and Gibraltar) are increasingly more so.

The FSB ordered Kaliningrad customs to prohibit bulk exports of Stolichnaya. Cases of the drink are routinely confiscated. Criminal charges were brought against directors and managers in the firm. The Deputy Minister of Agriculture is discrediting SPI in meetings with its distributors and business partners abroad. He is also accused by the firm of obstructing the court-mandated registration of its trademarks.

The courts have lately been good to SPI, coming out with a spate of decisions against the government's conduct in this convoluted affair. But on February 1, the firm suffered a setback, when a Moscow court ruled against it and ordered 43 of its brands, the prized Stolichnaya included, returned to the government (i.e., re-nationalized).

SPI is doing its best to placate the authorities. It is rumored to have offered last month to use its ample funds to supplement the federal budget. It has indicated last September that it is on the prowl for additional acquisitions in Russia - a bizarre statement for a firm claiming to have been victimized. "The Moscow Times" reported that it is planning to sign a $500,000 sponsorship agreement with the Russian Olympic Committee.

Summit Communications, a country image specialist, placed this on its Web site in November last year:

"One example of a savvy Russian company that has managed to do well in the West by finding the right partner is the Soyuzplodimport company (see also p. 14). Soyuzplodimport, or SPI, has the exclusive rights to export Stolichnaya, which vodka lovers in the U.S. fondly refer to as 'Stoli'. Some 50% of the company's export turnover comes from the United States, thanks mostly to its strategic alliance with Allied-Domecq for U.S. distribution.

'I'm not sure that all Americans know where Russia is on the map, but most of them know what Stolichnaya is,' muses Andrey Skurikhin, general director of SPI. 'I want the quality of Stolichnaya in America to create an image of Russia that is pure, strong and honest, just like the vodka. At SPI, we feel that we are like ambassadors and we will try to do everything to create a more objective and positive image of Russia in the U.S.'"

SPI's troubles may prove to be contagious. Allied Domecq, its British distributor in America and Mexico, now faces competition from Kryshtal International, a subsidiary of the troubled Kristal distillery, 51% owned by Rosspirtprom, a government agency. Kryshtal signed distribution contracts for "Stolichnaya" with distilleries backed by the Russian ministry of agriculture.

Allied and Miller Brewing have announced a $50 million investment in product launch and marketing campaigns only two years ago. "Stolichnaya" (nicknamed "Stoli" in the States) sells 1 million 12-bottle cases a year in the USA (compared to Absolut's 3 million cases).

The trouble started almost immediately with the first foreign investments in SPI. As early as 1991, Vneshposyltorg, a government foreign trade agency, tried to export Stolichnaya in Greece. This led to court action by the Greeks. Vodka wars also erupted between the newly-registered Russian firm "Smirnov" and Grand Metropolitan over the brand "Smirnoff".

The vodka wars are sad reminders of the long way ahead of Russia. Its legal system is rickety - different courts upheld government decisions and SPI's position almost simultaneously. Russia's bureaucrats - even when right - are abusive, venal, and obstructive. Russia's "entrepreneurs" are a penumbral lot, more enamored with off-shore tax havens than with proper management. The rule of law and private property rights are still fantasies. The WTO - and the respectability it lends - are as far as ever.

Vojvodina, Economy of

In October 2005, Parliamentary Assembly of Europe members tabled a draft resolution castigating the human rights situation in the province of Vojvodina. As EU accession looms larger for Serbia and Montenegro, such resolutions are bound to proliferate. Vojvodina is widely regarded as a test case and the touchstone of Serbia's post-Milosevic reforms.

Milosevic is still a hate figure in Vojvodina. Until he abolished it in 1989, the northern region, bordering on Hungary, enjoyed an autonomy granted by Tito's successive constitutions. Vojislav Kostunica, the current prime minister of erstwhile rump Yugoslavia and a one time winner of the first round of elections for the presidency of Serbia has replaced the deposed autocrat as chief villain. His opponent, the reform-minded Miroljub Labus, won convincingly only in Vojvodina and southwestern Serbia in the self-same elections.

Exactly four years ago, the provincial assembly of Vojvodina sacked the region's deputy prime minister, a Kostunica crony, and upgraded the status of Novi Sad to "capital city". The assembly's speaker stormed into the building of Novi Sad's TV and radio to protest a Belgrade appointment.

Serb radicals demanded full self-government, the large Hungarian minority - one eighth of Vojvodina's two million strong populace - petitioned for self-rule in locales with a Magyar majority, moderates urged Belgrade to start negotiating soon. Hungary, under the previous prime minister, Viktor Orban, agitated aggressively on behalf of its ethnic kin. It looked as though Vojvodina is about to join the ranks of independence-prone Kosovo and Montenegro. Many Vojvodina Serbs still regard it as central European, having been part of the Habsburg empire until 1918.

Vojvodina's denizens - pro-Western, highly educated, intellectuals, members of the free professions, and globe-trotting businessmen - were horrified by the barbarity of Yugoslavia's tortured demise. They now act as the self-appointed conscience of Serbia and Montenegro.

In June 2002, Nenad Canak, the head of the provincial parliament, demanded the prosecution of journalists who contributed to "warmongering" during Milosevic's reign. As reported by Radio B92, the organizers in Novi Sad in August 2002 of "Blood and Honey", an exhibition of photo-journalist's Ron Haviv's work in the Balkan in the 1990's, wrote in a letter addressed to Kostunica, among others:

"Why do you keep silent regarding nationalistic and chauvinistic behavior? Why is this problem being ignored? This is obviously not an isolated incident, but an organized, planned and financed action. Does this

mean that you are turning a blind eye to the truth? The [truth] is simple - wars happened and crimes were committed in them, crimes that we will have to face, sooner or later."

Even their dismay at NATO's surgical demolition during the 1999 Kosovo campaign of their three economically-critical bridges over the Danube and their only oil refinery did not turn them into anti-Western xenophobes.

Finally, in January-February 2001 and again in January-February 2002, the Serbian parliament restored some of the territory's previous powers and privileges - over its finances, agriculture, health care, justice, education, tourism, sports, the media, and social services. Mile Icakov, a triumphant parliamentarian, from the late Djindjic's DOS umbrella grouping of reformist parties, quoted by Radio Free Europe/Radio Liberty, uttered this veiled admonition:

"That's something we had and that's something that belonged to us and nobody has to grant it to us, but to return back what was taken away against the law and against the constitution... Everyone in Serbia has already agreed on the largest-possible autonomy for Kosovo. Nothing will change if they do the same for Vojvodina. It would be fair to give Vojvodina the [same rights]. It's not fair that the bad kid gets everything he asks for and the good kid gets nothing."

Yet, the omission to tackle Vojvodina's grievances - or even to consult it - in the March 14, 2002 EU-sponsored Agreement on Restructuring Relations between Serbia and Montenegro irritated the disgruntled province. Vojvodina is not only Yugoslavia's bread basket, it also harbors its nascent oil industry, and many of its blue-chips.

As a result, it is a net contributor to the federal budget and subsidizes the other parts of the rump Yugoslavia. It produces two firth of Serbia and Montenegro's dwindling GDP and attracts two thirds of its foreign direct investment - with only one fifth of its population.

In January 2002, the French multinational Lafarge bought a majority stake in the Beocin cement factory near Novi Sad. It paid $51 million of which Vojvodina is likely to see very little. Five loss making sugar factories were next in line. Serbia's privatization minister pledged to plough back one quarter of all future privatization receipts into the local economy.

Then Serbian Minister of Agriculture, Forestry and Water Management, Dragan Veselinov, offered to subsidize sugar beet, soybean, and sunflower crops and to buy 280,000 tons of wheat in 2003. But these belated pre-election bribes did not soothe jangled nerves.

During the 1990's Vojvodina was reluctantly flooded with Serb refugees from Bosnia, Croatia, and Kosovo. The "invasion" altered its character. The erstwhile bastion of tolerant Austro-Hungarian culture has been Balkanized and rendered discernibly more nationalistic, corruption-ridden, and fractious. Neo-fascist, anti-Semitic, revisionist, racist, pro-Greater Serbia, and skinhead organizations proliferate.

The two pillars of the movement for self-governance are, therefore, nostalgia and money. It is a belated reaction to the convulsive and blood-spattered disintegration of the federation. But it is also a rejection of Vojvodina's exploitation by the other provinces.

Like Scotland and Flanders, northern Italy and Quebec, and the Shiite and Kurd regions of Iraq, Vojvodina would like to retain a larger share of its resources for local consumption and investment. In a "Europe of regions" and a world of disintegrating nation-states, this was to be expected. In August 2002, the Committee for International Cooperation and Relations with Euroregions of the Vojvodina parliament voted to join the Assembly of European Regions (AER).

Vojvodina still faces the outcomes of a decade of Western economic sanctions and NATO military action. Sanctions-busting smuggling operations during Milosevic's rule criminalized some parts of the economy. Novi Sad's water, natural gas, the railway to Budapest, river cargo transport, and telecommunications infrastructure were rendered idle by the decimation of its bridges.

The reconstruction of the first, largest bridge, "Sloboda" (or Liberty) was completed in 2004 and cost 34 million euro in EU funds, according to "Balkan Times". Two temporary crossovers cater to the needs of Novi Sad's population - but they are poor substitutes. Rail links to the rest of Europe, for instance, have yet to be restored. The expensive and intricate clearing of the Danube of unexploded ordnance has been completed only recently.

Vojvodina strives to become a regional commercial hub. HINA, the Croat news agency, reports that the Serb province and the neighboring Vukovar-Srijem county in Croatia have agreed to rebuild bridges, in both the literal and the figurative senses. Vojvodina vowed to help

Vukovar secure the return of art expropriated by the Serbs during the internecine war, demine its environs, and find the whereabouts of missing Croat soldiers and civilians.

Vojvodina's parties are members of the ruling, Western-orientated, formerly Djindjic-led, coalition in Belgrade. The Vojvodina Reformists, who backed Kostunica in the recent bout of elections, once have teamed with a DOS breakaway faction to form a new, left of center, political force. Vojvodina plays a crucial role in Serb politics.

Even the leader of the Alliance of Vojvodina Hungarians, Jozsef Kasza, admitted to the Yugoslav daily "Dnevnik", that the status of the Hungarian minority is improving "step by step", though "Hungarians are still not adequately represented in the judiciary, prosecutions, in leading positions in the economy."

He elaborated: "During the Milosevic era they wouldn't let us have our schools, media, they banned the official use of the language. The situation has now improved, the Law on national communities has been passed which needs to continue its implementation more and more."

In an inversion of the traditional roles, the Beta news agency reported that Vojvodina's then secretary for culture and education, Zoltan Bunjik, announced a series of assistance programs targeted at the Serb minority in Hungary, including a Serb history and culture curriculum.

Volatility

Volatility is considered the most accurate measure of risk and, by extension, of return, its flip side. The higher the volatility, the higher the risk - and the reward. That volatility increases in the transition from bull to bear markets seems to support this pet theory. But how to account for surging volatility in plummeting bourses? At the depths of the bear phase, volatility and risk increase while returns evaporate - even taking short-selling into account.

"The Economist" has recently proposed yet another dimension of risk:

"The Chicago Board Options Exchange's VIX index, a measure of traders' expectations of share price gyrations, in July reached levels not seen since the 1987 crash, and shot up again (two weeks ago)... Over the past five years, volatility spikes have become ever more frequent, from the Asian crisis in 1997 right up to the World Trade Centre attacks. Moreover, it is not just price gyrations that have increased, but the volatility of volatility itself. The markets, it seems, now have an added dimension of risk."

Call-writing has soared as punters, fund managers, and institutional investors try to eke an extra return out of the wild ride and to protect their dwindling equity portfolios. Naked strategies - selling options contracts or buying them in the absence of an investment portfolio of underlying assets - translate into the trading of volatility itself and, hence, of risk. Short-selling and spread-betting funds join single stock futures in profiting from the downside.

Market - also known as beta or systematic - risk and volatility reflect underlying problems with the economy as a whole and with corporate governance: lack of transparency, bad loans, default rates, uncertainty, illiquidity, external shocks, and other negative externalities. The behavior of a specific security reveals additional, idiosyncratic, risks, known as alpha.

Quantifying volatility has yielded an equal number of Nobel prizes and controversies. The vacillation of security prices is often measured by a coefficient of variation within the Black-Scholes formula published in 1973. Volatility is implicitly defined as the standard deviation of the yield of an asset. The value of an option increases with volatility. The higher the volatility the greater the option's chance during its life to be "in the money" - convertible to the underlying asset at a handsome profit.

Without delving too deeply into the model, this mathematical expression works well during trends and fails miserably when the markets change sign. There is disagreement among scholars and traders whether one should better use historical data or current market prices - which include expectations - to estimate volatility and to price options correctly.

From "The Econometrics of Financial Markets" by John Campbell, Andrew Lo, and Craig MacKinlay, Princeton University Press, 1997:

"Consider the argument that implied volatilities are better forecasts of future volatility because changing market conditions cause volatilities (to) vary through time stochastically, and historical volatilities cannot adjust to changing market conditions as rapidly. The folly of this argument lies in the fact that stochastic volatility contradicts the assumption required by the B-S model - if volatilities do change stochastically through time, the Black-Scholes formula is no longer the correct pricing formula and an implied volatility derived from the Black-Scholes formula provides no new information."

Black-Scholes is thought deficient on other issues as well. The implied volatilities of different options on the same stock tend to vary, defying the formula's postulate that a single stock can be associated with only one value of implied volatility. The model assumes a certain - geometric Brownian - distribution of stock prices that has been shown to not apply to US markets, among others.

Studies have exposed serious departures from the price process fundamental to Black-Scholes: skewness, excess kurtosis (i.e., concentration of prices around the mean), serial correlation, and time varying volatilities. Black-Scholes tackles stochastic volatility poorly. The formula also unrealistically assumes that the market dickers continuously, ignoring transaction costs and institutional constraints. No wonder that traders use Black-Scholes as a heuristic rather than a price-setting formula.

Volatility also decreases in administered markets and over different spans of time. As opposed to the received wisdom of the random walk model, most investment vehicles sport different volatilities over different time horizons. Volatility is especially high when both supply and demand are inelastic and liable to large, random shocks. This is why the prices of industrial goods are less volatile than the prices of shares, or commodities.

But why are stocks and exchange rates volatile to start with? Why don't they follow a smooth evolutionary path in line, say, with inflation, or interest rates, or productivity, or net earnings?

To start with, because economic fundamentals fluctuate - sometimes as wildly as shares. The Fed has cut interest rates 11 times in the past 12 months down to 1.75 percent - the lowest level in 40 years. Inflation gyrated from double digits to a single digit in the space of two decades. This uncertainty is, inevitably, incorporated in the price signal.

Moreover, because of time lags in the dissemination of data and its assimilation in the prevailing operational model of the economy - prices tend to overshoot both ways. The economist Rudiger Dornbusch, who died last month, studied in his seminal paper, "Expectations and Exchange Rate Dynamics", published in 1975, the apparently irrational ebb and flow of floating currencies.

His conclusion was that markets overshoot in response to surprising changes in economic variables. A sudden increase in the money supply, for instance, axes interest rates and causes the currency to depreciate. The rational outcome should have been a panic sale of obligations denominated in the collapsing currency. But the devaluation is so excessive that people reasonably expect a rebound - i.e., an appreciation of the currency - and purchase bonds rather than dispose of them.

Yet, even Dornbusch ignored the fact that some price twirls have nothing to do with economic policies or realities, or with the emergence of new information - and a lot to do with mass psychology. How else can we account for the crash of October 1987? This goes to the heart of the undecided debate between technical and fundamental analysts.

As Robert Shiller has demonstrated in his tomes "Market Volatility" and "Irrational Exuberance", the volatility of stock prices exceeds the predictions yielded by any efficient market hypothesis, or by discounted streams of future dividends, or earnings. Yet, this finding is hotly disputed.

Some scholarly studies of researchers such as Stephen LeRoy and Richard Porter offer support - other, no less weighty, scholarship by the likes of Eugene Fama, Kenneth French, James Poterba, Allan Kleidon, and William Schwert negate it - mainly by attacking Shiller's underlying assumptions and simplifications. Everyone - opponents and proponents alike - admit that stock returns do change with time, though for different reasons.

Volatility is a form of market inefficiency. It is a reaction to incomplete information (i.e., uncertainty). Excessive volatility is irrational. The confluence of mass greed, mass fears, and mass disagreement as to the preferred mode of reaction to public and private information - yields price fluctuations.

Changes in volatility - as manifested in options and futures premiums - are good predictors of shifts in sentiment and the inception of new trends. Some traders are contrarians. When the VIX or the NASDAQ Volatility indices are high - signifying an oversold market - they buy and when the indices are low, they sell.

Chaikin's Volatility Indicator, a popular timing tool, seems to couple market tops with increased indecisiveness and nervousness, i.e., with enhanced volatility. Market bottoms - boring, cyclical, affairs - usually suppress volatility. Interestingly, Chaikin himself disputes this interpretation. He believes that volatility increases near the bottom, reflecting panic selling - and decreases near the top, when investors are in full accord as to market direction.

But most market players follow the trend. They sell when the VIX is high and, thus, portends a declining market. A bullish consensus is indicated by low volatility. Thus, low VIX readings signal the time to buy. Whether this is more than superstition or a mere gut reaction remains to be seen.

It is the work of theoreticians of finance. Alas, they are consumed by mutual rubbishing and dogmatic thinking. The few that wander out of the ivory tower and actually bother to ask economic players what they think and do - and why - are much derided. It is a dismal scene, devoid of volatile creativity.

Voucher Communities

I. Executive Summary

"Voucher Communities" are communities of unemployed workers organized in each municipality. The unemployed exchange goods and services among themselves in a barter-like or countertrade system. They use a form of "internal money": a voucher bearing a monetary value.

Thus, an unemployed electrician can offer his services to an unemployed teacher who, in return, gives the electrician's children private lessons. They pay each other with voucher money. The unemployed are allowed to use voucher money to pay for certain public goods and services (such as health and education). Voucher money is redeemed or converted to real money – so it has no inflationary or fiscal effects, though it does increase the purchasing power of the unemployed.

II. The Clearing Authority

The Clearing Authority has four functions:

(1) To ***issue (print) the vouchers*** in various currency-equivalent denominations

(2) To create and maintain the project's ***information systems*** (see below).

(3) To issue laminated plastic (and, later, magnetic striped) ***identification cards*** to voucher recipients ("Voucher Beneficiary ID Cards")

(4) To provide binding ***dispute settlement and resolution mechanisms and forums***

III. Liaison with municipal and state authorities

In some countries, vouchers issued by the Clearing Authority can be used to defray expenditures related to ***education and health*** and to pay ***local taxes***. This is subject to ***agreements*** signed between the Clearing Authority and the relevant local and state authorities.

The Employment Bureau provides the Clearing Authority with ***information about the status of applicants*** (are they unemployed or not), pursuant to the receipt of written release from the applicant.

IV. Liaison with employers

Some Clearing Authorities act as ***employment agencies***. They match jobseekers with employers who then proceed to pay their employees in vouchers. In these cases, the Clearing Authorities provides employers with vouchers on condition that they are used to employ the hitherto unemployed beneficiaries.

V. The Vouchers

The voucher is a ***contract between service providers***. It contains the following elements and components:

(1) It is headlined ***"Contract" between payer and receiver to render services***.

(2) A ***denomination*** (how many currency units the voucher represents) known as "Value Store".

(3) The ***serial ID or registration number*** of the voucher.

VI. Recipients and Beneficiaries

The vouchers are distributed to the unemployed and the homeless in order to ***enhance their purchasing power*** and enable them to ***resume an economically productive role in society***.

The ***total sum of vouchers*** distributed to any given recipient or beneficiary should not exceed one third of his or her income from all other sources combined.

The vouchers should be distributed ***once every quarter*** and expire at the end of the quarter in which they were distributed.

The voucher recipients or beneficiaries can ***use them to pay*** only for services rendered by other recipients or beneficiaries. They should be allowed to ***freely negotiate transactions*** and agree prices among themselves.

VII. Information Systems

The Clearing Authority maintains a ***Central Registry*** in both hard, print copy and computerized form (Excel spreadsheet).

The Central Registry contains the following data and is indexed thus:

(a) ***Name*** of recipient/beneficiary

(b) ***Profession*** of recipient/beneficiary and ***services rendered*** by him or her

(c) ***Contact details*** (address, phone number, e-mail) of recipient/beneficiary

(d) ***Number and value of outstanding, unused vouchers*** in any given quarter

Customers of the service provider are allowed to ***comment online*** on the service provider's (the voucher recipient's/beneficiary's) performance and conduct and to ***rate*** it.

To summarize:

Each beneficiary/recipient of vouchers has a ***record*** in bother print and computerized forms.

The record comprises his or her name, professional qualifications, services rendered, contact details, number and value of outstanding and unused vouchers, and comments and rating by clients pertaining to the beneficiary/recipient's performance and conduct in rendering his or her services.

VIII. Macroeconomic and Microeconomic Implications and Outcomes

(1) Positive

Enhancing the ***purchasing power*** of the unemployed and the homeless

Restarting the ***economic cycle*** in deprived neighborhoods and regions

Increasing the ***psychological well-being*** and motivation of deprived and dysfunctional strata of the population

Engendering ***networks*** of service-providers and customers which can later integrate into the formal, monetized economy

No ***inflationary*** ill effects

No ***fiscal*** ill effects (no budgetary deficits)

(2) Negative

Possible ***hoarding*** of vouchers (largely prevented by the introduction of ***beneficiary/recipient ID cards***)

Vouchers are a form of ***money substitute***. Not only do they subvert the money issuance monopoly of the central bank, they also demonetize the economy and have no multiplier effects. In other words, they create a parallel system that is detached and distinct from the main money supply transmission mechanisms and channels.

This can be overcome by ***limiting the amount*** of vouchers in circulation and their duration (expiry or maturity date). The whole operation should be carried out in coordination with the central bank and the Ministry of Finance.

War

I. War and the Business Cycle

Peace activists throughout the world accuse the American administration of profit-motivated warmongering. More sophisticated types remind us that it was the second world war - rather than President Franklin Delano Roosevelt's New Deal - that ended the Great Depression. "Wag the Dog" is a battle cry in Europe implying that the United States is provoking yet another conflict in Iraq to restart its stalled economy and take the collective mind off an endless stream of corporate sleaze.

In the wake of the previous Gulf war, in the Spring 1991 issue of the Brookings Review, a venerable American economist, George Perry, wrote:

"Wars have usually been good for the U.S. economy. Traditionally they bring with them rising output, low unemployment and full use of industrial capacity as military demands add to normal economic activity."

According to Perry, writing long before the dotcom euphoria and slump, war is counter-cyclical.

The National Bureau of Economic Research (NBER) Business Cycle Dating Committee tends to support this view. The strongest expansions were registered during and after major crises - the Civil War, the first and second world wars, the Korea War, throughout most of the conflict in Vietnam and immediately following Operation Desert Storm, the previous skirmish in Iraq.

In the wake of September 11, US military spending is already up one tenth and poised to continue its uptrend. Defense contractors and service industries, concentrated across the southern USA stand to undoubtedly benefit after a lean decade following the unwinding of the Cold War. GDP may grow by 0.6 percent this year based on $50 billion in war-related expenditures, project DRI-WEFA for MSN's Money Central.

This is an unrealistic price tag. According to the Cato Institute, Operation Desert Storm cost $80 billion (in 2002 dollars), the bulk of which was covered by grateful allies. This war may be more protracted, less decisive and its costs are likely to be borne exclusively by the United States. Postwar reconstruction in Iraq will dwarf these outlays, even allowing for extra revenues from enhanced oil production.

DRI-WEFA present a worst case scenario in which GDP falls by 2.2% over two quarters, the Fed Funds rate ratchets up to 6% to staunch inflation, and unemployment peaks at 7.8%. Recovery is unlikely in the first 18 months of this nightmarish script.

On the minus side, the budget deficit has already ballooned, crowding out lending to the private sector, stoking inflation and threatening to reverse the downtrend in interest rates. Edward Yardeni of Prudential has demonstrated how inflation has followed every single military conflict since 1800. Ultimately, taxes are likely to rise as well.

Yet, that war impacts the timing and intensity of the business cycle is by no means universally accepted.

In an International Finance Discussion Paper titled "Money, Politics and the Post-war Business Cycle" and published by the Board of Governors of the Federal Reserve system in November 1996, the authors, Jon Faust and John Irons, sweepingly dismiss "political effects on the economy". "If they exist" - they add - "they are small and difficult to measure with confidence."

David Andolfatto, from the Department of Economics of Simon Fraser University in British Columbia, Canada, in his "U.S. Military Spending and the Business Cycle" dated October 2001, quotes an email sent to him by one of his students:

"I heard someone say that the US government tends to 'find themselves in war' every time they are in a recession. This person also claimed that the increased government expenditures on war pulled the US out of each of the last few recession they've been in. Furthermore, this person said that the 'military industry' is one of the biggest industries in the US, which is why greater government expenditures on war always pull the US out of recessions ... the boom the US had in the last decade was in large part attributed to all their considerable military effort..."

Andolfatto then proceeds to demolish this conspiratorial edifice. Military spending per adult in the USA has remained constant at $2000 between 1947-2000. It actually declined precipitously from 15 percent of gross domestic product during the Korea War to 4-5 percent today. Military buildups - with the exception of the Gulf War - mostly happen during peacetime.

During the Unites States' recent spate of unprecedented prosperity in the 1990s, military layouts actually shrank. When they did expand in 1978-1987, the economy endured at least one serious recession (1979-1983). In reality, changes in military expenditures lag changes in GDP. Surprisingly, mathematical analysis reveals that GDP growth does not respond measurably to unexpected surges in military spending. Rather, military budgets swell when GDP suddenly increases.

But this is a minority view. Even economists who dispute the economic schools of shock-driven cycles admit that war does affect the economy. Theoretically, at least, government spending, investment decisions and consumer confidence should be affected.

Jonas Fischer at the Chicago Federal Reserve Bank claims that real business cycle models cannot account for the response to fiscal shocks of real wages and hours worked, unless they unrealistically assume that marginal income tax rates are constant and that increased government purchases are financed in a specific manner.

In any case, war, or a commensurate military buildup, do cause expansionary deficit-financed government purchases, employment, output and nonresidential investment to rise while real wages, residential investment and consumption fall. This is compatible with the predictions of neo-classical business cycle models.

There are longer-term effects. According to Martin Eichenbaum from Northwestern University, productivity in the manufacturing sector declines - though it rises in the private sector as a whole. Ultimately, the production of durable goods contracts and interest rates, having initially dropped, end up rising. Marginal income tax rates tend to mount post conflict.

Consumers and investors are inclined to postpone big-ticket decisions in times of uncertainty. Hence the adverse reaction of the capital markets to the recent crisis over Iraqi disarmament. With the exception of the Gulf War and the Cuban Missile Crisis, the Dow Jones Industrial Average has always crumbled in the face of hostilities, only to skyrocket when the situation stabilized and certainty was restored.

The DJIA went down 12 percent when the Korean War broke in 1953 - only to reverse the entire loss and climb yet another 18 percent in the following 3 months. After September 11, 2001 it plunged 14 percent and then clawed back the shortfall and soared an extra 21 percent by the yearend.

After the first victorious day in Operation Desert Storm, stocks surged by 4.6 percent on Jan. 17, 1991, by another 7 percent in the following 30 days and by a total of 25 percent in the next 2 years. According to Ned Davis Research, quoted by USA Today, the Dow has risen on average by c. 15 percent in the year after every triumphant excursion by America's military. Messier conflict, though - like the Vietnam War - induce no exuberance, it seems.

The Gulf War was preceded by a brief recession in the United States. The Dow lost one fifth of its value. Unemployment soared. House prices fell and so did retail sales. When the war erupted, business in shopping malls, car dealerships and airlines ground to a halt. The spike in oil prices added to their woes.

But the recession lasted merely nine months and ended officially a month before the actual invasion of Kuwait by Iraq. It was followed by the longest expansion on record. It affected both sides of the Atlantic. This, despite the fact that the economy was in bad shape long before Saddam's antics. Interest rates stood at about 8 percent, inflation was running at double the current rate and President George Bush Sr. raised taxes rather than lower them, as his son has done.

Was the quiver in 1991-2 induced by the war in Iraq - or by the contraction of defense and aviation industries following the end of the Cold War? Probably the latter.

But talking about a uniform trend in a country as vast as the United States is misleading. As Knight Kiplinger, editor-in-chief of the Kiplinger Letter notes, regions and industries in the USA have endured recessions even as the entire economy boomed.

So, is war good for business?

Depends on which economist you happen to ask. Some would say that war reflates the economy, re-ignites the economic engine, generates employment, increases consumption, innovation and modernization. Others, that it is merely a blip. The truth is out there but don't count on the dismal science to reveal it.

II. New Paradigms, Old Cycles

Until recently, the very existence of business (trade) cycles was called into question by the devotees of the New Economy. It took a looming global recession to convince wild-eyed optimists that old cycles are more reliable guides than any new paradigm. Even now, three years later and still in the throes of a meltdown of capital and real markets on both sides of the Atlantic, the voguish belief in the demise of pre-1990s economics is alive and well.

Consider inflation.

Even conservative voices, such as The Economist reassure us that consumer price inflation is dead and that policymakers should concentrate on the risk of deflation brought on by asset disinflation. Central bankers - particularly Alan Greenspan the mythical Chairman of the Federal Reserve - are castigated for adhering to outmoded schools of thought and for fighting the last war (against inflation), or the wrong one (artificially perking up the stock markets).

The Economist was among the most consistent and persistent critics of the New Economy. Yet, by preaching that certain economic phenomena - notably inflation - are "over" it has joined, unwittingly, a growing camp of "revisionist" economists who spot the demise of the business cycle.

As recapped by Victor Zarnowitz, the research director of the Foundation for International Business and Economic Research in New-York, the optimists believed that downsizing, new technologies, inventory control, the predominance of the services sector, deregulation, better government and globalization have rendered boom and bust a thing of the past.

They tended to tone down the roles of earnings, inventories, investment and credit, the drivers of the "now defunct" classical business cycle. They also largely ignored the interplay between different sectors of the economy and between entwined national economies - continuous interactions which determines inventory planning, the level of wages and pricing. The purported connection between the money supply and output was largely discounted as unproven.

The consensus now, though, is that the cycle is alive and well, though it is less volatile and more subdued. Economies spend less time in recession than they used to until 1980. The cycle is still susceptible, though, to exogenous shocks, such as war, or an abrupt increase in the price of oil. Bursting asset bubbles, if they become more frequent in the future due to financial liberalization, globalization and unbridled credit growth, may restore past volatility, though.

Another ominous phenomenon is the synchronization of recessions and expansions across continents. According to the International Monetary Fund, gross capital flows has exceeded $7.5 trillion globally in 2000 - four times the amount of money sloshing around in 1990. Foreign portfolio assets doubled as a percentage of household assets.

The ratio of merchandise exports to world output has long exceeded its 1913 level, the previous record year. Such unhindered exchange exerts similar influences on countries as far apart as Germany, the United states, Argentina and Singapore - all in the throes of a concurrent recession.

Still, expansions continue to be restricted by the increase in population, net investment and, importantly, technological innovation. The downside is also limited by population increase, government policy on income support and investment. The economy fluctuates to adjust itself to these constraints. The business cycle is a symptom of this process of adaptation.

The waxing and waning of credit made available by alternately over-optimistic and over-cautious financial intermediaries plays a crucial part. Fiscal policy - which affects investment and employment - also matters as do foreign trade, monetary policies and the reaction of the financial markets.

The business cycle typically passes through seven phases correlated with the fluctuations in the output gap - the difference between an economy's actual and potential gross domestic product. Cycles are self-perpetuating, though they can be hastened by exogenous shocks, such as a precipitous rise in oil prices or a protracted military campaign. They can also be smoothed or ameliorated by the operation of automatic fiscal stabilizers and appropriate counter-cyclical government policies.

Centuries of cumulative experience allow us to identify these stages better than ever before, though timing them with any accuracy is still impossible. They are based on the shifting balance between the emotions of greed and fear - as immutable as human nature itself.

Every economic cycle invariably starts with inflation. The previous sequence having ended - and the new one just begun - the environment is mired in uncertainty. In the wake of a recession, often coupled with deflation, goods and services are (absolutely) scarce and money is (relatively) abundant.

When too much money chases few products, the general price level rises. But this constant and ubiquitous increase (known as "inflation") is also the outcome of mass psychology. Households and firms compensate for the aforementioned high degree of uncertainty (that is, of risk) by raising the prices they charge. Market signals are thus garbled by psychological noise and uncertainty increases. It is a vicious cycle: inflation brought on by uncertainty only serves to enhance it.

Ignorant of the appropriate or optimal equilibrium price level, everyone is trying to stay ahead of perceived economic threats and instabilities by increasing the risk premiums that they demand from their customers. On their part, consumers are willing to pay more today to avoid even higher prices tomorrow.

Inflation appears to be a kind of market pathology, or a market failure. But the psychological underpinnings of inflation have been thoroughly dissected in the last few decades. It is the source and dynamics of economic uncertainty that remain obscure.

Inflation disguises the suboptimal and inefficient economic performance of firms and of the economy as a whole. "Paper" profits make up for operational losses. The incentives to innovate, modernize, and enhance productivity suffer. Economic yardsticks and benchmarks are distorted and prevent meaningful analyses and well-founded decision making.

Inflation leads to technological and economic stagnation. Pecuniary aspects are emphasized while industrial and operational ones are neglected. Financial assets are preferred to investments in machinery, infrastructure, research and development, or marketing. This often yields stagflation - zero or negative growth, coupled with inflation.

In an effort to overcome the pernicious effects of inflation, governments liberalize, deregulate and open their economies to competition. This forces firms to innovate and streamline. Efficiency, innovation, entrepreneurship, productivity and competitiveness are the buzzwords of this phase.

As trade barriers fall, cross border capital flows and investments increase, productivity gains and new products are introduced. The upward price spiral is halted and contained. The same amount of money buys better, more reliable products, with added functionality.

The rise in real incomes results in increased demand. The same dose of working capital generates more production. This is technological deflation. It is beneficial to the economy in that it frees economic resources and encourages their efficient allocation.

Increased consumption (both public and private) coupled with a moderate asset price inflation prevent an outright downward spiral in the general price level (monetary deflation). Moreover, as Jeffrey Miron demonstrated in his book, "The Economics of Seasonal Cycles", output growth causes a surge in money supply.

These conflicting influences allow inflation to remain within a sustainable "band". This transitory phase - from hyperinflation or high inflation to a more supportable plateau - is known as "disinflation". It usually lasts one or two decades.

Various studies have shown that the revolutions in knowledge, communications and transportation technologies have shortened both the cycle and every stage in it. This is attributed to the more rapid dissemination and all-pervasive character of contemporary information.

The values of important parameters such as the equilibrium general price level and other gauges of expectations (such as equity prices) are all determined by data. The more information is available more readily - the more efficient the markets and the shorter and the speedier the business cycles. This enhances the false perception that modern markets are inherently unstable. Yet, rapid cycling does not necessarily imply instability. On the contrary, the faster the adjustments in the marketplace - the more efficient the mechanism is.

The psychological wellbeing and reassurance brought on by disinflation generate demand for assets, especially yielding ones (such as real estate or equities). The more certain the future value of streams of income, the more frequently people transact and the more valuable assets become.

Assets store expectations regarding future values. An assets bubble is created when the current value (i.e. price) of money is low compared to its certain future value. This is the case when prices are stable or decreasing. Stock exchanges and real estate then balloon in irrational exuberance out of proportion to their intrinsic (or book) value.

All asset bubbles burst in the end. This is the fifth phase. It signifies the termination of the bull part of the cycle. Asset prices collapse precipitously. There are no buyers - only sellers. Firms find it impossible to raise money because their obligations (commercial paper and bonds) are not in demand. A credit crunch ensues. Investment halts.

The bursting of an assets bubble generates asset price deflation. The "wealth effect" is replaced with a "thrift effect". This adversely affects consumption, inventories, sales, employment and other important angles of the real economy.

The deflationary phase, on the other hand, is usually much shorter. People do not expect it to last. They fully anticipate inflation. But though not assured of low prices, they are so preoccupied with economic survival that they become strongly risk averse. While in times of inflation people are looking for ways to protect the value of their money - in times of deflation people are in pursuit of mere livelihood. A dangerous "stability" sets in. People invest in land, cash and, the more daring, in bonds. Banks do the same. Growth grinds to a halt and then reverses.

If not countered by monetary and fiscal means - a lowering of interest rates, a fiscal Keynesian stimulus, an increase in money supply targets - a monetary deflation might set in.

Full-fledged deflations are rare. Outright or growth recessions, business slumps, credit crunches, slowdowns - are more common. But a differentiated or discriminatory deflation is more common. It strikes only certain sectors of the economy or certain territories.

A monetary deflation - whether systemic or specific to certain industries - is pernicious. Due to reversed expectations (that prices will continue to go down), people postpone their consumption and spending. Real interest rates skyrocket because in an environment of negative inflation, even a zero interest rate is high in real terms. This is known as a "liquidity trap".

Investment and production slump and inventories shoot up, further depressing prices. The decline in output is accompanied by widespread bankruptcies and by a steep increase in unemployment. The real value of debt increases ("debt deflation"). Coupled with declining asset prices, deflation leads to bank failures as a result of multiple debts gone sour. It is a self- perpetuating state of affairs and it calls for the implementation of the seventh and last phase of the cycle: reflation.

The market's failure, at this stage, is so rampant that all the mechanisms of self-balancing and allocation are rendered dysfunctional. State intervention is needed in order to restart the economy. The authorities need to inject money through a fiscal stimulus, to embark on a monetary expansion, to lower interest rates, to firmly support the financial system and to provide tax and other incentives to consume and to import.

Unfortunately, these goals are best achieved militarily. War reflates the economy, re-ignites the economic engine, generates employment, increases consumption, innovation and modernization.

Still, with or without war, people sense the demise of an old cycle and the imminent commencement of a new one, fraught with uncertainty. They rush to buy things. Because the recessionary economy is just recovering from deflation - there aren't usually many things to buy. A lot of money chasing few goods - this is the recipe for inflation. Back to phase one.

But the various phases of the cycle are not only affected by psychology - they affect it.

During periods of inflation people are willing to hazard. They demand to be compensated for the risk of inflation through higher yields (returns, profits) on financial instruments. Yet, higher returns inevitably and invariably imply higher risks. Thus, people are forced to offset or mitigate one type of risk (inflation) with another (credit or investment risk).

Paradoxically, the inflationary segment of the business cycle is an interval of certainty. That inflation will persist is a safe bet. People tend to adhere to doctrinaire schools of economics. Based on the underlying and undeniable certainty of ever-worsening conditions, the intellectual elite and decision-makers resort to peremptory, radical, rigid and sometimes coercive solutions backed by ideologies disguised as "scientific knowledge". Communism is a prime example, of course - but so is the "Free Market" variant of capitalism, known as the

"Washington Consensus", practiced by the IMF and by central bankers in the West.

Economic Management in a State of War

Countries with a non-convertible currency and a developing economy more and more often face low intensity and prolonged guerilla warfare which leads to a ***gradually worsening economic situation***.

Measures number 2C, 4, 6A, 6B, 7, 9, 11A, 11B below are applicable to such a situation.

Another scenario is a ***crisis in balance of payments***. The country then often seeks trade relief under GATT or WTO rules and multilateral financial aid packages (such as the IMF's CCF).

These measures are then applicable:

1B-1H, 2A, 2B, 2C, 2D, 2E, 3, 4, 5, 6A, 6B, 6C, 6D, 7, 8, 9, 11C, 11D, 11E, 11F.

The last and worst scenario is an unmitigated, all out, ***state of war***.

These measures would then apply:

1A-1H, 2A, 2B, 2C, 2D, 2E, 3, 4, 5, 6A, 6B, 6C, 6D, 6E, 7, 8, 9, 10, 11C, 11D, 11E, 11F, 12, 13.

1. Foreign Exchange Regime and Capital Controls

1A. The central bank can fix the exchange rate or establish a currency board

1B. A ceiling or quota is often placed on foreign exchange payments to non-residents
1C. Central bank approval is required for investments by residents abroad
1D. Approval is required for payments under guarantees or non-trade purposes
1E. Payments abroad can be effected from domestic accounts only
1F. Domestic credit facilities to non-resident firms, banks, brokers, etc. are disallowed
1G. Limitations are placed on cash and credit card travel allowances in foreign exchange
1H. Transfers between external accounts require approval of the central bank

2. Banking Regime

2A. Certain types of reserves of the banks with the central bank – for lending to import businesses, for instance - are increased
2B. Certain types of reserves of the banks with the central bank - for lending to export businesses, for instance – are decreased
2C. Reporting of transactions by the banks to the central bank is tightened
2D. Deposit controls are introduced (including a ceiling on interest payments, and a prohibition, or encouragement, as the case may be, of foreign exchange indexation of savings and obligations)
2E. Controls, ceilings, and quotas on withdrawals in foreign exchange are introduced

3. Interest Rate Regime

Increases in Lombard and discount rates to offset speculation against the currency.

4. Export Revenues Regime

Reduce the period for repatriation of export proceeds.

5. Import Controls

Prohibition on import of luxury goods and non-commercial vehicles.
Increase customs tariffs and duties on all imports (and introduce countervailing measures under GATT/WTO rules).

6. Public Procurement Regime

6A. Ceiling budgeting (the imposition of ceilings on item expenditures and micromanagement of the accounts of the budget users)
6B. Positioning of Finance Ministry supervisors and co-signatories in all budget users
6C. Freezing of public procurement of non-essentials
6D. Freezing of public procurement of essentials
6E. Expropriation of logistical war materiel (for instance, cars)

7. Emergency Borrowing Facilities

IMF facilities under an arrangement
World Bank - emergency borrowing
Bilateral – USA
Bilateral – EU
Bilateral – Others
Rescheduling of foreign debt (Paris Club, London Club)

Donor Conferences

8. War Bonds (linked to foreign exchange or nominal)

War effort bonds – voluntary (firms with turnover above a certain amount are "encouraged" to purchase the bonds through tax incentives)
Patriot Bonds – compulsory (firms with turnover above a certain amounts are obligated to purchase the bonds and a percentage of all wages is paid with these bonds, or a fixed quota of bonds is purchased by each household according to the number of members of the household)
Deductions from salaries are used to purchase the bonds
Financial transactions tax is imposed to finance the war effort
Increases in VAT, excise, and other consumption taxes are introduced in order to finance the war effort

9. Budgeting

War budget items can be part of the current budget.
A separate, supplementary budget can cater to the financial needs of the war.
A War Fund can be established – separately managed and includes all the proceeds from war bonds, etc.

10. Emergency Regime

Freeze on wages
Freeze on hiring in public administration
Freeze on indexation of pensions and other state obligations
Freeze on public expenditures and public procurement
Freeze on interest payments
Freeze on repayment of internal debt

11. Strategic Reserves

11A. Decision on which goods are to be included in the strategic reserves (oil, food)
11B. Decision on the quantities of goods to be included in the strategic reserves
11C. Budgetary allocation for the purchase of the goods in the strategic reserves and their warehousing
11D. Preparation of warehouses
11E. Hiring a trading firm (not through a public tender)
11F. Discrete market purchases

12. Suspension of Laws

Suspension of tax reductions in existing laws
Suspension of Public Sector Reform
Suspension of liberalization of the foreign exchange regime

13. Rationing and Subsidies

Rationing of essential goods (oil, food)
Food subsidies to the needy
Fight against criminal and black market (war profiteering) activities

War Reparations

As its disintegration in 1992 has proven, Czechoslovakia may have been merely an artificial multi-ethnic chimera. But it was also an industrial and military powerhouse. In the fateful 1930's, its - mainly heavy - industry was the 7th largest in the world. Even the Germans were awed by its well equipped and well trained army.

The Sudeten was a region of Czechoslovakia bordering on Germany and Austria and inhabited mainly by Germans. The new-fangled country incorporated more than 3 million Germans in what used to be Austrian Silesia. These Germans, once members of the ruling majority in the Austrian Empire - became overnight a minority subjected to subtle forms of discrimination in their new country.

The Germans - a hostile and restless lot - demanded to have an autonomy, which Czechoslovakia refused to grant them. It feared that the Germans will secede and join Hitler's emerging "Great Reich". Such calamity would have deprived Czechoslovakia of important industrial and mineral assets and of its rail links to northern Europe. The Sudeten was also a formidable natural barrier against an imminent German invasion.

Unemployment and inflation further radicalized the Sudeten Germans. Support for Hitler and his pan-Germanic policies increased with every bloodless and bold German victory: the militarization of the Rhineland and the Anschluss (the unification with Austria). The extremist Sudeten German party, led by the Nazi puppet Konrad Henlein, blossomed after 1938.

Henlein sought the dissolution of Czechoslovakia, "this French air carrier in Europe's midst", in Hitler's words. The Germans demanded to exercise the right to self-determination enshrined in numerous international treaties. The status of the German language was a major issue as was the local participation of Germans in the police forces and army. Hitler instructed Henlein: "You must always demand so much that you cannot be satisfied."

"Spontaneous" demonstrations, protests, and riots erupted all over the Sudetenland. The Czechoslovaks were cast by Hitler and the West as intransigent racists, bigots, and bullies. The economies and armies of France and Britain were pitifully unprepared for war. Western leaders were traumatized by the great conflagration of 1914-8. They were reflexive appeasers and pressured Czechoslovakia into making one unpalatable concession after another.

Britain and France bullied Czechoslovakia by annulling their mutual defense pacts. Bonnet, France's Minister of Foreign Affairs advised the Czechoslovaks not to be "unreasonable". Otherwise, he warned, France will "consider herself released from her bonds". Halifax, the British Foreign Minister, enlightened his Ambassador in Paris about the "importance of putting the greatest possible pressure on Dr. Benes (Czechoslovakia's president) without delay".

The Sudeten Germans have, in the meantime, established militias and clashed with Czechs in mixed towns. An "independent" British mediator - Lord Runciman - was dispatched to arm twist the Czechoslovaks. His instructions were to prevent war at all costs. "We will use the big stick on Benes" - thus Cadogan, permanent under-secretary in the British Foreign Office.

Henlein kept raising new demands or reviving old ones. On September 4, 1938, an exhausted President Benes accepted all German demands. This was rejected by both Henlein and Hitler as "too late". Even a pro-German idea of referendum in the Sudetenland was rebuffed by Hitler.

Finally, the French and the British presented this ultimatum to democratic, multiethnic Czechoslovakia, on

September 22, 1938 - Quoted in "On the Origins of War and the Preservation of Peace" by Donald Kagan:

"One - That which has been proposed by England and France is the only hope of averting war and the invasion of Czechoslovakia.
Two - Should the Czechoslovak Republic reply in the negative, she will bear the responsibility for war.
Three - This would destroy Franco-English solidarity, since England would not march.
Four - If under these circumstances the war starts, France will not take part; i.e., she will not fulfill her treaty obligations."

Benes accepted this ultimatum. Hitler demurred. Now he demanded that German troops occupy parts of Czechoslovakia to protect rioting Sudeten Germans from Czechoslovak retribution. In the Munich Conference of the leaders of the West these demands were essentially accepted and Czechoslovakia was no more. Hitler conquered it, in stages, and assimilated it in the German Reich.

The infamous British Prime Minister, Neville Chamberlain made this radio address to the British people in the heat of the crisis on September 27, 1938:

"How horrible, fantastic, incredible it is that we should be digging trenches and trying on gas masks here because of a quarrel in a far-away country between people of whom we know nothing ... However much we sympathize with a small nation confronted by a big and powerful neighbors, we cannot in all circumstances undertake to involve the whole British Empire in war simply on her account. If we have to fight it must be on larger issues that that."

Between 1940, while still in exile in London, and 1946, when Czechoslovakia was reconstituted, president Benes issued a series of decrees, later made law by the Czechoslovak provisional national assembly. The decrees mandated the expulsion of 2.5 million Germans and tens of thousands of Hungarians from Czechoslovakia, expropriating their land and stripping their citizenship in the process. A few German males were subjected to forced labour.

The laws were never repealed and, technically, are still in force. Statutes of restitution enacted after the 1989 Velvet Revolution apply only to property confiscated by communists after the 1948 coup. The Czechs and Slovaks are still afraid of a flood of claims by relatives of the refugees.

Hungary's prime minister, Orban, repeatedly called on Prague and Bratislava to rescind the decrees. They are incompatible with EU membership, he thundered. The EU seems to unofficially agree with him. Officially, Gunther Verheugen, the EU Commissioner for Enlargement said that the decrees were issued long before there was a European Union and, therefore, should have no effect on EU-Czech relations. The European Parliament disagrees. It has called upon the Czech Republic in 1999 to revoke the laws and it has ordered its foreign policy commission to scrutinize the legality of the decrees.

The German Chancellor, Schroeder, cancelled a trip to the Czech Republic in March 2002. Joschka Fischer, the German foreign minister, said the decrees were the biggest obstacle to bilateral relations - despite a 1997 joint declaration that seemed at the time to have resolved the differences.

The decrees became an election campaign issue in these four central European countries. An association of Sudeten Germans based in Austria is preparing to sue the Czech government in a Czech court, aiming to, as they put it "rectify damages resulting from the decrees' infringement on human rights".

Another, US-based group, is contemplating a similar move, according to "Forward Magazine". A lawsuit was filed by Sudeten Germans located in Germany against the German authorities for failing to act to countermand the Benes Decrees.

Czechs are not unanimous about the decrees either. A former presidential advisor, Jiri Pehe, told Radio Free Europe/Radio Liberty:

"I think that from the whole package of decrees, [parliament] should repeal those decrees which massively violated human rights and were essentially undemocratic, because not all the decrees issued by President Benes were like that. Decision making through decrees in the first months after the war was a legitimate component of the Czech legal order. To that end, the decrees were ratified by the provisional parliament."

A group of prominent Czechs, including Bishop Vaclav Maly, is circulating a "Stop Nationalism" petition, urging politicians not to exploit the controversy in the run-up to the June elections.

But the Czech Republic's former - and possibly future - outspoken prime minister, Vaclav Klaus, suggests to embed the decrees in the country's accession agreement with EU in order to render them tamper-proof. Zeman, the current Czech premier labeled the Sudeten Germans "Hitler's fifth column" and "traitors" in an interview in an Austrian magazine.

The reparations demanded by the Sudeten Germans ever since they filed a petition with the UN in 1975, potentially amount to tens of billions of US dollars. They cover confiscated bank accounts, annulled insurance policies, land, property, artifacts, and compensation for slave labour and wrongful deaths.

It is an irony of history that the struggle of the Sudeten Germans is greatly aided by the recent successful settlement of claims of - mostly Jewish - holocaust victims.

US House of Representatives Resolution 562 dated October 13, 1998 - in support of these claims - calls upon "countries which have not already done so to return wrongfully expropriated properties to their rightful owners or, when actual return is not possible, to pay prompt, just and effective compensation, in accordance with principles of justice...to remove restrictions which limit restitution or compensation ...to persons who reside in or are citizens of the country..."

As early as 1952, West Germany has enacted the Federal Indemnification Law (BEG). Other laws aimed at compensating the victims of the holocaust followed in 1953, 1956, and 1965. Austria has similar legislation on its books. But, contrary to popular mythology, these laws were shamefully stingy and heartless. They have mostly lapsed now.

Survivors were given small monthly sums to amortize health care and medical costs. Eligibility criteria were so strict and application procedures so convoluted that a cottage industry of restitution lawyers and advisors has sprung up.

Some victims still receive monthly allowances from the German social security fund. The slave labour of a few workers is even recognized for the purpose of accumulating pension benefits. A tiny group of mothers receive symbolic child rearing benefits. The State of Israel support the vast majority of these crippled and traumatized people from funds it allocates under its Invalids and Nazi Prosecution Law.

Despite the fact that the holocaust occurred mainly in central and eastern Europe, holocaust survivors behind the iron curtain were ineligible for German compensation. A "Hardship Fund" was set up in 1980 and paid 5,000 DM to 180,000 claimants from these countries. But Jews residing in the region are still not eligible to any other kind of aid - 13 years after the downfall of communism.

In response to repeated complaints, the German government has set up a Central and East European Fund (CEEF). It pledged to contribute to CEEF $180 million in 4 annual installments starting in 1999. By end 2001, the Fund has paid c. $150 million to more than 17,000 survivors, with maximum monthly benefits of $120.

All told, the Germans allocated $220 million to victims from Poland and less than $470 million to survivors from Russia and Ukraine combined. More than 4.5 million people perished in these three countries - exterminated in camps such as Auschwitz. At least 10,000,000 people served as slave laborers between 1933-1945, enriching a clutch of German firms and senior Nazis in the process. About 2,000,000 of them are still alive.

It took decades of negotiations - and a re-unified Germany - to secure funds for formerly ineligible survivors. The Article 2 Fund was established in 1993. The very few who fulfill the myriad, cumulative, conditions, receive less than $250 a month. Germany claims that since it has provided 12 west European governments with "global compensation" funds between 1959 and 1964, their subjects are not eligible either.

Austria set up its compensation fund in 1995, conveniently well after most of the victims died. The maximum indemnity Austria pays is $6000 per person. In a typically cynical fashion, Austria auctioned off art looted from the Jews in 1996 and used the proceeds to compensate the victimized former owners through its Mauerbach Fund.

The governments of formerly Nazi-occupied territories proved sometimes to be more generous than the perpetrators. Denmark and the Netherlands financially support disabled victims to this very day. Norway established in 1999 a $58 million fund for its few remaining Jews. Even Switzerland founded, in 1997, Shoa - a $183 million fund for 310,000 Needy Victims of the Holocaust.

The corporate and banking sectors were next.

Following intensive public pressure by Jewish organizations - and a thinly-disguised anti-Semitic backlash - funds to compensate slave laborers were set up by various firms (Siemens, Volkswagen). Allianz, BASF, Bayer, BMW, DaimlerChrysler, Deutsche Bank, Degussa-Hüls, Dresdner Bank, FrieDrive Krupp, Hoesch-Krupp, Hoechst, Siemens and Volkswagen and 50 other wartime exploiters - boosted by matching funds from the German federal authorities - grudgingly and reluctantly formed a "Foundation Initiative of German Firms: Memory, Responsibility and Future." The Foundation has $5 billion to distribute to slave laborers and their descendants.

In August 1998, Switzerland's two major banks, UBS and Credit Suisse, agreed to set up a $1.25 billion fund to settle claims by holocaust survivors and their relatives. The red-faced Swiss government threw in $210 million. It seems that banks - from the USA to Switzerland - were in no hurry to find the heirs to the murdered Jewish owners of dormant account with billions of dollars in them.

A settlement was reached only when legal action was threatened against the Swiss National Bank and both public opinion and lawmakers in the USA turned against Switzerland. It covers owners of dormant accounts, slave laborers, and 24,000 refugees turned back to certain death at the Swiss border - or their heirs.

A high level international commission, headed by Paul Volcker, a former chairman of the Federal Reserve Board, identified 54,000 accounts opened by holocaust victims - not before it inspected 350,000 accounts at an outlandish cost, borne by the infuriated banks, of $400 million. A similar - though much smaller ($45 million) settlement was reached with Bank Austria and Creditanstalt of Vienna. Another $2 billion are claimed from 9 French banks.

Five major insurance firms - Allianz AG, AXA, Generali, Zurich and Winterthur Leben - formed an International Commission on Holocaust Era Insurance to deal with unresolved insurance claims of holocaust victims. Assicurazioni Generali went ahead and set aside $12 million in a compensation fund. But the claims may total $1 to 4 billion.

Surprisingly, calls for the restitution of Jewish real-estate, property, bank accounts, insurance policies, and art works confiscated by the Nazis and their collaborators are fairly recent. The International Committee on Restitution took until 1999 to appeal to the Austrian government to restore assets to their rightful Jewish owners.

Governments from Austria to France and from Belgium to the Netherlands appointed commissions to investigate Jewish claims. The United Kingdom has posted to the Internet a list of tens of thousands of assets confiscated - mostly from refugee Jews - under the 1939 Trading with the Enemy law.

More than $60 million were set aside by 18 governments in the 1997 London conference on Nazi gold. A French commission, chaired by Jean Matteoli, a resistance fighter, identified $1 billion in expropriated Jewish property, including 40,000 apartments and hundreds of thousands of works of art.

According the World Jewish Congress, Germany and Poland confiscated $3 billion of Jewish property each (in 1945 values), Romania and France - $1 billion each, the Czech Republic and Austria - c. $700 million each. Hungary saw $600 million appropriated and the Netherlands - $450 million. Russia still holds 200,000 looted works of art. Plundered pieces by Monet and van Gogh, among others, were identified and restored to their Jewish owners all over the world - from Boston to Berlin.

Matters are more complicated in eastern Europe where the concept of property rights is novel and communist confiscations followed Nazi ones, hopelessly complicating the legal situation. Moreover, victims and survivors of waves of ethnic cleansing have recently lodged claims with post-communist governments. Macedonians from the Aegean part of Greece, recently repatriated Kosovars, Serbs expelled from Croatia, Croats exiled from Serbia, Hungarians everywhere - are all studying the Jewish example and its precedents thoroughly.

The Bulgarian ministry of finance has just announced that it will pay reparations to some of the 350,000 Turks forcibly expelled from Bulgaria to Turkey during Zhivkov's communist regime in 1984-89. The Haskovo City Council demanded compensation for 550 bulldozed houses.

The government - which includes in its coalition the ethnic-Turkish Movement for Rights and Freedoms (DPS) - agreed to cough up the funds. The accommodation of such demands for compensation by an ethnic minority is unprecedented. It could be the harbinger of massive, politically destabilizing, claims, expensive court battles, and multi-billion dollar settlements.

This tidal wave is not confined to Europe. Aborigines in Australia, descendents of slaves in the States, Japanese-Americans incarcerated during WWII are all suing. "The

Economist" wrote in its review of Elazar Barkan's "The Guilt of Nations":

"Negotiations over these claims are not really about the past, but the future. However they are resolved, they give victims, usually the poor and dispossessed, a voice and a reason to believe that they have a stake in their society. And such negotiations force the better-off to recognise their obligations to those beneath them in the pecking order. A society which can face the ugly episodes in its own history, and agree a way to repudiate them, is also a society capable of setting moral standards for itself, of constraining its own worst instincts, and of aspiring to a better future."

Water

Growing up in Israel in the 1960's, we were always urged to conserve precious water. Rainfall was rare and meager, the sun scorching, our only sweet water lake under constant threat by the Syrians. Israelis were being shot at hauling water cisterns or irrigating their parched fields. Water was a matter of life and death - literally.

Drought often conspires with man-made disasters. Macedonia experienced its second worst dry spell during the civil strife of last year. Benighted Afghanistan is having one now - replete with locusts. Rapid, unsustainable urbanization, desertification, exploding populations, and economic growth, especially of water-intensive industries, such as microprocessor fabs - all contribute to the worst water crisis the world has ever known.

Governments reacted late, hesitantly, and haltingly. Water conservation, desalination, water rights exchanges, water pacts, private-public partnerships, and privatization of utilities (e.g., in Argentina and the UK) - may have been implemented too little, too late.

Rising incomes lead to the exertion of political pressure on the authorities by civic movements and NGO's to improve water quality and availability. But can the authorities help? According to the World Bank, close to $600 billion will be needed by 2010 just to augment existing reserves and to improve water grade levels.

The UNDP believes that half the population in Africa will be subject to wrenching water shortages in 25 years. The environmental research institute, Worldwatch, quoted by the BBC, recommends food imports as a way to economize on water.

It takes 1000 tons of water to produce 1 ton of grain and agriculture consumes almost 70 percent of the world's water - though only less than 30 percent in OECD countries. It takes more than the entire throughput of the Nile to grow the grain imported annually by Middle Eastern and North African countries alone. Some precipitation-poor countries even grow cotton and rice, both insatiable crops. By 2020, says the World Water Council, we will be short 17 percent of the water that would be needed to feed the population.

The USA withdraws one fifth of its total resources annually - proportionately, one half of Belgium's drawdown. But according to the OECD, Americans are the most profligate consumers of fresh water, more than double the OECD's average in the 1990's. Britain and

Denmark have actually reduced their utilization by 20 percent between 1980 and 1996 - probably due to sharp and ominous drops in their water tables.

Stratfor, a strategic forecasting firm, reported on May 14, 2002 that Mexico and the USA are in the throes of a conflict over Mexico's "failure to live up to its water supply commitments under a 1944 treaty", which allocates water from the Colorado, Rio Concho, and Rio Grande among the two signatories.

Mexico seems to have accumulated a daunting debt of 1.5 million acre-feet between 1994-2002 - the result of a decade long drought. Each acre-foot is c. 1.2 million liters. Mexico's reservoirs are less than 25 percent full. Some of the water, though, has been used to transform its borderland into a major producer of fresh vegetables for the American market - at the expense of Texas farmers.

Faced with the worst drought in more than a century in some states, the Bush administration has announced on May 3, 2002 that it is considering sanctions, including, perhaps the suspension of water supplies from the Colorado to Mexico. Texas lawmakers demanded to re-open NAFTA and amend it punitively.

Mexico is a typical case. Only 9 percent of its streams and rivers are fit for drinking. Its underground water is almost equally polluted. Its infrastructure is crumbling, leading to severe seepage of more than two fifths of the water. Half of the rest evaporates in open canals.

Moreover, water is under-priced, thus encouraging wasteful consumption, mainly by farmers. Stratfor cites an estimate published in the May 5, 2002 issue Fort Worth

Star-Telegram - more than $60 billion will be needed over the next decade to refurbish Mexico's urban and rural networks.

William K. Reilly, former administrator of the EPA, writing in the "ITT Industries Guidebook to Global Water Issues", mentions the human cost of water scarcity: a million dead children a year, a billion people without access to treated water, almost double this number without sanitation.

More than 11,000 people died in a cholera epidemic induced by polluted water in Latin America in the 1990's. Every year, according to the World Bank, the amount of water polluted equals the quantity of water consumed. In many parts of the world, notably in Africa, people walk for hours to obtain their contaminated daily water rations.

Water shortage hobbles industrial production in places as diverse as Sicily and Malaysia. The lower estuaries of the Yellow River - China's most important - are now dry two thirds of the year. The water table beneath China's fertile northern plane is falling by 1.5 meters a year.

The drought in Sri Lanka is so severe and so prolonged that the International Red Cross had to intervene and launch an appeal for emergency funds. The Mekong River, which flows from China to Vietnam, is being obstructed by 7 Chinese dams under construction. Once completed, its flow will be reduced by half.

Close to 200 million people in seven countries will be affected. In a retaliatory move, Laos is planning to hold back c. 70 percent of its contribution to the Mekong by constructing 23 dams. Thailand follows with 20 percent of its contribution and a mere 4 dams. Vietnam is likely to pay the price of this "dam war". Thailand is sufficiently rich to simply buy the water it needs from its truculent neighbors.

Australia is in no better shape. The diversion of Snowy River inland led to massive salinization of the lands it irrigates - Australia's bread basket. Many of the tributaries are now unfit for either irrigation or drinking. In India, the holy river, Ganges, is depleted and impregnated with poisonous arsenic.

A long running dispute is simmering between India and Bangladesh regarding this dwindling lifeline, recent progress in negotiations notwithstanding. This is reminiscent of a low intensity conflict that has been brewing along the banks of the Nile between an assertive Egypt and the encroaching Sudan and Ethiopia since the Nile Basin Initiative has been signed in 1993.

A July 2000 conference of the riparian states, backed by the likes of the World Bank and the United Nations, eased the tension somewhat by promulgating a workable plan to redistribute the African river's throughput. The emphasis in the February 2001 meeting of the International Consortium Cooperation on the Nile, though, was on hydro-power over the contentious minefield of water usage rights.

Turkey is constructing more than two dozen dams on the Tigris and Euphrates within the Southeastern Anatolia Project (GAP). Once completed, Turkey will have the option to deprive both Syria and Iraq of their main sources of water, though it vowed not to do so. In a cynical twist, it offers to sell them water from its Manavgat river. Iraq's own rivers have shriveled by half. Still, this is the less virulent and violent of the water conflicts in the Middle East.

Israel controls the Kinneret Sea of Galilee. It is the source of one third of its water consumption. The rest it pumps from rivers in the region, to the vocal dismay of Syria, Lebanon, and Jordan. Despite decades of indoctrination, Israelis are water-guzzlers. They quaff 4-6 times the water consumption of their Palestinian and Arab neighbors.

"The Economist" claims that:

"The argument over Syria's water rights to the Sea of Galilee is now the only real stumbling-block to a peace treaty between Syria and Israel. Negotiations broke down last January, after the two sides appeared to agree on everything save the future of a sliver of territory on the north-east coast of the sea. Israel had insisted on keeping control of that, since the Sea of Galilee supplies more than 40% of its drinking water."

Only two decades ago, the Aral Sea featured in encyclopedias as the world's fourth largest inland brine. In a typical hare-brained subterfuge, the communists diverted its two sources - the Amu Darya and Syr Darya - to grow cotton in the desert. The "sea" is now a series of disconnected, toxic, patches overlaid on a vast wasteland of salt.

But excess water can be as damaging to multilateral relationships - and to the economy - as scarcity. Floods brought on by the Zambezi River have devastated the countries on its path, despite their efforts to harness it. Often, these calamities are man-made. Zimbabwe wrought a deluge upon its region by opening the gates of the Kariba dam on March 2000. The countries of West Africa, from Ghana to Mali are "one river states". Their fortunes rise and fall with the flow and ebb of waterways.

Sometimes watercourses are conduits of destruction and death. A single - though massive - chemical spill in Romania on January 31, 2000 devastated the entire Tisa River which runs through Yugoslavia and Hungary. Only when the waste reached the Danube did the West wake up to the danger.

Nor are these phenomena confined to the poor precincts of our planet. The people of Catalonia in Spain are thirsty. They contemplate diverting water from the river Rhone in France to Barcelona. A five years old government plan to redistribute water from rain-drenched regions to the arid 60 percent of Spain meets with stiff domestic resistance. The Ogallala aquifer in the USA, its largest, has been depleted to near oblivion. The BBC estimates that it lost the equivalent of 18 Colorado rivers by 2000.

All the lakes around Mexico City have dried and it is now sinking into the cavernous remains of its withered reservoirs. Soil subsidence is a major problem in cities around the world, from Bangkok to Venice. According to "The Economist", the town of Cochabamba in Bolivia, once a florid valley is now a dust bowl. Some of its residents receive water only a few hours every two or three days. A World Bank financed project attempts to pipe the precious liquid from mountain rivers near the city.

Singapore, concerned by its dependence on water from capricious Malaysia, decided in November 2001 to purchase water from private sector suppliers who will be required to build one or more desalination plants, capable of providing it with 10% of its annual consumption.

Singapore is so desperate, it even considered importing water from the strife-torn (and now tsunami-devastated) Aceh province in Indonesia. The cost of Malaysian fresh water skyrocketed following a bilateral accord with Singapore signed September 2000.

Control of water sources has always served as geopolitical leverage. In Central Asia, both Kyrgyzstan and Tajikistan often get their way by threatening to throttle their richer neighbors, Kazakhstan and Uzbekistan - and by actually cutting them off from the nourishing rivers that traverse their territories. This extortion resulted in inordinately cheap supplies of gas, coal, and agricultural products.

To avoid such dependence, Turkmenistan has decided to divert water from the catchment basin of one of the rivers - the Amu Darya - to a $6 billion artificial lake. This inane project is comparable only to China's much-disputed Three Gorges Dam - the $30 billion, 180 meters tall hydroelectric plant that will block the fierce Yangtze River.

On January 2000, a Kinshasa-based firm, Western Trade Corporation, and an American partner, Sapphire Aqua, proposed to raise financing for a $9 billion set of 1000-2000 km. pipes from the Congo River to the Middle East and South Africa. Stratfor justly noted that the water were to be given free, casting in doubt the viability - or the even the very existence - of such a project.

Con-artists and gullible investors notwithstanding, water is big business. Water Forum 2002, sponsored and organized by the World Bank, attracted many NGO's, donors, and private companies. The Agadir conference in June 2002 attracted scholars and governments as well. According to the government of Morocco, it dealt with "views and experiences on water pricing, cost recovery and the interactions between micro and macro policies related to water".

T. Boone Pickens, a corporate raider, has bought water rights from Texans during the 2001 drought. He succeeded to amass c. 200,000 acre-feet worth c. $200 million.

Economic competition coupled with acute and growing scarcity often presage conflict.

"Water stress" is already on the world's agenda at least as firmly as global warming. The Hague Ministerial Declaration released on March 2000 identified seven 'water-related challenges'. This led to the establishment of the 'World Water Assessment Program' and UNESCO's 'From Potential Conflict to Cooperation Potential' (PC to CP) which 'addresses more specifically the challenge of sharing water resources primarily from the point of view of governments, and develops decision-making and conflict prevention tools for the future'."

Simultaneously, Green Cross International and UNESCO floated "Water for Piece" project whose aims are "to enhance the awareness and participation of local authorities and the public in water conflict resolution an integrated management by facilitating more effective dialogue between all stakeholders." In its efforts to minimize tensions in potential and actual conflict regions, the project concentrates on a few case studies in the basins of the Rhine, the Aral Sea, the Limpopo/Incomati, the Mekong, the Jordan River, the Danube, and the Columbia.

Peter Gleik of the Pacific Institute suggested this taxonomy of water-related conflicts (quoted in thewaterpage.com):

- "**Control of Water Resources** (state and non-state actors): where water supplies or access to water is at the root of tensions.
- **Military Tool** (state actors): where water resources, or water systems themselves, are used by a nation or state as a weapon during a military action.
- **Political Tool** (state and non-state actors): where water resources, or water systems themselves, are used by a nation, state, or non-state actor for a political goal.
- **Terrorism** (non-state actors): where water resources, or water systems, are either targets or tools of violence or coercion by non-state actors.
- **Military Target** (state actors): where water resource systems are targets of military actions by nations or states.
- **Development Disputes** (state and non-state actors): where water resources or water systems are a major source of contention and dispute in the context of economic and social development."

Mark de Villiers, author of "Water Wars" contrasts, in ITT's aforementioned Guidebook, two opposing views about the likelihood of water-related conflicts. Thomas Homer-Dixon, the Canadian security analyst says:

"Water supplies are needed for all aspects of national activity, including the production and use of military power, and rich countries are as dependent on water as poor countries are ... Moreover, about 40 percent of the world's population lives in the 250 river basins shared by more than one country ... But ... wars over river water between upstream and downstream neighbors are likely only in a narrow set of circumstances. The downstream country must be highly dependent on the water for its national well-being; the upstream country must be able to restrict the river's flow; there must be a history of antagonism between the two countries; and, most important, the downstream country must be militarily much stronger than the upstream country."

Frederick Frey, of the University of Pennsylvania, disagrees:

"Water has four primary characteristics of political importance: extreme importance, scarcity, maldistribution, and being shared. These make internecine conflict over water more likely than similar conflicts over other resources. Moreover, tendencies towards water conflicts are exacerbated by rampant population growth and water-wasteful economic development. A national and international 'power shortage,' in the sense of an inability to control these two trends, makes the problem even more alarming."

Who is right?

The citizens of Karnataka and Tamil Nadu states in India are enmeshed in bloody skirmishes over the waters of the Carvery River. Colonel Quaddafi has been depleting the Iittoral aquifer in the Sahara for decades now - to the detriment of all his neighbors - yet, not a single violent incident has been recorded. In 2001, the Rio Grande has failed to reach the Gulf of Mexico - for the first time in many decades. Yet, no war erupted between the USA and Mexico.

As water become more scarce, market solutions are bound to emerge. Water is heavily subsidized and, as a direct result, atrociously wasted. More realistic pricing would do wonders on the demand side. Water rights are already traded electronically in the USA. Private utilities and water markets are the next logical step.

Water recycling is another feasible alternative. Despite unmanageable financial problems and laughable prices, the municipality of Moscow maintains enormous treatment plants and re-uses most of its water.

Wars are the outcomes of cultures and mores. Not every casus belli leads to belligerence. Not every conflict, however severe, ends in battle. Mankind has invented numerous other conflict-resolution mechanisms. There is no reason to assume that water would cause more warfare than oil or national pride. But water scarcity sure causes dislocation, ethnic tension, impoverishment, social anomy, and a host of other ills. It is in fending off these pernicious, all-pervasive, and slow-acting social processes that we should concentrate our efforts.

Women (in Central and Eastern Europe)

"[In]... the brothels off Wenceslas Square, in central Prague, [where] sexual intercourse can be bought for USD 25 - about half the price charged at a German brothel... Slav women have supplanted Filipinos and Thais as the

most common foreign offering in [Europe]."
The Economist, August 2000, p.18

"I'm also wary of the revolutionary ambition of some feminist texts, with their ideas about changing present conditions, having seen enough attempted utopia's for one lifetime."
Petr Príhoda, The New Presence, 2000, p. 35

"As probably every country has its Amazons, if we go far back in Czech mythology, to a collection of Old Czech Legends, we come across a very interesting legend about the Dévín castle (which literally means 'The Girls' Castle'). It describes a bloody story about a rebellion of women, who started a vengeful war against men. As the story goes, they were not only capable warriors, they had no mercy and would not hesitate to kill their fathers and brothers. Under the leadership of mighty Vlasta, the 'girls' lived in their castle, 'Dévín', where they underwent a severe military training. They led the war very successfully, and one day Vlasta came up with an shrewd plan, how to take hostage a famous nobleman, Ctirad. She chose the lovely Sárka from the body (sic!) of her troops and had her tied up to a tree by a road with a horn and a jar of a mead out of her reach, but in her sight. In this state, Sárka was waiting for Ctirad to find her. When he actually really appeared and saw her, she told him a sad story of how the women from Dévín punished her for not following their ideology by tying her to the tree, mockingly putting a jar and a horn (so that she would be always reminded that she is thirsty and helpless) near by. Ctirad, enchanted by the beautiful woman, believed the lure and untied her, and when she handed him the mead, he willingly drunk it. When he was drunk already, she let him blow the horn, which was a signal for the Dévín

warriors to capture him. He was then tortured in many horrible ways, at the end of which, his body was woven into a wooden wheel and displayed. This event mobilized the army, which soon afterwards destroyed Dévín. (Very significantly, this legend is the only account of radical feminism in Czech Lands.)"
"The Vissicitudes of Czech Feminism" by Petra Hanáková

"We myself... and many others are not in search of global sisterhood at all, and it is only when we give up expecting it that we can get anywhere. It is each other's very 'otherness' that motivates us, and the things we find in common take on greater meaning within the context of otherness. There is so much to learn by comparing the ways in which we are different, and which the same elements of women's experience are global, and which aren't, and wondering why, and what it means."
Jirina Siklová

"It is difficult to carry three watermelons under one arm."
Proverb attributed to Bulgarian women

"The high level of unemployment among women, segregation in the labour market, the increasing salary gap between women and men, the lack of women present at the decision making level, increasing violence against women, the high levels of maternal and infant mortality, the total absence of a contraceptive industry in Russia, the insufficiency of child welfare benefits, the lack of adequate resources to fund current state programs - this is only part of the long list of women's rights violations."
Elena Kotchkina, Moscow Centre for Gender Studies, "Report on the Legal Status of Women in Russia"

The European Monitoring Center on Racism and Xenophobia (EUMC) warned yesterday against a rising tide of anti-Semitism and anti-Muslim views in the European Union in the wake of the September 11 atrocities in the United States. The report states that the main victims of this resurgent racial prejudice are women wearing traditional headscarves.

This is merely the latest in an uninterrupted tradition of victimization.

Last month, Donna Hughes from the University of Long Island, published a damning overview of Russian prostitution. She described the work of the Angel Coalition of non-governmental organizations trying to save women and girls in Russia and other former Soviet republics from human trafficking and subsequent sexual slavery.

Tens of thousands of young females from Moldova, Belarus, Ukraine, Albania, Macedonia, Bulgaria and a host of other erstwhile communist countries, suffer this fate every year. Lured by promises of work or marriage, they are smuggled to the Persian Gulf, to Russia and to western Europe by organized crime gangs in cahoots with local politicians. Tellingly, many former communist countries, Russia foremost, have no laws against these practices.

AIDS and other sexually transmitted diseases among women sex workers are rampant. They are the main conduit of infection of heterosexuals and neonates in these societies. A policy forum hosted by the State Department in August 2000 recommended to "decriminalize prostitution and redefine it as 'sex work' — i.e., a form of labor ... Since 'migrating sex workers are simply responding to a demand for their labor', migration laws should be reformed to accommodate their transnational travel. Prostitution in foreign countries was described as potentially 'empowering' for women because it would enable them to migrate to other countries and to achieve 'greater economic independency and autonomy from men."

The Angel Coalition rejects this counsel: "Legalization of prostitution would ruin this country. Russian women have suffered enough exploitation. They do not deserve to become the (prostitutes) of the world." According to the Vienna-based International Organization for Migration, more than half a million women from east Europe serve as sex workers in the West.

The Economist remarked wryly in August 2000: "(In)... the brothels off Wenceslas Square, in central Prague, (where) sexual intercourse can be bought for USD 25 - about half the price charged at a German brothel... Slav women have supplanted Filipinos and Thais as the most common foreign offering in (Europe)."

Yet, grave as they are, these transgressions against the 200 million women and girls in the 27 countries in transition are the least of their concerns. Elena Kotchkina from the Moscow Centre for Gender Studies, wrote this in the "Report on the Legal Status of Women in Russia":

"The high level of unemployment among women, segregation in the labour market, the increasing salary gap between women and men, the lack of women present at the decision making level, increasing violence against women, the high levels of maternal and infant mortality, the total absence of a contraceptive industry in Russia, the insufficiency of child welfare benefits, the lack of adequate resources to fund current state programs - this is only part of the long list of women's rights violations."

The mythology of the left in Europe, well into the 1980s, postulated that communism may have been tough on men but a Shangri-la for women. Actually it was a gender-neutral hell. Feminine participation in the labor force was, indeed, encouraged. Amenities such as day care centers, kindergarten, daylong schools and abortion clinics were common, except in Poland.

Women were allotted quotas in all governance levels, from parliament down, though the upper echelons remained unwaveringly and invariably male-dominated. March 8 - a cross between Valentine's Day and a matriarchal May 1 - is still celebrated throughout the region with great official fanfare.

But this magnanimous gender equality was a mere simulacrum. Women were not allowed to work night time or shifts or in certain jobs, nor were they paid as much as men in equal functions. By the demise of communism in 1989, more than 90 professions in Poland were found to be women-free, probably by design.

Women were quashed by the "triple burden" of obligatory employment, marital and childrearing chores and inescapable party activism. According to surveys quoted by UNESCO, women worked, on average, 15 weekly hours more than their male counterparts. Communism had use only for "super-women", Ninotchka-like, communist bluestockings. Yet, "it is difficult to carry three watermelons under one arm" - goes a Bulgarian proverb.

Thus, the Marxist revolution did not extend to "kitchen, children, church". The woman's traditional domestic roles within a largely patriarchal family remained intact. "Scientific Marxism" made limited headway only in urban centers like Moscow. Folk wisdom reflected these tensions between dogma and reality. "The woman is the neck that moves the head, her husband", went the old adage. Czech men often referred to themselves self-deprecatingly as "underslippers". But male prominence and statal patriarchy prevailed.

Unemployment - officially non-existent in the communist utopia - was ignored. So were drugs, AIDS and battered women. The legal infrastructure left by communism was incompatible with a modern market economy. While maternal leave was an impossibly generous 18 to 36 months - there were no laws against domestic or spousal violence, women trafficking, organized crime prostitution rings, discrimination, inequality, marital rape, date rape and a host of other issues.

No medium (print or electronic) catered to the idiosyncratic needs of women. Academic gender studies programs, or women's studies departments were unheard of. According to Slavenka Drakulic, author of "Cafe Europa" and "How We Survived Communism and Even Laughed", no factories in the region manufactured tampons or sanitary bandages.

Women, who formed an integral and important part of national and social movements throughout the region, were later shunned and marginalized. They felt betrayed and exploited. Disenchanted and disillusioned, they voted overwhelmingly for right wing parties ever since. They conservatively reverted to the safe values, mores and petite bourgeois aspirations of the 19th century.

Writing in the July 2001 World & I, Christine Weiss described the situation in Slovakia:

"Slovakia is similar to many other countries in central and eastern Europe in its attitudes toward women and their role in society. Officially equal to men under communism and given equal government representation by law, women nevertheless carried the greater burden of domestic duties and were not given decision-making positions. Women's involvement in politics and political parties has decreased drastically in the last decade. Most Slovak women agree with the official myth that they are 'equal' to men, making it difficult for them to seek help with issues such as protection against domestic violence, employment discrimination, and inadequate health care.

The worsening economic situation has placed a greater burden on women since 1990. Increasingly, there is an out-migration of men to larger towns, more prosperous regions, or other countries for work. This heightens the domestic burden on women; the help they got from husbands, sons, or other relatives is now largely removed. The economic slump has also forced women to increase food production from the family plots."

Feminism failed to take root in pragmatic central and east Europe. It was too ideological, often Marxist, too extreme, family-disparaging and man-hating. Petr Prihoda offered the male point of view in the Czech-English monthly New Presence: "I'm also wary of the revolutionary ambition of some feminist texts, with their ideas about changing present conditions, having seen enough attempted utopias for one lifetime."

Czech women tend to agree. "We myself...and many others are not in search of global sisterhood at all, and it is only when we give up expecting it that we can get anywhere." - says Jirina Siklova from the Gender Studies Center in Prague - "It is each other's very 'otherness' that motivates us, and the things we find in common take on greater meaning within the context of otherness. There is so much to learn by comparing the ways in which we are different, and which the same elements of women's experience are global, and which aren't, and wondering why, and what it means."

Capitalism has improved the lot of women in some countries - and considerably worsened it in others. According to Elizabeth Brainerd of Harvard University, writing in the October 2000 issue of the Industrial & Labor Relations Review:

"Under state socialism, women fared relatively well in the labor market: female-male wage differentials were similar to those in the West, and female labor force participation rates were among the highest in the world. Since the introduction of market reforms (there is) a consistent increase in female relative wages across Eastern Europe, and a substantial decline in female relative wages in Russia and Ukraine. Women in the latter countries have been penalized by the tremendous widening of the wage distribution in those countries. Increased wage inequality in Eastern Europe has also depressed female relative wages, but these losses have been more than offset by gains in rewards to observed skills and by an apparent decline in discrimination against women."

All in all, transition was not good to women. The privatization of state-owned enterprises was dominated by a male nomenclature of managers and insiders. Technological modernization was both male-driven and male-biased. Men in central and eastern Europe are still three times as likely as women to find a job. Between three and four fifths of all women's - mostly menial - jobs were lost, notably in the industrial sectors, especially in textile and clothing.

According to the February 2000 issue of the UNESCO Courier, 14 million of the 26 million jobs that vanished in eastern Europe since 1989 were women's. Unemployment among women is 5 percentage points higher than among men. Two years ago, the inter-gender gap in pay in Russia was 24 percent. It was over 15 percent in both Poland and Hungary.

In all the countries in transition, the highest rates of unemployment are among middle aged and older women. Three quarters of the unemployed are women. The Ukrainians call it "unemployment with a female face". Women go unrecorded both when employed and when unemployed - thus deprived of social benefits, health and unemployment insurance and labor-related legal rights.

When trained, women are relegated to clerical, low-skilled and low-paying jobs. Men are assigned to assimilate new and lucrative technologies. In some countries, women are asked by prospective employers to waive their rights, to produce a medical certificate confirming non-pregnancy, or, more rarely, to provide proof of sterilization prior to gaining employment.

Even in higher education, where women's participation has gradually increased - they are confined to "feminine" - i.e., low pay and low status - occupations. Vocational and technical schools are either defunct or do not welcome women. The rising cost of tertiary schooling threatens to dampen women's educational opportunities. Even in feminized professions (such as university teaching), women make less than 20% of the upper rungs (e.g., full professorships).

The very ethos of society has adversely changed. Resurgent nostalgic nationalism, neo traditionalism and religious revival seek to confine them to home and hearth. Negative demographic trends - declining life expectancy and birth rate, numerous abortions, late marriage, a high divorce rate and an increasing suicide rate - provoke a nagging sensation of "we are a dying nation" and the inevitable re-emphasis of the woman's reproductive functions. Hence the fierce debates about the morality of abortion in Catholic Poland, in Lithuania, Slovenia and even in the agnostic Czech Republic.

Many women believe that capitalism is for men, emphasizing, as it does, masculine traits, such as aggressiveness, assertiveness, and competition. Women political representation shriveled since 1989 when rubber stamp parliaments were transformed into loci of real power.

The few women that did make it are typically relegated to "soft" committees which deal with budget-poor social issues. There is a dearth of women among business executives of medium and large enterprises, or the owners of privatized enterprises. Job advertising is sex-specific and sexist to this very day.

Pay regulations and tax system are skewed in favor of male employees. Child benefits were all but eliminated, maternal leave shortened, affordable day care facilities rendered extinct by massive cuts in social outlays. The quality of social benefits not yet axed has deteriorated, access to them has been restricted and supplies are often short.

The costs of public goods, mainly health and education, have been transferred from state to households either officially, once services have been commercialized, or surreptitiously and insidiously (e.g., patients required to purchase their own food, bed sheets and medication when hospitalized).

The swift deterioration in the quality of the region's health systems and the proscription, in certain countries, of the only effective form of contraception - abortions - led to an upsurge in maternal mortality and teenage pregnancy. The curtailing or absence of sex education yielded an epidemic of sexually transmitted diseases. Rape, spousal abuse, date rape, street prostitution, begging, especially by destitute widows - are common phenomena. Divorce maintenance payments are often both pitiful and delinquent.

A generational abyss opened between young women and their older sisters. The post-communist generations are conspicuous consumers, car owners, and career opportunists. They aspire to be managers, shareholders, politicians and professionals. The older ones, exhausted by decades of social turmoil and futile activism, prefer to stay at home, in relative tranquility, tinged with benign dependence.

Yet, neither fare well. East European pseudo-yuppies lack business skills, knowledge, contacts, supportive infrastructure, or access to credit. Older women cannot work long hours, lack skills and, when officially employed, are expensive, due to the burden of their social benefits. Consequently, women mostly migrate to services, light industry and agriculture - the less lucrative sectors of the dilapidated economies of their homelands.

As far as women as concerned, the brave, new world of liberal democracy is old, patriarchal, discriminatory and iniquitous. This may yet prove to be transition's worst failure.

Work Ethic

"When work is a pleasure, life is a joy! When work is a duty, life is slavery."
Maxim Gorky (1868-1936), Russian novelist, author, and playright

Airplanes, missiles, and space shuttles crash due to lack of maintenance, absent-mindedness, and pure ignorance. Software support personnel, aided and abetted by Customer Relationship Management application suites, are curt (when reachable) and unhelpful. Despite expensive, state of the art supply chain management systems, retailers, suppliers, and manufacturers habitually run out of stocks of finished and semi-finished products and raw materials. People from all walks of life and at all levels of the corporate ladder skirt their responsibilities and neglect their duties.

Whatever happened to the work ethic? Where is the pride in the immaculate quality of one's labor and produce?

Both dead in the water. A series of earth-shattering social, economic, and technological trends converged to render their jobs loathsome to many - a tedious nuisance best avoided.

1. ***Job security*** is a thing of the past. Itinerancy in various McJobs reduces the incentive to invest time, effort, and resources into a position that may not be yours next week. Brutal layoffs and downsizing traumatized the workforce and produced in the typical workplace a culture of obsequiousness, blind obeisance, the suppression of independent thought and speech, and avoidance of initiative and innovation. Many offices and shop floors now resemble prisons.

2. ***Outsourcing and offshoring*** of back office (and, more recently, customer relations and research and development) functions sharply and adversely effected the quality of services from helpdesks to airline ticketing and from insurance claims processing to remote maintenance. Cultural mismatches between the (typically Western) client base and the offshore service department (usually in a developing country where labor is cheap and plenty) only exacerbated the breakdown of trust between customer and provider or supplier.

3. The populace in developed countries are addicted to ***leisure time***. Most people regard their jobs as a necessary evil, best avoided whenever possible. Hence phenomena like the permanent temp - employees who prefer a succession of temporary assignments to holding a proper job. The media and the arts contribute to this perception of work as a drag - or a potentially dangerous addiction (when they portray raging and abusive workaholics).

4. The other side of this dismal coin is ***workaholism*** - the addiction to work. Far from valuing it, these addicts resent their dependence. The job performance of the typical workaholic leaves a lot to be desired. Workaholics are fatigued, suffer from ancillary addictions, and short attention spans. They frequently abuse substances, are narcissistic and destructively competitive (being driven, they are incapable of team work).

5. The ***depersonalization of manufacturing*** - the intermediated divorce between the artisan/worker and his client - contributed a lot to the indifference and alienation of the common industrial worker, the veritable "anonymous cog in the machine".

Not only was the link between worker and product broken - but the bond between artisan and client was severed as well. Few employees know their customers or patrons first hand. It is hard to empathize with and care about a statistic, a buyer whom you have never met and never likely to encounter. It is easy in such circumstances to feel immune to the consequences of one's negligence and apathy at work. It is impossible to be proud of what you do and to be committed to your work - if you never set eyes on either the final product or the customer! Charlie Chaplin's masterpiece, "Modern Times" captured this estrangement brilliantly.

6. Many former employees of mega-corporations abandon the rat race and establish their own businesses - ***small and home enterprises***. Undercapitalized, understaffed, and outperformed by the competition, these fledging and amateurish outfits usually spew out shoddy products and lamentable services - only to expire within the first year of business.

7. Despite decades of advanced notice, ***globalization*** caught most firms the world over by utter surprise. Ill-prepared and fearful of the onslaught of foreign competition, companies big and small grapple with logistical nightmares, supply chain calamities, culture shocks and conflicts, and rapacious competitors. Mere survival (and opportunistic managerial plunder) replaced client satisfaction as the prime value.

8. The decline of the ***professional guilds*** on the one hand and the trade unions on the other hand greatly reduced worker self-discipline, pride, and peer-regulated quality control. Quality is monitored by third parties or compromised by being subjected to Procrustean financial constraints and concerns.

The investigation of malpractice and its punishment are now at the hand of vast and ill-informed bureaucracies, either corporate or governmental. Once malpractice is exposed and admitted to, the availability of malpractice insurance renders most sanctions unnecessary or toothless. Corporations prefer to bury mishaps and malfeasance rather than cope with and rectify them.

9. The quality of one's work, and of services and products one consumed, used to be guaranteed. One's personal idiosyncrasies, eccentricities, and problems were left at home. Work was sacred and one's sense of self-worth depended on the satisfaction of one's clients. You simply didn't let your personal life affect the standards of your output.

This strict and useful separation vanished with the rise of the malignant-narcissistic variant of ***individualism***. It led to the emergence of idiosyncratic and fragmented standards of quality. No one knows what to expect, when, and from whom. Transacting business has become a form of psychological warfare. The customer has to rely on the goodwill of suppliers, manufacturers, and service providers - and often finds himself at their whim and mercy. "The client is always right" has gone the way of the dodo. "It's my (the supplier's or provider's) way or the highway" rules supreme.

This uncertainty is further exacerbated by the pandemic eruption of mental health disorders - 15% of the population are severely pathologized according to the latest studies. Antisocial behaviors - from outright crime to pernicious passive-aggressive sabotage - once rare in the workplace, are now abundant.

The ethos of teamwork, tempered collectivism, and collaboration for the greater good is now derided or decried. Conflict on all levels has replaced negotiated compromise and has become the prevailing narrative. Litigiousness, vigilante justice, use of force, and "getting away with it" are now extolled. Yet, conflicts lead to the misallocation of economic resources. They are non-productive and not conducive to sustaining good relations between producer or provider and consumer.

10. ***Moral relativism*** is the mirror image of rampant individualism. Social cohesion and discipline diminished, ideologies and religions crumbled, and anomic states substituted for societal order. The implicit contracts between manufacturer or service provider and customer and between employee and employer were shredded and replaced with ad-hoc negotiated operational checklists. Social decoherence is further enhanced by the

anonymization and depersonalization of the modern chain of production (see point 5 above).

Nowadays, people facilely and callously abrogate their responsibilities towards their families, communities, and nations. The mushrooming rate of divorce, the decline in personal thrift, the skyrocketing number of personal bankruptcies, and the ubiquity of venality and corruption both corporate and political are examples of such dissipation. No one seems to care about anything. Why should the client or employer expect a different treatment?

11. The ***disintegration of the educational systems*** of the West made it difficult for employers to find qualified and motivated personnel. Courtesy, competence, ambition, personal responsibility, the ability to see the bigger picture (synoptic view), interpersonal aptitude, analytic and synthetic skills, not to mention numeracy, literacy, access to technology, and the sense of belonging which they foster - are all products of proper schooling.

12. ***Irrational beliefs***, pseudo-sciences, and the occult rushed in to profitably fill the vacuum left by the crumbling education systems. These wasteful preoccupations encourage in their followers an overpowering sense of fatalistic determinism and hinder their ability to exercise judgment and initiative. The discourse of commerce and finance relies on unmitigated rationality and is, in essence, contractual. Irrationality is detrimental to the successful and happy exchange of goods and services.

13. Employers place ***no premium on work ethic***. Workers don't get paid more or differently if they are more conscientious, or more efficient, or more friendly. In an

interlinked, globalized world, customers are fungible. There are so many billions of potential clients that customer loyalty has been rendered irrelevant. Marketing, showmanship, and narcissistic bluster are far better appreciated by workplaces because they serve to attract clientele to be bilked and then discarded or ignored.

Work, Future of

A US Department of Labor report published, aptly, on Labor Day 1999, summed up the conventional wisdom regarding the future of this all-pervasive pastime we call "work". Agriculture will stabilize, service sector jobs will mushroom, employment in the manufacturing sector will be squeezed by "just in time" inventory and production systems and by labor-intensive imports. An ageing population and life-prolonging medicines will prop up the healthcare sector.

Yet, the much touted growth in services may partly be a statistical illusion. As manufacturing firms and households contracted out - or outsourced - hitherto internal functions, their employment shrank while boosting the job figures of their suppliers. From claims and wage processing to take-away restaurants and daycare centers, this shift from self-reliance to core competencies spawned off a thriving service sector. This trend was further enhanced by the integration of women in the workforce.

The landscape of future work will be shaped by technological change and globalization. The latter is erroneously considered to be the outcome of the former. But as "The Economist" has pointed out in a series of "School Briefs", the world has been much more globalized one hundred years ago, long before the Internet.

These two independent trends reinforce each other in a virtuous cycle which will profoundly impact the future of work. Enhanced flows of information increase market efficiency, partly through global competition and price transparency and partly through shorter product life cycles.

But innovation by itself would not have had such an impact on work patterns. Manufacturing techniques - chiefly miniaturization - had a profound effect on the relocation of work from factory and office to home and car. Machine tools and office equipment well into the 1980's were too cumbersome to install at home.

Today everyone has a telephone and many have a fax, a mobile phone, an Internet connection, and a PC. As a result, work-from-home and flextime are burgeoning. Increasingly - with the advent of Internet-enabled PDA's, laptops, beepers, and wireless access to e-mail and the Web - so does work-on-the-move: in cars, in trains, everywhere. Work has become ubiquitous.

This harks back to the past. Even at the end of the 19th century - at the height of the Industrial Revolution - more than half the population still worked from home. Farmers, medical doctors, blacksmiths, small time retailers - lived and slogged in combined business and domestic units. A steady career in an organisation is a recent invention, as William Bridges pointed out in his book "Job Shift".

Harlan Cleveland and Garry Jacobs explained the emergence of Organisation Man in the newsletter of the World Academy of Art and Science:

"The job - the kind that you had, or hoped to get - became a central fixture of life in industrial countries. Its importance was great because it served many needs. For managers and efficiency experts, job assignments were the key to assembly-line manufacturing. For union organizers, jobs protected the rights of workers. For political reformers, standardized civil service positions were the essence of good government. Jobs provided an identity to immigrants and recently urbanized farm workers. They provided a sense of security for individuals and an organizing principle for society."

Currently, three types of work are surfacing. Old, industrial-age, permanent, and workplace-bound jobs are increasingly the preserve of low and medium skilled workers - about 80 percent of the workforce in Britain. New, itinerant, ad-hoc, home-based, technology-intensive, brand-orientated, assignment-centered careers characterize another tenth of the workforce. Temporary and contract work work - mainly in services - account for the rest. It is a trichotomous landscape which supplanted the homogeneous labor universe of only two decades ago.

Nowadays, technologically-literate workers - highly skilled, adaptable, well-educated, and amenable to nontraditional work environments - are sought by employers and rewarded. The low skilled, computer-illiterate, uneducated, and conservative - lag behind.

In 1999, more than 13 million people in the USA alone held multiple jobs, or part time, or contract jobs (i.e., freelancing). Work from home and flextime accounted for one fifth of all other employees. Contrary to their image as rigid labor marketplaces, self-employment and temporary work were more prevalent in the European Union (except Britain) than in the USA.

The Bureau of Labor statistics in the US Department of Labor noted these demographic changes to the workforce. Though pertaining to the USA, they are applicable, in varying degrees, to the rest of the world, with the exception of certain parts of Africa. America is a harbinger of trends in employment and of changes in the nature of work.

(1) Labor force growth will slow down to an annual 0.2 percent after 2015 - compared to 2.6 percent between 1970-1980 and 1 percent during the last decade. This is when Baby Boomers start retiring and women's participation will level off. Women already make almost half the labor force. More than three quarters of all mothers are working. The propensity to hold a job is strongest among single mothers.

(2) The median age of the labor force will reach a historically unprecedented 41 years in 2008 - compared to 35 in 1978. As middle management layers are made redundant by technology and as start-ups mature - experienced executives will be in great demand and short supply. Even retirees are being recalled as advisors, or managers of special projects. This - coupled with a dramatic increase in functional life expectancy - may well erode the very concept of retirement.

The Urban Institute predicted, for ABCNews, that, as Generation X, Generation Y, and young immigrants enter the workforce, it will be polarized between the under-25's and the over-45's.

(3) Labor force growth is strongest among immigrants and minorities. In the USA, they will make up more than a quarter of the total workforce in 2008. Those with higher education and those devoid even of a high school diploma are over-represented among recent immigrants.

(4) College graduates already earn twice as much - and their earnings are still growing in real terms - as people with a high school diploma whose inflation-adjusted earnings are dwindling. High school dropouts are four times as likely to be unemployed as college graduates. These disparities are going to be further exacerbated. On the job training allows people to catch up.

(5) Five of the ten fastest growing occupations are computer-related and three are connected to healthcare. Yet, contrary to hype, half of the new jobs created by 2008 will still be in traditional, labor-intensive, sectors such as retail or trucking. One in two jobs - and two in three new ones - are in small companies, with less than 100 workers. Even behemoths, like General Motors, now resemble networks of small, autonomous, businesses and profit and loss centers.

(6) Much hectoring and preaching notwithstanding, the burden of wage-related taxes and benefits in the USA is heavy, at one half the base salary - though it has held stable at this level since 1970.

(7) The shift from defined benefit to defined contribution retirement plans continues apace. This enhances labor mobility as workers are able o "carry" their personal plans

with them to new employers. Still, the looming social security crisis is far from resolved. In 1960, there were 5 workers per every beneficiary.

By 2060, there will be less than two. Moreover, close to a third of all beneficiaries will be the relatives of retired or deceased workers - rather than the pensioners themselves. This is likely to create severe social tensions between workers and beneficiaries.

(8) Job tenure has decreased markedly in all age groups over the last two decades - but only among men. Both boom and bust contributed. Economic growth encourages job-hunting, job hopping, and job-shopping. Recessions foster downsizing and bankruptcies. Jobs are mainly obtained through nimble networking. This is especially true at the higher rungs of the income ladder.

Still, the median figure for job stability hasn't changed much since 1983 in both the USA and the UK. Moreover, some jobs - and employment in some states - are far more stable than others. Transformation across all professions took place among workers younger than 32 and workers with long tenure.

The job stability of the former decreased markedly. By the age of 32 they had already worked for 9 different firms, according to figures published by "The Economist". The job security of the latter has vanished as firms, until less than 2 years ago, succumbed to a "youth cult" and inanely rid themselves of precious social and professional capital.

Another phenomenon is the emergence of a Hollywood-like star system among ultra-skilled workers - both technical and executive. Many of them act as freelancers and get paid with a mixture of cash and equity. They regard themselves as a brand and engage in brand marketing on a global scale.

The more capable they are of managing organisational change, leading teams, and identifying business opportunities - the more rewarded they are, according to a study by Timothy Bresnahan, published in the June 1999 issue of the "Economic Journal".

(9) About 3 percent of the workforce are employed through temporary help agencies. This is 6 times the figure in 1983. Public prejudices aside, even engineers and system analysts work as "temps". Many people prefer Mac-jobs, freelancing, or temporary assignments. It allows them to preserve their independence and free lifestyle. More than 90 percent of all Americans are happily ensconced in their jobs.

(10) Work gradually encroaches on family life and leisure time. In 1969, couples aged 25-54 toiled a combined 56 hours a week. By 2000, they were spending 67 hours at work - or 70 hours if they were childless. This increasing absence has probably contributed to the disintegration of the nuclear family, the emergence of alternative family systems, and the loosening of community ties.

Workplaces and employers - and employment laws - have as much adapting to do as do employees.

The UK's Economic and Social research Council runs a Future of Work Programme, launched in 1998, to investigate "changing organisational forms and the reshaping of work". The program studies novel work-organisation structures - temporary work, franchise, multi-employer sites, partnerships, supply-chain collaboration, and variants of outsourcing, including outsourcing to the company's own employees.

In Working Paper no. 14 published November 2000, the authors say:

"The development of more complex organisational forms involving cross-organisation networking, partnerships, alliances, use of external agencies for core as well as peripheral activities, the growth of multi-employer sites and the blurring of public/private sector divide have implications for both the legal and the socially constituted nature of the employment relationship.

The notion of a clearly-defined employer-employee relationship becomes difficult to uphold under conditions where the employee is working in project teams or on site beside employees from other organisations, where responsibilities for performance or for health and safety are not clearly defined, or involve organisations other than the employer.

This blurring of the relationship affects not only legal responsibilities, grievance and disciplinary issues and the extent of transparency and equity in employment conditions, but also the definition, constitution, and implementation of the employment contract."

In a futuristic piece published in the last day of the millennium, ABCNews described "corporate hotels" where one would work with other employees from the vicinity. Up to one third of all employees will work from home, according to David Pearce Snyder of "The

Futurist". Companies will share "hot desks" and start-up incubators will proliferate.

But the phenomenon of self-employment in conjunction with entrepreneurship, mostly in the framework of startups and mainly in the services and technology sectors - is still marginal. Contrary to contemporary myths, entrepreneurship and innovation are largely in-house corporate phenomena - known as "intrapreneurship".

Yet, workers did not benefit from the wealth created by both the technology-engendered productivity rise and the ensuing capital markets bubble. Analysts, such as Alan Harcrow of "Workforce" magazine have long been sounding the alarm: "The thing is, the average employee hasn't been able to enjoy the benefits of increased productivity. There's no reward."

A recent tome by Kevin Phillips - "Wealth and Democracy: A Political History of the American Rich" - claims:

"The top 1 percent pocketed 42 percent of the stock market gains between 1989 and 1997, while the top 10 percent of the population took 86 percent." Most American had more invested in their car than in their stock exchange portfolio. To Phillips, America is an old-fashioned, though no less pernicious for that, plutocracy.

No wonder that 40 percent of all employees hate the notion of working - though they may like the specific jobs they are in. Work is perceived by them as an evil necessary to finance their vacations, hobbies, and socializing - and, by many, as a form of exploitation. Insecure, bored, and disgruntled workers make bad entrepreneurs. Forced self-employment does not amount to entrepreneurship and, even in America, the former far outweighs the latter.

There are other ominous signs. The worker of the future will interface mainly with machines or with others through machines - often from home. The merging of home and work, the seamless fusion of leisure time and time on the job - are already creating a privacy backlash and "out of the rat race" social movements.

Admittedly, future workers are likely to be much more autonomous than their predecessors - either by working from home or by participating is "self-governing teams" and "stakeholder councils". Yet, the aforementioned blurring of boundaries between private life and working time will exact a heavy psychological and social toll. It will impact family life adversely and irreversibly. Job insecurity coupled with job hopping and personal branding will transform most elite workers into free - but anxious - agents trapped in a process of perpetual re-education.

As globalization and technological ubiquity proceed apace, competition will grow relentless and constant. Immigration and remote work will render it also global. Insurance claims processing, airline bookings, customer care, and many other business-support services are farmed out to India. Software development takes place in Israel and Ireland.

Society and community will unravel in the face of these sea changes. Social safety nets and social contracts - already stretched beyond their foreseen limits - will crumble. Job protection, tenure privileges, generous unemployment, retirement, and healthcare benefits - will all vanish from the law books and become a nostalgic memory. The dispossessed will grow in number and in restlessness. Wealth will further concentrate in the hands of the few - the educated, the skilled, the adaptable - with nary a trickle down effect.

Some scholars envision a plutocracy superimposed on a post-industrial proletariat . Dysfunctional families and disintegrating communities will prove inadequate in the face of growing racial tensions and crime. Ironically, this dystopian future may well be the inevitable outcome of this most utopian period - the present.

WTO (World Trade Organization)

On April 8, 2003, in a testimony before the Senate Steel Caucus, industry executives urged legislators to ignore the future decision of a World Trade Organization appeals panel, widely expected to uphold an earlier preliminary ruling that U.S.-imposed steel tariffs flouted international trade law.

Several senators called on the United States to withdraw from the multilateral body. Wilbur Ross, chairman of International Steel Group, blamed the burgeoning balance of payments deficit on the rulings and regulations of the WTO.

According to Steve Seidenberg in the National Law Journal, defiance of the WTO is a growing trend. Gary Horlick of the Washington DC law firm, Wilmer, Cutler & Pickering, reckons that one in seven judgments rendered by the WTO's dispute mechanisms have been hitherto ignored.

Nor is the USA alone in its transgressions.

Ten polities - including the European Union and Canada - are serial violators. The WTO cannot enforce its decrees. It can only grant complainants permission to retaliate by imposing their own tariffs on products imported from the unrepentant country. This is a blunt and ineffective instrument. Experts warn of a return to unilateralism with the entire edifice of multilateral trade law discredited.

Revamping the dispute settlement rules is one item on the agenda of the current phase of trade negotiations, dubbed, in a November 2001 WTO Ministerial Conference, the Doha "Development" Round. Like the rest of the itinerary, it is going nowhere fast.

Alarmed by a looming and unrealistic deadline on May 31, 2003 the Chairman of the Dispute Settlement Body (DSB), Peter Balas, proposed to first concentrate on a framework document, followed by a draft text. But, as James Wolfensohn, the former President of the World Bank, observed, with everyone preoccupied with Baghdad, Doha - arguably far more crucial to the global economy - is sidelined.

This is unfortunate - and ominous. The 146 members of the WTO - the newest one being Macedonia - failed to agree on the future shape of farm trade by the stipulated deadline of March 31, 2003. The goalposts were then moved again and again with a deadline conference in December 2005. The September 2003 Ministerial Conference convenes in Cancun, Mexico was an abysmal failure.

In the meantime, the multilateral regime which bolstered international trade in the past 10 years, is being supplanted by a patchwork of bilateral and regional treaties, albeit subject to WTO rules. Scholars disagree whether, in the absence of a global compact, these are preferable to the status quo. But everyone accepts that international rules are the best option.

But divisions run deep.

India - an important player and the unofficial spokesperson for the "less privileged" club - joined Cuba, Egypt, Malaysia, Dominican Republic, Honduras and Jamaica in demanding "special and differential developing country provisions". With Indonesia, Malaysia, Mauritius, Egypt, Kenya, Nigeria, Tanzania, Uganda and Zimbabwe, it insists on preferential market access for the group's non-agricultural goods.

The developing countries regard the previous Uruguay Round as a rip-off perpetrated by the club of developed and industrialized countries at the expense of the indigent. They have sworn not be led down the garden path again. Hence their furious resistance to demands to expand the negotiations to include such issues as animal welfare, food safety and labeling and the protection of geographical trade names. They see these as thinly veiled attempts to introduce trade restraints through the backdoor.

Instead, they want to concentrate on their main exports - agricultural produce and textiles - on tariff reductions and preferences, special treatment for certain products and safeguard provisions. Some of them want rich-world farm and export subsidies - totaling more than $300 billion a year - dramatically reduced, or even eliminated altogether.

Export credits and state-owned trading enterprises are also contentious topics. The atmosphere is so dour that no one even broaches industrial tariffs and anti-dumping.

Poor countries are especially incensed at the United States for having torpedoed an agreement to grant poor countries access to generic drugs to fight AIDS and other diseases - and at the European Union for postponing any serious tweaking of its egregious Common Agricultural Policy (CAP) to 2013.

The United States - faced with inane European subventions - raised its own farm support by a whopping four fifths in May 2003. Yet, it is still far below EU largesse. America is also the prime driver - together with the Cairns group of agricultural exporters (including Canada, New Zealand, Australia and Brazil) - of a bold initiative to cut subsidies down to 5 percent of production, to slash tariffs to 25 percent and to abolish all export-related aid.

Japan, insensitively, is trying to reduce its rice import quota. Together with Norway, India, the EU and South Korea - known as the "friends of multifunctionality" - it is championing an unworkable "linear" formula by which countries should cut subsidies and tariffs equally, irrespective of prevailing levels of farm aid. Even so, the EU would like to slash subsidies by no more than 45 to 55 percent and tariffs by less than 36 percent, as per the WTO's Agreement on Agriculture.

Nor is the camp of developing countries either homogeneous or cohesive. African and Caribbean nations enjoy preferential access to markets in the EU and the United States. Others - notably India - are terrified of the inevitable onslaught of efficient competition following farm liberalization. But no country, rich or poor, seems to be preparing its agricultural sector to cope with the impact of a successful Doha round.

Time is running out. The term of Pascal Lamy, the EU's capable trade commissioner, ended in 2004 and he was replaced by Peter Mandelson. President George Bush's fast track negotiating authority expires in 2007, if he makes it that far. As The Economist warns, the "peace clause", yielded by the Uruguay Round, elapsed on December 31, 2003. While in force, it prevented a deluge of farm-related litigation from erupting on the scene. A trickle is already evident: Brazil has sued both the USA and the EU over cotton and sugar subsidies, respectively. Textile wars erupted between China and both the EU and the USA and were settled by inconclusive short-term agreements.

The crisis at the WTO is part of a global transition from the multilateralism that characterized the Cold War - to unilateralism or, rather, bilateralism. The breakdown of consensus-based alliances strains international institutions and laws. National - or supranational - interests emerge as renewed sources of legitimacy. While the United States may be blamed for the demise of political multilateralism - it is the EU that is largely responsible for the collapse of the international economic order.

The Doha Development Agenda falls prey to these geopolitical upheavals as it tries to tackle the most prickly issues. In a presentation in March 2003 to the 3rd International Temperate Rice Conference in Punte del Este, Uruguay, Dan Horovitz, of the Theodore Goddard law firm in Brussels, reminded the participants how uncertain the outcomes are:

"Whereas the average non-agricultural worldwide tariff is 4 percent, the average tariff imposed by developed countries on agricultural products is 40 percent, with peaks as high as 500 percent ... The new Round's negotiations are of paramount importance for the very viability and credibility of the WTO system. A failure to provide for proper solutions to the problems of the global agricultural trade would have particularly devastating results not only for trade in agriculture, but for the current trading system as a whole."

XYZ

Yugoslavia

Precisely two years ago, in March 2003, the West killed Serbia's Prime Minister since January 2001, Zoran Djindjic. By forcing him, at times against his better judgment, to surrender one more war criminal, to pursue yet another mobster, to eliminate the remaining subsidies that rendered tolerable the drab and destitute lives of Serbs - the West cast Djindjic as its lackey.

His compatriots often accused him of being a supine American stooge. According to recent opinion polls, Djindjic trailed 10 other politicians in popularity. In truth, people also resented his vainglorious athleticism, conspicuous consumption, incisive intellect, his good looks, youth, energy, inexplicable wealth and meteoric rise to power.

He was a difficult man: haughty, stubborn, outspoken, abrasive and impatient. Aleksandar Tijanic, a Serb polemicist and columnist, called him "Little Slobo(dan Milosevic)" in an article in the daily Danas. His supporters dubbed him "The Manager" in recognition of his organizational skills.

Nor the did the West sweeten the bitter nostrums it so liberally administered. Money promised never arrived, sanctions were repeatedly threatened, ten years worth of onerous - and much disputed - economic reforms were unwisely compressed into the past 26 months. Foreign investors - with the exception of a few multinationals - abstained.

In a belated attempt to emulate his erstwhile ally and current archival, the ubiquitously popular Milosevic-lite Vojislav Kostunica, Djindjic demanded a final settlement of the Kosovo gaping wound and courted the hitherto hostile Orthodox Church. But this turnaround was deemed by his countrymen to be merely his latest cynical ploy to revive his sagging political fortunes.

As leader of the Democratic Party in the 1990s, Djindjic cultivated a relationship with Yugoslavia's president, Slobodan Milosevic and his reviled regime. He fraternized with the likes of Radovan Karadzic, the Bosnian Serb leader and war criminal and Zeljko Raznatovic ("Arkan") the bloodstained militia chieftain and mafia capo.

During the Kosovo war in 1999, he infamously fled from bombed Serbia to tranquil Montenegro, claiming implausibly that, being branded by Milosevic "NATO's mercenary", his life was in the balance. An opportunistic dealmaker, he was dogged to his dying day by persistent rumors about his alleged contacts with the mob.

The head of the Zemun gang, based in a suburb of Belgrade, is Milorad Lukovic a.k.a. Legija. The municipality was formerly run by Vojislav Seselj, an indicted war criminal, now incarcerated at the Hague. When Lukovic commanded an elite police unit, the "Red Berets", he helped Djindjic attain power by refusing Milosevic's orders to suppress dissent. His lot now stand accused of the assassination.

Paradoxically, the death of Djindjic restored stability to Serbia. A state of emergency was declared, tantamount in some ways to a military putsch. But the army, police and security organs did not leverage this fortuity into full control of the tormented country and Kostunica re-emerged in due time to capture the Serb presidency and then appoint a reformer to the premiership.

Shocked by the atrocity, the umbrella grouping of 18 political parties, the Democratic Opposition of Serbia, now in power, re-coalesced around a single leader. Radicals of all stripes were flogged by a disgusted electorate. The relationship between the two uneasy constituents of "Serbia and Montenegro" weakened further, as the latter drifted away.

But in one respect Djindjic may be irreplaceable. He was a true economic reformer with the will to proffer painful solutions to apparently intractable problems.

The Djindjic-prodded government liberalized prices, restructured state finances, rescheduled Serbia's international debts, cleaned up the banking sector by closing down otherwise dysfunctional money laundering outfits, freed the labor market, widened the tax base by eliminating loopholes and exemptions and privatized aggressively.

The much-lauded governor of the central bank, Mladjan Dinkic, stabilized the Yugoslav (now Serbian) dinar, cut hyperinflation to low double digits and succeeded to have some Milosevic-era debts written off.

This earned them a three year standby agreement with the International Monetary Fund, World Bank soft loans and close to $300 million to overhaul the crumbling energy infrastructure.

But the economy, despite growing at an annual rate of more than 3 percent since 1999, is still less than half its already depressed 1989 level of about $2700 in gross domestic product per capita. Serbia endured a decade of war, sanctions, civil wars, international pariah status, bombing, and refugees.

Its infrastructure is decrepit, its industry obsolete, its agriculture shattered to inefficient smithereens, its international trade criminalized. The foreign exchange reserves are depleted by years of customs evasion and theft. Serbia's exports may have climbed by one tenth on Djindjic's watch- but imports surged by one third. The country's yawning trade deficit is menacing as is the stagnation in its dilapidated industrial output.

Serbia is destitute. The average monthly salary is $100 (or c. $140 in Belgrade). In 2000, more than one third of the population subsisted under the official poverty line. Things got worse since then. One fifth of the populace survives on $1 or less a day.

Privatization resulted in mass layoffs - 15,000 were made redundant when the Zastava factory in Kragujevac was sold. Another 10,000 lost their jobs when the licenses of four banks were withdrawn due to illicit activities. In a workforce of about 1.5 million people - such numbers hurt.

No wonder that the government took a breather, relegating to the sidelines legislation pertaining to mortgages, bankruptcy, denationalization and the financing of political parties. A White Book published in February 2003 by the Foreign Investors Council in Belgrade recounted the unfinished agenda of languishing reforms:

"The civil, in particular commercial, procedure should be strengthened to facilitate the speedy conduct of the trials; Judgments of superior courts should be made binding on inferior courts; A larger number of judges need to be trained and the current case-load per judge should be reduced; Banking legislation should be enhanced with respect to loan loss provisioning and establishment of the legal lending limit; Repayment history (should be used) for the purpose of the calculation of loan loss provisions; Increase the legal lending limit, where transactions are backed up by quality collateral; Allow investors the right to re-sell the right to use of land; (Provide) option for subdivision of the land use obtained; Allow buyer to collateralize the 'irrevocable right of use' after transfer."

The document also calls for objective criteria in the granting of tax holidays, the speedy introduction of the value added tax, a reform of the antiquated payment system, the formation of a special unit to handle the tax affairs of expat confidentially. A new law on concessions should streamline the application procedure by unambiguously identifying the authorities in charge and by rendering the process transparent. The requirements for work and residence permits should be simplified and made less exacting.

Next Djindjic moved to tackle the murky underbelly of Serbia's thoroughly criminalized economy.

Albeit reluctantly, he clamped down on arms sales to the likes of Iraq - an important source of foreign exchange and employment. The decision to hand Milosevic and a few other henchmen to the war crimes tribunal in the Hague was largely economic, too, in that it released $1.2 billion in international aid.

Djindjic curbed petrol smuggling by permitting only the importation of crude oil and by obliging importers to refine locally. Illegal construction was demolished in accordance with stricter new statutes, incurring the wrath of many penumbral figures, collectively decried as "the construction mafia".

The next target was the mob's extensive and all-pervasive pecuniary and commercial reach in cahoots with the ministry of interior, the secret services and the military. This particular ambition may have cost him his life.

In a public debate with Dusan Djordjevic on the Web pages of Central Europe Review, I wrote in October 2000:

"There are undercurrents and overriding themes in Serb history that perseverate and appear immutable. There is no reason to believe that the election of the hitherto non-corrupt and fiercely nationalistic law professor, Vojislav Kostunica, will miraculously transform the apparently ineluctable essence of Serb history and its salient proclivities ... Balkan societies are organized in (often regional) networks of political patronage, business and crime in equal measures. Politicians, criminals and businessmen are indistinguishable and interchangeable.

Perhaps as an inescapable consequence of all the above, the Balkans (and Serbia) lack institutions (though it fanatically maintains the verisimilitude of having ones). The ultimate arbiters have always been raw force or the threat of using it. The disempowered are passive-aggressive. Recondite sabotage and pertinacious stonewalling are their modes of self-defense and self-expression. The unregenerate power elites react with contemptuous suppression and raging punishment. It is a war from within to mirror the war from without. The result is a moral quagmire of depravity and perfidy."

Djindjic was a consummate philosopher. He studied under Jurgen Habermas in Germany. The titles of his four books are his most precise and comprehensive obituary: "Serbia - neither East nor West," "Subjectivity and Violence," "Yugoslavia - the Partially Formed State" and "The Fall of the Dialectics".

THE AUTHOR

Shmuel (Sam) Vaknin

Curriculum Vitae

Born in 1961 in Qiryat-Yam, Israel.

Served in the Israeli Defence Force (1979-1982) in training and education units.

Education

Completed a few semesters in the Technion – Israel Institute of Technology, Haifa.

Ph.D. in Philosophy (major: Philosophy of Physics) – Pacific Western University, **California**, USA.

Graduate of numerous courses in Finance Theory and International Trading.

Certified E-Commerce Concepts Analyst by Brainbench.

Certified in Psychological Counselling Techniques by Brainbench.

Certified Financial Analyst by Brainbench.

Full proficiency in Hebrew and in English.

Business Experience

1980 to 1983

Founder and co-owner of a chain of computerised information kiosks in Tel-Aviv, Israel.

1982 to 1985

Senior positions with the Nessim D. Gaon Group of Companies in Geneva, Paris and New-York (NOGA and APROFIM SA):

– Chief Analyst of Edible Commodities in the Group's Headquarters in Switzerland
– Manager of the Research and Analysis Division
– Manager of the Data Processing Division
– Project Manager of the Nigerian Computerised Census
– Vice President in charge of RND and Advanced Technologies
– Vice President in charge of Sovereign Debt Financing

1985 to 1986

Represented Canadian Venture Capital Funds in Israel.

1986 to 1987

General Manager of IPE Ltd. in London. The firm financed international multi-lateral countertrade and leasing transactions.

1988 to 1990

Co-founder and Director of "Mikbats-Tesuah", a portfolio management firm based in Tel-Aviv.

Activities included large-scale portfolio management, underwriting, forex trading and general financial advisory services.

1990 to Present

Freelance consultant to many of Israel's Blue-Chip firms, mainly on issues related to the capital markets in Israel, Canada, the UK and the USA.

Consultant to foreign RND ventures and to Governments on macro-economic matters.

Freelance journalist in various media in the United States.

1990 to 1995

President of the Israel chapter of the Professors World Peace Academy (PWPA) and (briefly) Israel representative of the "Washington Times".

1993 to 1994

Co-owner and Director of many business enterprises:

– The Omega and Energy Air-Conditioning Concern
– AVP Financial Consultants
– Handiman Legal Services

Total annual turnover of the group: 10 million USD.

Co-owner, Director and Finance Manager of COSTI Ltd. – Israel's largest computerised information vendor and developer. Raised funds through a series of private placements locally in the USA, Canada and London.

1993 to 1996

Publisher and Editor of a Capital Markets Newsletter distributed by subscription only to dozens of subscribers countrywide.

In a legal precedent in 1995 – studied in business schools and law faculties across Israel – was tried for his role in an attempted takeover of Israel's Agriculture Bank.

Was interned in the State School of Prison Wardens.

Managed the Central School Library, wrote, published and lectured on various occasions.

Managed the Internet and International News Department of an Israeli mass media group, "Ha-Tikshoret and Namer".

Assistant in the Law Faculty in Tel-Aviv University (to Prof. S.G. Shoham).

1996 to 1999

Financial consultant to leading businesses in Macedonia, Russia and the Czech Republic.

Economic commentator in "Nova Makedonija", "Dnevnik", "Makedonija Denes", "Izvestia", "Argumenti i Fakti", "The Middle East Times", "The New Presence", "Central Europe Review", and other periodicals, and in the economic programs on various channels of Macedonian Television.

Chief Lecturer in courses in Macedonia organised by the Agency of Privatization, by the Stock Exchange, and by the Ministry of Trade.

1999 to 2002

Economic Advisor to the Government of the Republic of Macedonia and to the Ministry of Finance.

2001 to 2003

Senior Business Correspondent for United Press International (UPI).

2007 –

Associate Editor, Global Politician

Founding Analyst, The Analyst Network

Contributing Writer, The American Chronicle Media Group

Expert, Self-growth.com

2008

Columnist and analyst in "Nova Makedonija", "Fokus", and "Kapital" (Macedonian papers and newsweeklies). Seminars and lectures on economic issues in various forums in Macedonia.

2008-

Advisor to the Minister of Health of Macedonia on healthcare reforms

Web and Journalistic Activities

Author of extensive Web sites in:

– Psychology ("Malignant Self Love") - An Open Directory Cool Site for 8 years.
– Philosophy ("Philosophical Musings"),
– Economics and Geopolitics ("World in Conflict and Transition").

Owner of the Narcissistic Abuse Study Lists and the Abusive Relationships Newsletter (more than 6,000 members).

Owner of the Economies in Conflict and Transition Study List , the Toxic Relationships Study List, and the Links and Factoid Study List.

Editor of mental health disorders and Central and Eastern Europe categories in various Web directories (Open Directory, Search Europe, Mentalhelp.net).

Editor of the Personality Disorders**,** Narcissistic Personality Disorder, the Verbal and Emotional Abuse, and the Spousal (Domestic) Abuse and Violence topics on Suite 101 and Bellaonline.

Columnist and commentator in "The New Presence", United Press International (UPI), InternetContent, eBookWeb, PopMatters, Global Politician, The Analyst

Network, Conservative Voice, The American Chronicle Media Group, eBookNet.org, and "Central Europe Review".

Publications and Awards

"Managing Investment Portfolios in States of Uncertainty", Limon Publishers, Tel-Aviv, 1988

"The Gambling Industry", Limon Publishers, Tel-Aviv, 1990

"Requesting My Loved One – Short Stories", Yedioth Aharonot, Tel-Aviv, 1997

"The Suffering of Being Kafka" (electronic book of Hebrew and English Short Fiction), Prague, 1998-2004

"The Macedonian Economy at a Crossroads – On the Way to a Healthier Economy" (dialogues with Nikola Gruevski), Skopje, 1998

"The Exporters' Pocketbook", Ministry of Trade, Republic of Macedonia, Skopje, 1999

"Malignant Self Love – Narcissism Revisited", Narcissus Publications, Prague, 1999-2007 (Read excerpts - click here)

The Narcissism Series (e-books regarding relationships with abusive narcissists), Prague, 1999-2007

Personality Disorders Revisited (e-book about personality disorders), Prague, 2007

"After the Rain – How the West Lost the East", Narcissus Publications in association with Central Europe Review/CEENMI, Prague and Skopje, 2000

Winner of numerous awards, among them Israel's Council of Culture and Art Prize for Maiden Prose (1997), The Rotary Club Award for Social Studies (1976), and the Bilateral Relations Studies Award of the American Embassy in Israel (1978).

Hundreds of professional articles in all fields of finance and economics, and numerous articles dealing with geopolitical and political economic issues published in both print and Web periodicals in many countries.

Many appearances in the electronic media on subjects in philosophy and the sciences, and concerning economic matters.

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Philosophy: http://philosophos.tripod.com/
Poetry: http://samvak.tripod.com/contents.html
Fiction: http://samvak.tripod.com/sipurim.html