5 ECONOMISTS WHO GOT IT RIGHT PREDICT THE WORST IS YET TO COME

GLOBAL POLITICS, ECONOMICS, AND IDEAS

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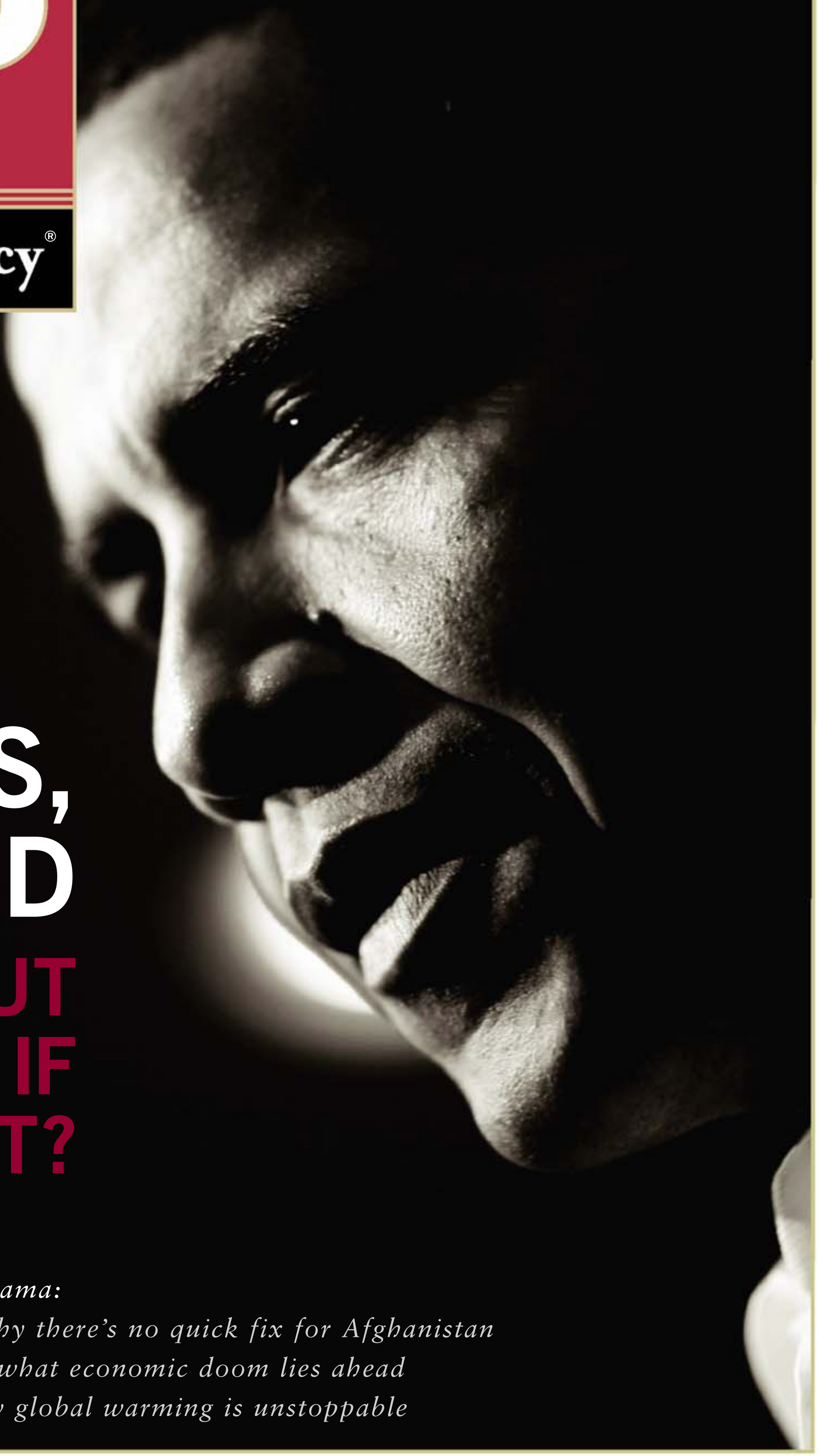

YES, HE DID

BUT WHAT IF HE CAN'T?

The Trials of Barack Obama:

DAVID PETRAEUS *on why there's no quick fix for Afghanistan*

NOURIEL ROUBINI *on what economic doom lies ahead*

BILL McKIBBEN *on how global warming is unstoppable*

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Our Change, His Challenge

What if he can't?

In the weeks after Barack Obama's historic win, it's a question that seemed even downright impertinent to ask. As the world celebrated the sheer improbability of the young, new American president's rise—and his stirring promises of change—the conversation has been more "Yes, he did" than "What will he do next?" But this issue of Foreign Policy convenes a provocative cast of writers, thinkers, and doers who suggest, in different ways, why even Obama might not be able to overcome the daunting global challenges he will face.

There are few more pressing than global warming. And on this subject, it's not wrong to call **Bill McKibben** a prophet; he warned about the Earth's heating atmosphere before most had heard the words "climate change." His powerful Think Again overturns what remained of our comforting assumptions about global warming: "Solving this crisis," McKibben concludes, "is no longer an option."

Then there are the grinding wars in Iraq and Afghanistan: Obama comes to office determined to wind down the one and to salvage a flagging effort in the other. America's warrior-scholars, led by **Gen. David Petraeus**, are rewriting not just the campaign plan for a losing war in Afghanistan—they're on a mission to apply Big Ideas about small wars to the entire U.S. military. They are selling the new president on a major strategic shift toward a full-fledged counterinsurgency operation in Afghanistan, designed, as Petraeus told *FP* days after taking on this next war, "to be seen as serving the population, in addition to securing it." But Petraeus is also sanguine about the challenge of what he calls the "longest campaign of the long war." What Obama now faces is the uncomfortable reality that ending the war in Iraq may actually be easier than winning the war in Afghanistan.

But perhaps even harder than stabilizing Afghanistan will be stabilizing a global economy still reeling from a financial crash that took much of the world by surprise. To understand where the economy is headed, we turned to five economists who weren't surprised, including New York University's **Nouriel Roubini**, whose prescience—captured in an *FP* cover story last spring—famously earned him the title "Dr. Doom." The resulting predictions for 2009 are alarming, to say the least: Roubini counts more than a dozen bubbles only beginning to burst; **Stephen Roach**, chief of Morgan Stanley Asia, traces the future arc of the contagion around the non-Western world; and **Dean Baker** of the Center for Economic Policy and Research notes that once all these massive credit and asset bubbles have imploded, the dollar will lose its privileged place in the world economy.

With such an agenda, you don't have to be a skeptic to wonder just what kind of change Obama will be able to deliver. Along with the rest of the world, we'll be hoping. And starting in early January, we'll be making some dramatic changes of our own: a major relaunch of our Web site, **ForeignPolicy.com**, to chronicle and interpret the world Obama now faces. We're creating a daily online magazine for a global era that will be as vibrant and ambitious as its print parent (and just as fervently committed to the principle that serious and boring are not synonymous). We'll have new columns and blogs by big names, and those about to be, as well as original reporting dedicated to exploring the intersection between Washington and the world as the age of Obama begins. Let us know what you think—the change has just begun.

The Editors

FP Foreign Policy

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Meet the Authors

Although global warming now seems a universal, even existential worry, it was just 1989 when environmental journalist **Bill McKibben** penned the first major book on climate change, *The End of Nature*. Since then, he's lent his steady, eloquent voice to the cause through hundreds of articles, books, and lectures. In 2008, he founded 350.org, the first truly global grassroots climate campaign. | **See "Think Again: Climate Change," p. 32**

Few soldiers know counterinsurgency better than **Nathaniel C. Fick** and **John A. Nagl**, right. A U.S. Marine, Fick was featured in the book-turned-HBO miniseries *Generation Kill*. Nagl, a former lieutenant colonel in the U.S. Army and West Point professor, wrote the acclaimed history of counterinsurgency, *Learning to Eat Soup with a Knife*. "We have not given the commanders on the ground the resources they need to prevail," says Nagl. | **See "How to Win a Losing War," p. 42**

As the White House passes to Obama, the watchword on foreign policy won't be "change" as much as it is "continuity," says **Christian Brose**, Foreign Policy's new senior editor. For the past four years, Brose was Condoleezza Rice's chief speechwriter and policy advisor at the State Department, where he worked in a small office down the hall from Rice. "Her office was in what's called 'mahogany row,'" he says. "Mine was in the part that looks like a high school." | **See "The Making of George W. Obama," p. 52**

New York University economist **Nouriel Roubini** has warned of economic collapse for years. His March/April 2008 cover story for *FP*, "The Coming Financial Pandemic," laid out in grim detail how the worst global economic crisis since the Great Depression would play out. Known as "Dr. Doom," Roubini has little patience for claims that he's a "perpetual pessimist"—for him, pessimism is the new realism. "The bubbles," he now warns, "have only begun to burst." | **See "The Worst Is Yet to Come," p. 62**

For **Gershom Gorenberg**, author of *The Accidental Empire: Israel and the Birth of the Settlements, 1967-1977*, swiftly expanding Israeli settlements in the West Bank are a critical impediment to a two-state solution. Originally from California, Gorenberg moved to Israel in 1977 and now blogs for South Jerusalem, named for "the only place in the world where you can be a left-wing, skeptical Orthodox Zionist Jew and feel like you are part of a mass movement." | **See "The Other Housing Crisis," p. 56**

London-based reporter **Carla Power**, who has written about female scholars of the Koran and young Muslim rappers for *Time*, *Newsweek*, *The New York Times Magazine*, and *Forbes*, found investigating the world of Islamic finance a challenge. "The rock-star scholars are so sought after," she says, "that tracking down a few for an interview can be as tricky as pinning down a pop star—without the publicity machine to help you." | **See "Faith in the Market," p. 70**

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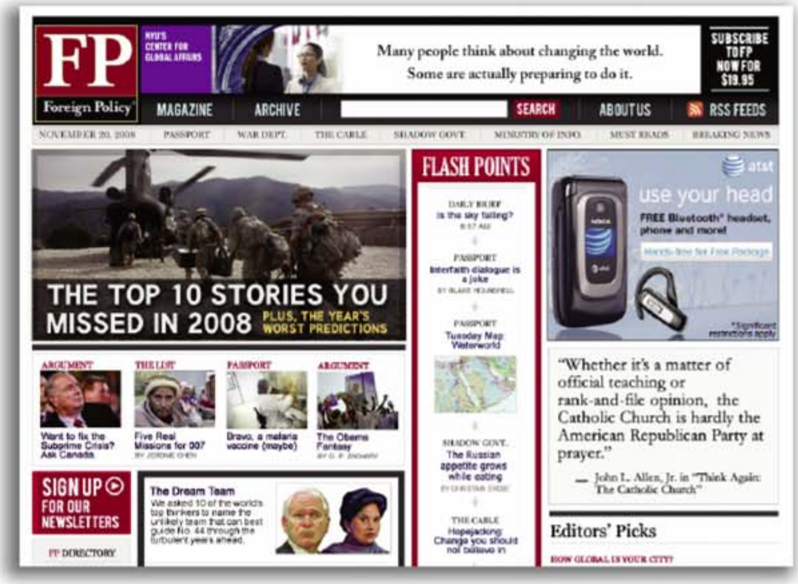
The world does not stand still, and starting in January, there will be a vibrant daily online magazine to capture it: the new ForeignPolicy.com. We'll have a whole lot more of the great features you already love—and new ventures to places we haven't taken you before. Here's a sneak peek at our shiny new design:



Over the next few weeks and months, we'll introduce a roster of smart contributors to help you navigate and interpret the world. We'll feature the ideas shaping the global conversation, as well as daily, original reporting on the people and institutions that shape foreign policy. We'll debut a lineup of plugged-in writers from the world's power centers. And we'll also bring you the best of what's already out there but is often impossible to find. Consider us your scouts for the coming 3.0 world.

This is the beta test for the new ForeignPolicy.com. We'll be reinventing our Web magazine throughout 2009 and want to hear from you about it: what works, what doesn't, what we're missing, and what you can't live without. So, send us your feedback and ideas to redesign@ForeignPolicy.com. We'll be giving you regular updates at the Web site as well as in this space.

From this issue:
Watch a narrated slide show on Afghanistan with Gen. David Petraeus, John Nagl, Nathaniel Fick, and *FP* Executive Editor Susan Glasser at:
ForeignPolicy.com/extras/petraeus.

Our new blogs:

Daniel W. Drezner
On global politics, economics, academia, and pop culture

David Rothkopf
On how the world is really run

Stephen M. Walt
A realist's take for an ideological age

Shadow Government
Notes from the loyal opposition

The Best Defense
Tom Ricks's daily take on national security

... and more.

And featuring

Passport
A blog by the editors of Foreign Policy

Food Fight

Eric Werker ("Power to the People," November/December 2008) accuses aid agencies of adopting a paternalistic approach that includes "dumping" imported food in poor countries. He is firing at the wrong target. In fact, a number of humanitarian organizations object to this very practice. CARE, for example, decided to abandon certain food-aid strategies because they were doing more harm than good. What Werker should demand is a change in government policy. That's what we're working for.

By law, most U.S. food aid to poor countries must be in the form of U.S.-grown food that's shipped overseas on U.S.-flagged carriers and then directly distributed or sold to generate funds for other development work. Approximately 65 percent of the expense goes toward transportation and administration. This outdated and inefficient system is more beneficial to agribusiness and the shipping industry than to the poor—or to the American taxpayer.

The generosity of the U.S. government and its citizens would be far better served if more food aid came in the form of cash. That would give humanitarian agencies the flexibility to respond in the most efficient and appropriate way to each situation.

Sometimes the best way to help involves buying food supplies locally or regionally, which stimulates production within developing countries. Werker favors vouchers that poor people can exchange for whatever assistance they need most. Vouchers can be a powerful tool, one that CARE uses whenever possible and appropriate. But we can't make them materialize from nothing.

There is no magic bullet to solve the global food crisis. Werker is right that the aid system badly needs reform, but he should send that message where it might make a difference—to Washington.

—Helene D. Gayle
President and CEO
CARE USA
Atlanta, Ga.

Eric Werker replies:
I agree quite strongly with a number of Helene Gayle's points, and I commend CARE for abandoning the monetized food aid it could receive from the U.S. government.

Gayle suggests I demand a change in government policy. That is exactly my intention. To put humanitarian-aid decisions in the hands of those who are most affected, we cannot rely on the goodwill and coordination of hundreds of nonprofit actors. Instead, we must establish systems that give incentives to humanitarian agencies to serve their beneficiaries first and foremost, not their benefactors. And the only "we" capable of putting those complex systems in place are governments and multilateral organizations.

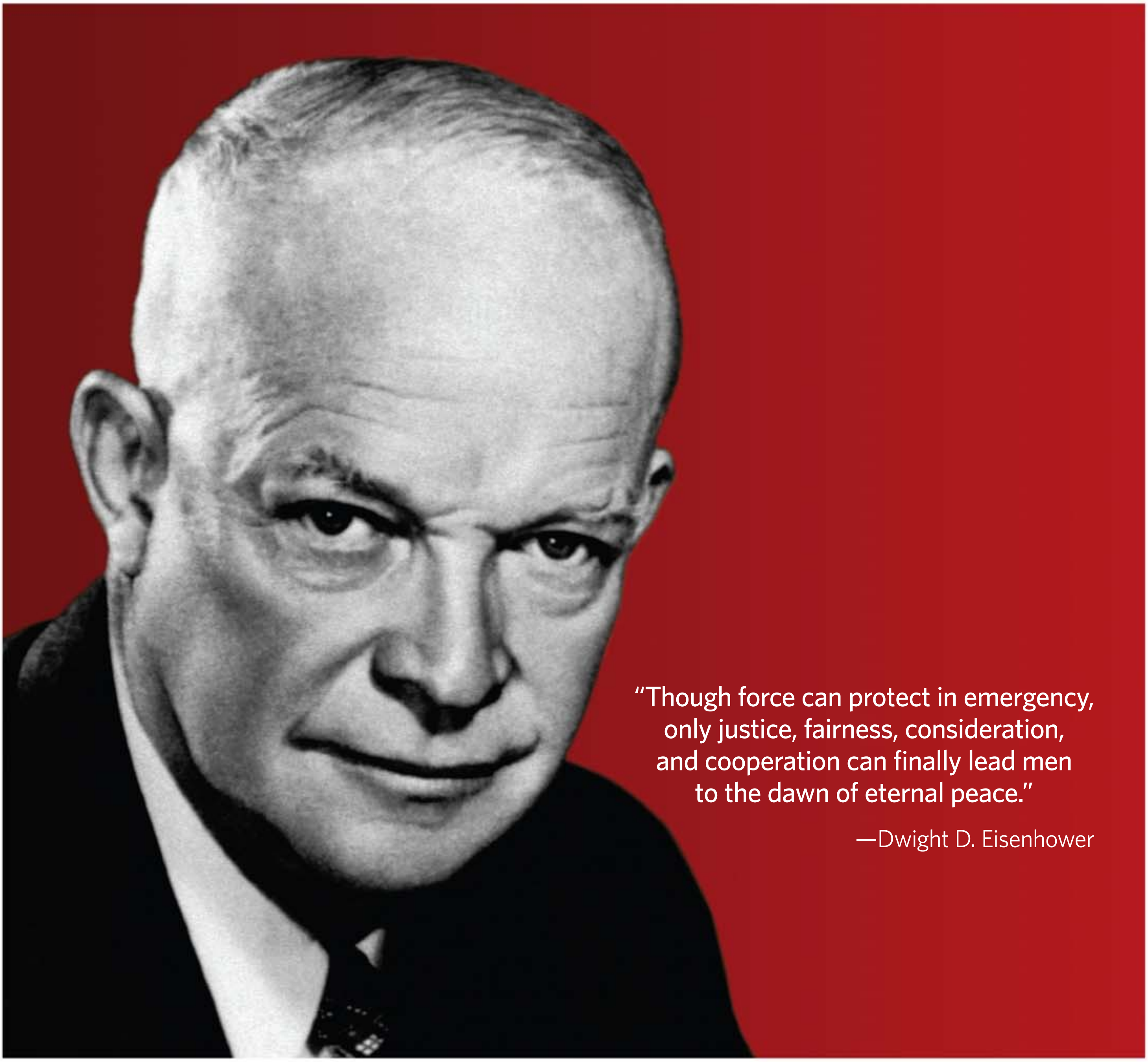
Granting humanitarian agencies cash instead of food aid would certainly afford them more flexibility to meet the needs of crisis victims. But why stop there? Many aid workers advocate giving cash directly to the victims, rather than whatever else the agency might provide. My proposal for vouchers—an intermediate solution, really—takes seriously the notion that humanitarian organizations have an active role to play in supplying solutions that might not otherwise be provided through markets alone.

Speaking The Gospel

John Allen ("Think Again: The Catholic Church," November/December 2008) makes a number of provocative arguments in addressing popular myths about Catholicism. Three of his observations, in particular, warrant more attention from international policymakers.

First, that far from "shrinking," the Catholic Church is actually in a period of enormous growth, particularly in Africa, Asia, and Latin America. Second, the "official positions of the church" are not simply "conservative"; the church consistently defends human life and dignity. Third, the church serves poor people throughout the developing world through its "vast network of schools, hospitals, and social service centers."

What lesson should foreign-policy practitioners and policymakers draw from these observations? They should


"Though force can protect in emergency,
only justice, fairness, consideration,
and cooperation can finally lead men
to the dawn of eternal peace."
—Dwight D. Eisenhower

view the Catholic Church as a potential ally and resource. Catholic social teaching provides a moral framework for addressing the toughest global challenges, and the on-the-ground experience of the church can contribute to finding policies that work more effectively.

The recent reauthorization of the U.S. President's Emergency Plan for AIDS Relief is a good example. The church worked on a bipartisan effort to expand the plan's funding and expand its reach through a "conscience clause" that permits religious institutions to participate in HIV/AIDS prevention, care, and treatment without violating their moral principles. The church also supported provisions that promote monogamy and other behaviors that research shows are highly effective in reducing HIV infection rates.

Hopefully, world leaders will see past the caricature and view the Catholic Church as a powerful ally in building a world of greater justice and peace.

—STEPHEN M. COLECCHI
Director of the Office
of International Justice and Peace
U.S. Conference of Catholic Bishops
Washington, D.C.

John Allen replies:
Stephen Colecchi is part of a remarkable brain trust at the U.S. Conference of Catholic Bishops working to bring the Catholic Church's teaching and human capital to bear on pressing social issues in ways that defy conventional partisan ideology. I can only say "amen" to his hope that international policymakers will pay greater heed.

Of course, the "caricature" of the church to which Colecchi refers is not entirely the fault of secular commentators. On a wide range of issues, the church itself has not always been effective in communicating its desire for "a world of greater justice and peace" or in mobilizing its resources to achieve it.

As Pope Benedict XVI has said, too often the world knows what the church is against, but not what it's for. This challenge will become steeper in the United States under the Barack Obama administration, as differences between church and state over "life issues," especially abortion, may complicate the effort to find common ground in other areas. Both sides will

need to look beyond caricatures, and one hopes that talented Catholic professionals such as Colecchi will lead the way—not just in calling upon politicians to think in new ways, but Catholics, too.

Small Truths

E.J. Graff ("The Lie We Love," November/December 2008) rightly argues that international adoption should serve the best interests of children rather than the needs of potential adoptive parents. But she misses the larger picture by arguing that the world orphan crisis has been invented to meet the "demand" of wealthy Westerners.

Graff falsely asserts that children are manufactured because potential adoptive parents are unwilling to adopt older or special needs children. This statement fails to account for the thousands of special needs adoptions completed each year, including nearly half the children adopted from China.

Additionally, studies of Romanian children in institutions and long-term foster care show that many physical and developmental delays emerge after a child has lived in an institutionalized setting. Based on Graff's thesis, these formerly young, healthy children would have been adopted immediately as "prime candidates" before these conditions could develop.

Although it is true that intercountry adoptions into the United States increased earlier this decade, Graff conveniently does not report that international adoptions are down nearly 24 percent in the past four years. This decline does not reveal the absence of need; rather, it reflects an increase in regulation and, in some cases, overzealous implementation that spurred countries to halt intercountry adoption altogether.

No credible professional who serves children would argue that adoption should be easy, but that does not mean we should shut the door to a viable option for finding children a safe, permanent, and loving family. No child in need should ever be labeled a myth.

—Thomas DiFilipo &
Joelle Ruben

CEO and Director of Education & Research
Joint Council on International Children's Services
Alexandria, Va.

E.J. Graff replies:
Thomas DiFilipo and Joelle Ruben distort my findings. Yes, there is a world orphan crisis. It has two parts. First, millions of families need assistance and support to care for their children. Second, hundreds of thousands of abandoned or fully orphaned children—ones who are mostly older and have special needs—need homes. I have enormous admiration for organizations and adoptive parents trying to repair, support, or help these families and children.

The myth is that the world orphan crisis involves healthy babies. Outside China, that is rarely the case. Children generally find their way into institutions when they are older or after a crisis, but Westerners mostly seek to adopt healthy children 3 and under.

Of course, no one manufactures children, as DiFilipo and Ruben state. What's manufactured is their "orphan" status. Western adoption agencies pour disproportionately large sums into poor, corrupt countries—with few questions asked—in search of such healthy adoptable children. That money induces some people to take children away from their families.

Yes, international adoption is declining. Apparently, that's because China (the largest source for international adoptions) is allowing fewer of its children to be adopted internationally, and the Hague Convention on Intercountry Adoption—though far from perfect—appears to be successfully curbing some of the corruption.

As the myth is debunked and regulatory oversight improves, fewer Western families may be able to adopt foreign children. But at least those who do can be more confident that their children were not bought or stolen.

Questioning Intervention

I suppose it is too much to expect a reviewer to read my footnotes, but had he done so, James Traub ("A Fight to Protect," November/December 2008) would not have accused me of passing over non-Western interventions, such as India's invasion of Bangladesh or the Vietnamese invasion of Cambodia, in my book *The Thin Blue Line*. As it happens, I also discuss the Indian peacekeeping mission to Sri Lanka at some length.

I simply noted that these actions cannot be classified as humanitarian according to the definition that Traub himself uses. If you expand the concept to include self-justifications by invading states, we would have to accept Russia's recent intervention in Georgia as humanitarian as well.

Traub also makes a couple of notable errors over Somalia, the cause célèbre of humanitarian interventionists. It is simply not true to say that Operation Restore Hope "saved several hundred thousand lives." The famine was abating before U.S. marines arrived.

His blithe dismissal of the view that peace will only be restored to that long-suffering country by a process that engages its traditional clan-based community leaders also contradicts the findings of numerous expert studies and most impartial observers.

These errors mar what is otherwise a generally benign review.

—Conor Foley
Brasilia, Brazil

James Traub replies:
It's true! Footnote 20 of chapter 6 of *The Thin Blue Line* lists the Bangladesh and East Pakistan interventions, as well as Tanzania's move against Idi Amin of Uganda, but it says they don't qualify as "humanitarian," presumably because of the interveners' mixed motives. But if we are expected to await the angelic intervenor, many people will die in the meantime. What matters, according to the doctrine of the responsibility to protect, is the obligation of outsiders to act when states are unable or unwilling to protect their citizens from atrocities.

By the way, International Crisis Group President Gareth Evans reviews each of these three cases in his book *The Responsibility to Protect* and finds the humanitarian argument for action overwhelming. The intervening powers chose not to invoke this rationale, he notes, because of "the absolute primacy of sovereignty claims during this period."

When it comes to Somalia, the figures are disputed. Alex de Waal, who shares Foley's view of intervention and whom he often cites, claims that Operation Restore Hope had zero impact on mortality rates. Others cite the "several hundred thousand" figure I use. The 1994 report of the Refugee Policy Group cautiously puts the number of lives saved at 110,000. Perhaps I should have written "100,000 or more."

Should the United Nations have followed the advice of Mohamed Sahnoun, its envoy in Somalia at the time, to work with tribal elders rather than sending a vast peacekeeping operation? Sahnoun's counsel does look wise in retrospect, though the calamity that occurred makes almost any alternative course of action look preferable. My dismissal of this point should have been less blithe.

Fashion Statement

The article "A World Without Islam" (January/February 2008) included a reproduction of our historic and highly recognizable registered trademark, the Louis Vuitton Monogram Pattern, without our authorization. Such use could lead your readers to the mistaken impression that Louis Vuitton Malletier was involved in some way in its publication. The illustration, depicting a bearded man wearing a turban and robe featuring our trademark monogram, might be construed as offensive by people of the Islamic faith. Importantly, this use of our monogram design in an illustration could damage the long-established relationship we have carefully built with the Middle East and its people since the opening of our Louis Vuitton stores in the region.

—MICHAEL PANTALONY
Director of civil enforcement for North America
Louis Vuitton Malletier
New York, NY

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A MESSAGE FROM AMBASSADOR JOHN BRUTON

Head of Delegation

European Commission Delegation to the United States

In 2009, we celebrate the ten-year anniversary of the EU's Economic and Monetary Union. In a single decade, the euro—used in 16 Member States—has become one of the world's most important currencies. Cross-border trade and investment within the EU have increased, and a single monetary policy for the euro area, combined with coordinated national fiscal policies, provides a level of stability for businesses and national economies in the face of global crises such as the one we are dealing with now.

A word on the current financial crisis: given how interdependent we have become, protectionism by any one nation could have dire results. We need a global solution to this very big global problem, and such a solution must be agreed quickly and in a way that preserves an open trading system. If we do not get the fundamentals of international finance right, getting international politics right will be much more difficult.

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EU Economic and Monetary Union:

A Framework for Stability

"Our economies are too intertwined—we will sink or swim together…Europe can propose the principles and rules that will shape a new global order. We have an opportunity to come forward with proposals based on European values, based on open societies, and open economies. …In the financial crisis, Europe is leading the way toward a global solution."

European Commission President
José Manuel Barroso

inside

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4 The Euro
6 The European Central Bank and the Eurosystem
7 Enhanced Financial Market Integration: Safeguarding Stability and Prosperity in the EU
8 EU-U.S. Economic and Financial Cooperation

Arguably one of the most important monetary reforms in the past 50 years, the EU's Economic and Monetary Union (EMU) is unprecedented in modern European economic history and has transformed the global economic landscape.

A decade after its launch, EMU's most visible accomplishment, the euro provides stability for businesses and national economies and guards against speculative runs on national currencies. A single monetary policy for the 16 euro area Member States, combined with coordinated national fiscal policies, has fostered macroeconomic stability, spurred the economic integration of Europe, and boosted cross-border trade, financial integration and investment. Budgetary discipline has improved significantly thanks to the rules-based Stability and Growth Pact, and the exchange rate realignments that periodically traumatized European economies have become a thing of the past.

EMU has also increased the EU's resilience to adverse shocks and fostered the EU's leadership in the global economy—as demonstrated by its response to the current global financial upheaval. As the impact on Europe has intensified, EU leaders rapidly and resolutely responded with a rescue plan that allows governments to guarantee interbank lending, provide short-term liquidity, and buy into banks to increase their capital. Member State governments committed substantial funding to the EU's coordinated effort to restore confidence and stability.

Paralleling its immediate response to the current turbulence, the European Commission (the EU's executive arm) is also taking decisive action to reinforce the regulatory framework for the future, and has accelerated implementation of its 2007 Economic and Financial Roadmap designed to address weaknesses in the financial system. In the longer-term, the best approach is to comprehensively rethink regulatory and supervisory rules for financial markets—including banks and other lenders, hedge funds, and private equity—and continue

with economic reforms aimed at improving the underlying competitiveness of European businesses and the skills of the European labor force.

Tangible Benefits: Ten Years of Economic and Monetary Union

- **Economic stability.** During the first decade of EMU, inflation averaged just two percent per year, and nominal interest rates declined to an average of nine percent.
- **Jobs**. Almost 16 million jobs have been created in the euro area since 1999, and the unemployment rate has dropped to an estimated seven percent in 2008, the lowest rate in 15 years.
- **Sound public finances.** Public budget deficits fell to a record average low of 0.6 percent of GDP in 2007.
- **Closer economic and financial integration.** Internal EU trade now accounts for one-third of GDP, and total private and public investment within the euro area has risen to 22 percent of GDP. The euro has also driven the integration of interbank money, bond, and equity markets, and the single currency eliminates transaction costs associated with currency exchange.
- **International role of the euro.** The euro has rapidly become one of the world's most important currencies, and has overtaken the U.S. dollar in the international bond market.

Economic and Monetary Union: a Decade of Achievements

EU Commissioner for Economic and Monetary Affairs Joaquín Almunia and European Commission President José Manuel Barroso

"EMU has anchored macroeconomic stability and increased cross-border trade, financial integration, and investment. For the EU as a whole, the euro is a keystone of further economic integration and a potent symbol of our growing political unity. And for the world, the euro is a major new pillar in the international monetary system and a pole of stability for the global economy."

—Joaquín Almunia, EU Commissioner for Economic and Monetary Affairs

The EU's Economic and Monetary Union (EMU) encompasses the coordination of economic and fiscal policies, a common monetary policy, and a common currency, the euro. EMU, the culmination of visionary EU leadership over the years, represents a milestone in advancing European economic integration, a process begun when the EU was founded.

EMU, achieved in three main stages, is based on the concept of a single market for sovereign nations. During the first stage, beginning in 1990, the EU ensured completely free movement of capital within the EU and established the single market. Stage two (1994–1999) included the introduction of the European Monetary Institute (EMI), the precursor to the European Central Bank. The final stage, launched in 1999, witnessed the birth of both the euro and the European Central Bank's single monetary policy for the euro area.

Although all EU Member States are part of the Economic and Monetary Union, not all EU countries are part of the euro area, which includes only those that have adopted the euro as their currency and are subject to the monetary policy of the European Central Bank (ECB). All EU Member States—with the exception of Denmark and the United Kingdom, which negotiated "opt-out" clauses—are required to join the euro area once specific economic convergence criteria are met. EU member countries that have acceded since 2004 will join the euro area once they fulfill the necessary conditions; Slovenia, Cyprus, Malta, and Slovakia have already adopted the euro.

Economic policy under EMU requires that Member States ensure coordination of their economic policies, provide for multilateral surveillance of this coordination, and demonstrate financial and budgetary discipline. Monetary policy underpins the single currency's stability through price stability and respect for the market economy.

Fiscal policy (tax and spending) remains in the hands of individual national governments, as do policies about labor, pensions, and capital markets. However, sound public finances and flexible and integrated product, labor, and financial markets are vital for EMU to function effectively. Governments commit to respect

Economic Governance under EMU: The Players

Responsibility for EMU is divided between EU Member States and EU institutions.

- Comprised of EU heads of state and government and the President of the European Commission, the **European Council** defines the EU's general political directions and priorities.
- The EU's key legislative decision-maker (along with the European Parliament), the **Council of the EU** coordinates economic policymaking, undertakes economic surveillance, and monitors Member States' budgetary policies and public finances; determines whether a Member State has qualified to adopt the euro; and represents Member States through meetings attended by a minister from each Member State government.
- The **Eurogroup** is the key (informal) forum for euro area finance ministers to address issues pertaining to the single currency and coordinate policies of common interest for the euro area Member States.
- **Member States** each establish national budgets within agreed limits for deficit and debt and determine structural policies involving labor, pensions, and capital markets.
- The **European Commission** (EC), the EU's executive arm, monitors performance and compliance, and represents the interests of the EU as a whole. Responsibilities include proposing legislation, managing and implementing EU policies and budget, and enforcing EU law under the control of the European Court of Justice.
- With price stability as its primary objective, the **European Central Bank** sets the single monetary policy for the euro area, monitors ERM II, and ensures the coordination of monetary and exchange rate policy and the administration of intervention and financing mechanisms specified in the ERM II agreement.

commonly agreed rules on public finances through adherence to the Stability and Growth Pact (SGP), and coordinate their structural policies to better achieve continental level stability, growth, and development through the Lisbon Strategy for Growth and Jobs.

Stability and Growth Pact (SGP). EMU exacts discipline from its participants, and in return, it offers opportunities for economic stability, higher growth, and increased employment. The Stability and Growth Pact (SGP) helps to enforce fiscal discipline within the EMU and to ensure sound and sustainable public finances. The SGP, which applies to all EU countries, requires governments to maintain an annual budget with a deficit no greater than three percent of GDP and public debt at 60 percent of GDP or less.

The SGP operates with both a preventive and a corrective arm. The preventive arm of the SGP works to avoid excessive deficit procedures and achieve fiscal consolidation through medium-term budgetary objectives set for each Member State. Each country's particular economic situation and prospects are taken into account so as to provide a sufficient safety margin with respect to the three percent of GDP reference value and ensure prudent levels of debt.

SGP's preventive mechanism counts on peer pressure rather than sanctions to encourage governments to achieve sustainable budgets. Euro area countries draft annual stability programs—and non-euro countries prepare convergence reports—for submission to the European Commission and Council of the EU to ensure more rigorous budgetary discipline through surveillance and coordination of budgetary policies.

Exceeding the deficit and debt ratios can trigger an excessive deficit procedure and require a Member State to take corrective action. SGP corrective mechanisms have sufficient flexibility to consider and make allowances for circumstances where excessive deficits may be exceptional and temporary and result from a severe economic downturn or an unusual event beyond the government's control. Euro area countries may also be subject to financial penalties as a last resort.

The Lisbon Strategy for Growth and Jobs. First adopted in 2000 and relaunched in 2005, the Lisbon Strategy aims to boost growth, create more and better jobs, and make Europe an attractive place to invest and work through national structural reform programs. By combining economic dynamism with sustainable growth through investment in skills and education, leadership in research, and equipping people for change, the Lisbon Strategy creates an environment that fosters creativity, modernization, and the capacity of European enterprises to offer more innovative products and services more quickly.

Non-Euro Area Countries and ERM II

Once a Member State adopts the euro, an exchange rate is irrevocably fixed between its national currency and the euro throughout the transition to full use of the single currency. Member States outside the euro area can also choose to link their currencies to the euro under the Exchange Rate Mechanism (ERM II), in which participating currencies fluctuate within a specified margin (+/- 15 percent) around a stable but adjustable central rate. When necessary, a currency is supported by intervention (buying or selling) to maintain the exchange rate within the set limits.

ERM II was established to ensure that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market, and to help countries prepare to join the euro area. ERM II is a "training ground" for the euro, and euro area candidates are required to participate successfully in ERM II for at least two years before joining the euro area to satisfy the convergence criteria on exchange rate stability. Current members of ERM II are Estonia, Latvia, Lithuania, and Denmark.

On the Web

EMU and the Euro
http://ec.europa.eu/economy_finance/index_en.htm

European Central Bank
http://www.ecb.eu/home/html/index.en.html

Financial Markets
http://ec.europa.eu/internal_market/top_layer/index_24_en.htm

"Lisbon won't free the European economy from natural business cycles. It won't bring an end to the sort of external shocks we are witnessing today. What it can do is improve Europe's growth potential through structural reforms. It can make our economies more flexible and resilient. And it's working. 6.5 million new jobs in the last two years. An increase in productivity growth for the first time in 10 years. Unemployment the lowest in 25 years."

—European Commission President José Manuel Barroso

The Euro

The most visible symbol of European integration, the euro was launched as a "virtual currency" on January 1, 1999, followed by the introduction of banknotes and coins at the start of 2002. The euro area has expanded from its initial 11 members to 16 with the January 2009 addition of Slovakia.

Countries earn their way into the euro area through adopting the economic, monetary, and fiscal discipline necessary to comply with the required economic convergence criteria (the "Maastricht criteria," incorporated in the Treaty on European Union signed at Maastricht in 1992).

International Role and Impact of the Euro. After just a decade, the euro is already the world's second most important international currency, after the U.S. dollar. It is the second most actively traded currency in foreign exchange markets worldwide, and is used in more than one-third of all foreign exchange transactions. In 2004, euro-denominated international debt securities surpassed those of the U.S. dollar.

The official use of the euro has increased, with the worldwide share of disclosed reserves denominated in euros rising from 18 percent in 1999 to more than 25 percent in 2007. Similarly, its role as an invoicing or settlement currency has increased to cover more than half of the euro area's external trade. A number of non-EU countries, notably EU candidate and neighboring countries, invoice approximately 60 percent of their trade in euros.

Thanks to the euro's rising international status and the sheer size of the euro area economy, economic policies within EMU increasingly have a global impact, and the euro area has become a pole of stability for Europe and the world economy. With a credible macroeconomic framework and a sound financial system, the euro area has been contributing to a more orderly evolution of the global economy, even during this period of economic turbulence.

The euro has not been immune to the last decade's external shocks associated with the global business cycle. Nevertheless, any ensuing slowdowns in the euro area have been considerably more muted than during comparable episodes prior to the adoption of the single currency. Today, the euro once again appears protected from the worst of the global financial turbulence. The anchoring of inflation through the ECB's centralized monetary policy for the euro area, along with EMU's coordinated monetary policy for the non-euro Member States, has contributed to this improved resilience, as have the reforms carried out under the Lisbon Strategy for Growth and Jobs and the renewed budgetary discipline of the Stability and Growth Pact.

Slovakia Becomes the 16th Member of the Euro Area

On January 1, 2009, Slovakia adopted the euro as its official currency, having accomplished the hard work of meeting the required economic convergence criteria:

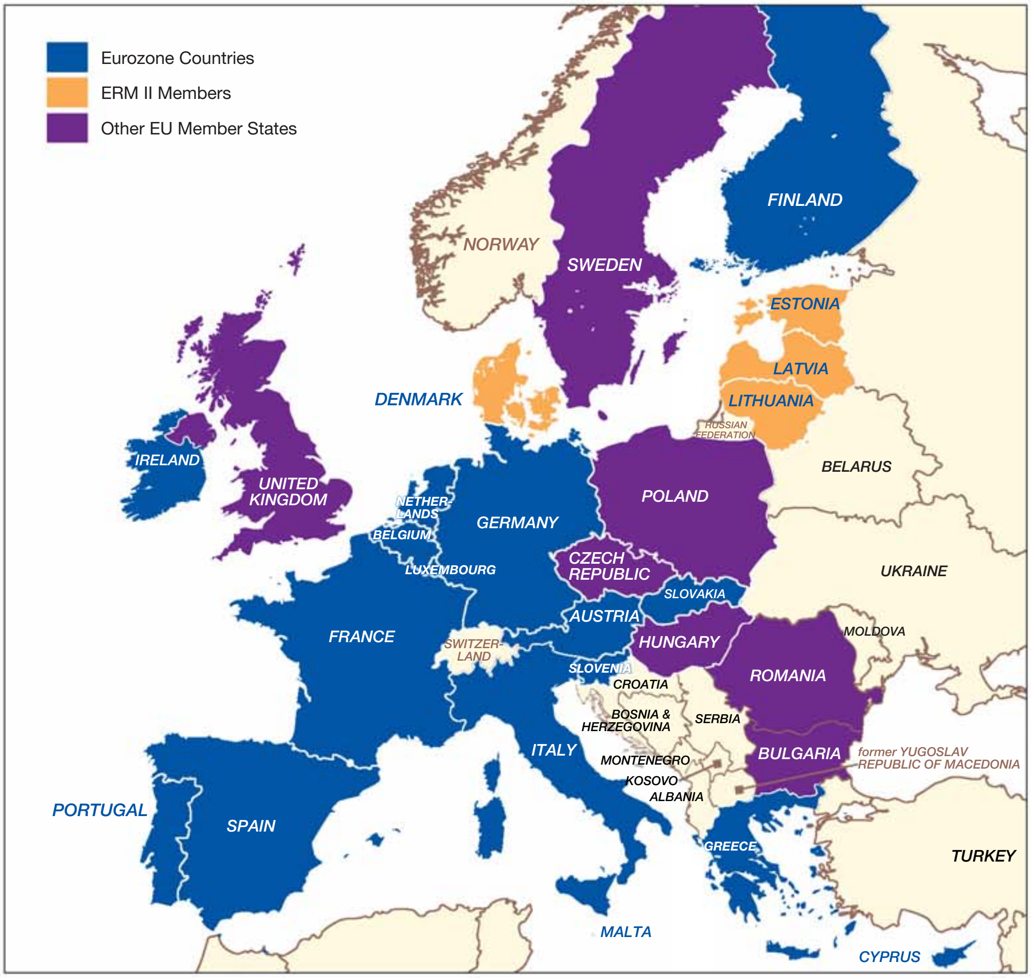
- Slovakia's 12-month average inflation in March 2008 was 2.2 percent, well below the 3.2 percent reference calculated for the same month.
- The deficit (2.2 percent of GDP and falling) and debt (24.9 percent of GDP) in 2007 were well within acceptable limits.
- The average long-term interest rate over the year to February 2008 was 4.5 percent, below the reference rate of 6.5 percent.
- The Slovak koruna participated successfully in ERM II from November 2005.
- Slovakia's legislation in the monetary field is compatible with EU legislation.

Slovakia adopts the euro on January 1, 2009.

The Maastricht Criteria

Five economic convergence criteria must be fulfilled before an EU Member State can adopt the euro:

- **Price stability.** The inflation rate should be no more than 1.5 percentage points above the previous year's rate for the three EU countries with the lowest inflation.
- **Budget deficit.** The national deficit generally must be below three percent of GDP.
- **Debt.** National debt should not exceed 60 percent of GDP, although a country with a higher rate can still adopt the euro, provided its debt level is falling steadily.
- **Interest rates.** Long-term rates should be no more than two percentage points above the previous year's rate in the three EU countries with the lowest interest rates.
- **Exchange rate stability.** The national currency's exchange rate should have remained within the authorized fluctuation margins for two years.



"This is a major success for Slovakia, the result of determined policies to promote convergence over recent years. Slovakia joins the euro area exactly ten years after its inception. During the last decade the single currency, which is now shared by some 325 million citizens, has been a remarkable success, and Slovakia is well placed to benefit from euro area participation. Still…Slovakia needs to remain committed to sound policies, particularly in the fiscal and structural domain. This is both in its own interest and part of the responsibility that all members share to ensure that the monetary union functions smoothly."

—Joaquín Almunia, EU Commissioner for Economic and Monetary Affairs

Economic and Monetary Union—A Timeline

1990 — 1995 — 2000 — 2005 — 2010

1990 First stage of EMU begins; Member States' economic policies are coordinated more closely and capital movement is liberalized.

1992 Maastricht Treaty is signed, setting out an EMU timetable and the convergence criteria all Member States must meet for participation in EMU.

1994 Second stage of EMU begins, including the creation of the European Monetary Institute (predecessor of European Central Bank). Member States are now required to fulfill five convergence criteria on inflation, interest rates, government deficit and debt, and exchange rate stability.

1997 Stability and Growth Pact is agreed upon, ensuring that Member States maintain budgetary discipline within EMU.

ERM II, the exchange rate mechanism, is developed to link the euro and currencies of non-participating Member States (revised in 2006).

1998 European Central Bank begins operation with the mandate to decide and conduct monetary policy for the euro area; its primary objective is price stability.

1999 Third stage of EMU begins, with the launch of the euro as a single (virtual) currency for 11 Member States: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain.

ECB begins conducting monetary policy for the euro area.

2001 Greece adopts the euro.

2002 Euro banknotes and coins are introduced in 12 euro area Member States.

2007 Slovenia adopts the euro.

2008 Cyprus and Malta adopt the euro.

2009 Slovakia adopts the euro.

The European Central Bank and the Eurosystem

"For nearly ten years, price stability has been broadly achieved despite the fact that strong global commodity price increases…have affected Europe and the rest of the world, leading to an average inflation rate that has been slightly above two percent since the launch of the euro. This is a remarkable result, taking into account all the shocks that have marked the period and the track record of the economies participating in the euro area."

—Jean-Claude Trichet, President of the European Central Bank

The Eurosystem, comprising the independent European Central Bank (ECB) and the national central banks (NCBs) of the EU Member States using the euro, is the monetary authority responsible for safeguarding price stability in the euro area. The Eurosystem also supports the EU's general economic policy objectives, including sustainable, non-inflationary economic growth and a high level of employment.

Decision-making in the Eurosystem is centralized, while implementation is decentralized. The ECB focuses on policy formulation and ensures consistent implementation of its decisions by the NCBs, which perform almost all the operational tasks of the Eurosystem.

The ECB's two main decision-making bodies are the Executive Board, which implements the decisions and is responsible for the ECB's daily management, and the Governing Council, which makes monetary decisions.

The Executive Board includes the ECB President, Vice-President, and four other appointed members, while the Governing Council consists of the members of the ECB's Executive Board and the governors of the euro area NCBs. The Governing Council meets monthly to analyze and assess economic developments and the risks to price stability and determine the appropriate level for key interest rates.

A third body, the General Council, includes the ECB President and Vice-President and the governors of all EU member NCBs, not just those within the euro area. The General Council's tasks include reporting on non-euro Member State preparations for adopting the single currency, contributing to the ECB's advisory functions, and helping to prepare the Bank's annual reports and collect statistical information. It will continue to exist as long as EU countries remain outside the euro area.

Monetary Policy and Price Stability. A key element in the ECB monetary policy strategy is its quantitative definition of price stability—a year-to-year increase in the consumer price index of below two percent in the euro area. Over the medium-term, the ECB aims to maintain inflation rates below but close to two percent so as to provide a sufficient safety margin to guard against the risks of deflation.

A deep and integrated money market, essential for an efficient monetary policy, ensures an even distribution of central bank liquidity and a homogeneous level of short-term interest rates throughout the single currency area. The ECB steers short-term interest rates through such monetary policy instruments as open market operations, standing facilities, and reserve requirements.

Banking. Unlike the Federal Reserve in the U.S., the European Central Bank does not have direct responsibility for bank supervision and financial stability, which remain under national jurisdiction in EU countries.

However, the ECB is charged with "contributing to the smooth conduct of policies… relating to the prudential supervision of credit institutions and the stability of the financial system." To fulfill this role, the ECB monitors and assesses financial stability at the euro area level; advises on the design and review of regulatory and supervisory requirements for financial institutions; and promotes cooperation between central banks and supervisory authorities on issues of common interest, such as payment system oversight and financial crisis management.

Main Tasks of the European Central Bank and the Eurosystem

- Define and implement monetary policy for the euro area;
- Conduct foreign exchange operations;
- Hold and manage the official foreign reserves of participating EU Member States;
- Promote the smooth operation of payment systems;
- Authorize the issue of banknotes by NCBs in the euro area;
- Contribute to financial stability and supervision through monitoring, assessment, and advice to the national authorities.

The European Central Bank, along with the NCBs of all EU Member States, comprise the European System of Central Banks (ESCB). As long as EU states remain outside the euro area, the ESCB and the Eurosystem will co-exist.

ECB President Jean-Claude Trichet (center), accompanied by European Commission President José Manuel Barroso (far left) and other officials, celebrates the 10th anniversary of the ECB.

Enhanced Financial Market Integration: Safeguarding Stability and Prosperity in the EU

By eliminating exchange rate risk in cross-border financial activities throughout much of the EU, the euro has acted as a powerful catalyst to financial market integration in Europe. Financial markets are crucial to the functioning of modern economies, and the more integrated they are, the more efficient the allocation of capital and long-run economic performance will be.

The EU's Financial Services Action Plan (FSAP) laid the foundation for a strong financial market in the EU, and has already resulted in many positive changes despite the turbulent global environment. Completing the single market in financial services is an EU priority, and the EU aims to achieve an integrated, open, inclusive, competitive, and economically efficient Union by:

- Implementing, enforcing, and evaluating existing legislation, and ensuring that future initiatives are based on rigorous impact assessment and thorough consultation;
- Removing any remaining barriers to the free provision of financial services and circulation of capital, eliminating unnecessary costs and delivering high levels of financial stability and consumer protection and benefits;
- Enhancing supervisory cooperation in the EU, deepening relations with other financial marketplaces internationally, and strengthening Europe's global influence.

Countering the Financial Crisis: Economic and Financial Roadmap

The European Central Bank has reacted quickly and effectively from the start of the financial turmoil that began in the U.S. sub-prime mortgage market in 2007, providing additional liquidity for the EU financial system. Additionally, in October 2007 the EU developed the "Ecofin Roadmap," comprising approximately 40 measures designed to address the main weaknesses perceived in the financial system.

The Roadmap seeks to:

- Improve financial transparency in the market by requesting that financial institutions reveal all areas where they are exposed to risk, provide basic statistics on these markets, and furnish investors with more and better information;
- Enhance financial reporting and valuation of financial products to give investors more detailed information on individual deals;
- Ensure proper valuation of assets, focusing on consistent application of international accounting standards vis-à-vis all financial intermediaries;
- Strengthen the prudential rules for banks in the context of managing liquidity risk, concentration risk, and off-balance sheet exposures;
- Investigate structural market issues, including the role played by credit rating agencies and their potential failures in the context of the financial turmoil.

The Roadmap includes key elements designed to safeguard the financial sector and the economy by bolstering confidence, containing risk, and introducing greater efficiency and openness in the banking and investment sectors.

The **Single Euro Payments Area (SEPA)** is a market-led initiative aimed at removing technical, legal, and commercial barriers against smooth cashless cross-border payments in euro. By November 2009, SEPA will enable the banking industry to shift from 31 national payment systems to an integrated euro payment area.

In force since November 2007, the **Market in Financial Instruments Directive (MiFID)** grants exchanges, multilateral trading facilities, and investment firms in Member States a "single passport" to operate throughout the EU based on authorization in their home country.

A proposed revision to an existing EU directive on **deposit guarantees** will raise the minimum level of deposit guarantees throughout the EU from €20,000 to €50,000 in the first year and to € 100,000 thereafter, while reducing the payout period from three months to three days in the event of a bank failure.

A proposed revision to the EU's **capital requirements** for banks would reinforce the stability of the financial system, reduce risk exposure by imposing limits on loans to any one party, and increase the supervision of banks that operate in more than one EU country.

Proposed adjustments to **accounting standards** will ensure that assets are valued according to their intrinsic value over time, rather than just the current market price. EU rules will align with those in other jurisdictions to avoid any competitive disadvantage for EU banks.

Proposed legislation requires legally binding registration of **Credit Rating Agencies (CRAs)**, as well as an external oversight regime whereby European regulators will supervise the policies and procedures followed.

"MiFID has largely been a success. Markets have become more competitive, service providers are able to move around Europe more easily, the integration of European capital markets has been promoted, and the investor protection innovations in MiFID are generally being welcomed by both industry and investors. Together with the other parts of the EU Financial Services Action Plan, MiFID is expected, over time, to lower the cost of capital and to bring major benefits for the European economy."

—Charlie McCreevy,
EU Commissioner for
Internal Market and Services

EU-U.S. Economic and Financial Cooperation

The $4 trillion EU-U.S. transatlantic economy is the largest, most integrated economic relationship in the world, and is a key driver of global economic growth, trade, and prosperity. Together, the partners represent approximately 12 percent of the world's population, close to 40 percent of global trade, and nearly 60 percent of world GDP.

In this interdependent, globalized age, it is vital to support open trade and investment by cooperatively addressing unnecessary regulatory burdens and promoting recognition of mutually acceptable standards. Since 1990, the EU and the U.S. have held annual presidential summits, with successive meetings clarifying the details of the bilateral relationship.

The Framework for Advancing Transatlantic Economic Integration, signed by the EU and the U.S. at the 2007 summit, achieved closer transatlantic economic integration and growth by promoting regulatory cooperation, capital markets integration, investment, and innovation, and by supporting the protection of intellectual property rights and facilitating secure trade. Specific transatlantic structures and dialogues have evolved to treat economic and financial issues relevant to both the EU and the U.S.

EU-U.S. Fin**ancial Market Dialogue.** Established in 2002, the emphasis has shifted from tackling existing frictions to looking ahead to common goals such as the equivalence and convergence of accounting standards internationally, and ensuring that transatlantic markets operate as openly and efficiently as possible and contribute to further integration of global financial markets.

As each partner considers whether to introduce new regulations, or strengthen existing rules and enforcement, the Dialogue has proven to be a flexible and pragmatic forum for exploring new ideas and approaches, while avoiding unnecessary regulatory conflicts. It is led by the European Commission (EC) and the U.S. Treasury Department and includes the U.S. Securities and Exchange Commission, Federal Reserve Board of the United States, and representatives of the EC's internal market.

Transatlantic Economic Council (TEC). Established at the 2007 EU-U.S. summit, the TEC oversees, guides, and accelerates the implementation of work designed to more closely integrate the EU and U.S. economies, bringing together those members of the European Commission and U.S. Cabinet who carry the political responsibility for closer economic ties. Topics include investment, financial markets, and reducing regulatory burden.

"In light of the considerable differences that exist between financial market structure and regulation on both sides of the Atlantic, and given the consolidation underway globally and transatlantically in this sector, we resolve to take steps, towards the convergence, equivalence, or mutual recognition, where appropriate, of regulatory standards based on high quality principles."

—2007 EU-U.S. Summit

Euro Challenge

The Euro Challenge is an innovative academic competition that tests U.S. high school students about their knowledge of European economic affairs and the euro. Student teams make presentations on specific aspects of the European economy and the EU's single currency. They are also asked to select one euro area country, examine an economic problem at the country level, and identify appropriate policy solutions.

Now in its fourth year, the Euro Challenge will continue to expand nationally with as many as 100 teams competing from various regions throughout the U.S. The program was developed and is supported by the European Commission's Washington Delegation, with technical support provided by the Federal Reserve Bank of New York. The Moody's Foundation funds prize awards for the winning team. More information is available online at http://euro-challenge.org.

Ambassador John Bruton (center back) and the 2008 EuroChallenge champions, from Rumson-Fair Haven High School in Rumson, NJ.

For further information: http://www.eurunion.org/eufocus

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IN BOX

India's New Deal

On a recent morning in a village in eastern India, Hirya Devi, a rail-thin woman in a tangerine sari, told a crowd of a few hundred poor laborers how she came to participate in the largest employment program in human history. For two months last year, Devi worked on a government-funded well construction project as part of India's National Rural Employment Guarantee Act, which promises 100 days of employment each year to the head of every rural household. Since the program began in 2006, 90 million Indians have been temporarily put to work, usually on road and well construction projects, earning minimum wages of about $1.60 a day.

The program isn't simply extraordinary because of its scale—though, incredibly, it could affect nearly 70 percent of India's 1.1 billion citizens. What makes the program truly exceptional is its transparency. Regular, public reviews of all documents—wage cards and bank records, engineers' reports and work completion papers, for example—ensure that laborers are being paid fairly. If shady practices occur, villagers like Devi can air their grievances at village meetings.

For many of India's rural poor, access to regular work is a life-changing development. "It's not the end of poverty," says Jean Drèze, one of India's most famous social activists and a chief architect of the program, "but it means the kind of extreme insecurity that people live in today is basically not there anymore."

New hires: **Putting 90 million Indians to work.**

What's more, the program's attempts at accountability represent a radical, game-changing agenda in a country where local politicians and businessmen often collude for kickbacks. As such, there has been a fair amount of backlash from local leaders, who contend that public access to documents challenges their authority. Many villagers complain bitterly that the program itself has become corrupt.

That's what brought Devi to the front of the crowd that morning. After two months of hard work, she had been denied her wages by a thieving contractor. "I'm an old woman," Devi explained. "I don't have money to go run after government officials." Although the top district official listened patiently, Devi likely won't receive her lost wages. No one expects such a large government program to be free of corruption overnight, but the fact that a chauffeur-driven bureaucrat showed up to listen to poor villagers surely suggests that men and women like Devi are learning they are entitled to more than just a handout. —*Daniel Pepper*

BRANDED

Running a country is a lot like managing a business: Reputation is everything. So, what can you do if your national image has been sullied—whether by war, drugs, or just bad neighbors? Break out a new branding campaign.

The slogan: "The Winner Is Georgia"
The architect: Bahrain office of London's M&C Saatchi
The pitch: Georgia lost decisively in its short war with Russia last summer, but don't tell that to the government's PR people. "The Winner Is Georgia" campaign pits the country against other nations—Georgia vs. France, Georgia vs. China, Georgia vs. Australia—and asserts that when it comes to the best place to do business or to visit, Georgia wins—even if not on the battlefield.

The slogan: "Korea, Sparkling!"
The architect: New York's BCA Marketing Communications
The pitch: In October, South Korean President Lee Myung-bak voiced what many of his citizens privately feared: Their neighbor to the north, Kim Jong Il, was tarnishing South Korea's reputation among tourists and investors. So, to counter Kim's moves, South Korea's spin doctors are pushing an effervescent new slogan to win over skeptics: "Korea, Sparkling!"

The slogan: "Colombia Is Passion"
The architect: Independent consultant David Lightle
The pitch: Cocaine trafficking, guerrillas, and assassinations color much of the world's view of this war-scarred nation. But as the country's civil conflict winds down, the Colombian government wants its rep to be among the first things to change. The solution? Play up the people's passion "for life, for family, for nature, and . . . for peace," according to the campaign.

TOP: JEREMY HORNER/CORBIS; BOTTOM, FROM LEFT TO RIGHT: CORBIS, ISTOCKPHOTO.COM, CORBIS

Grand Theft Solar

Lincoln Dahl, managing director of a company that markets alternative energies to African businesses, recently stepped into a used solar panel shop in Ouagadougou, Burkina Faso. He had come in to scope out his competition's wares. A few of the shop's solar panels looked stolen, still bearing the nameplates of their original owners. "Theft is a problem," Dahl says. "We find that to be a compliment—that means that there's a demand."

After years of slow growth in solar use, a rash of solar panel theft on five continents suggests that the alternative power source may finally be catching on. Missing panels have been reported this year in Australia, Spain, and the United States, but it's in the developing world where solar theft has been most glaring. In July, South Africa scrapped a year-old program to install solar-powered traffic lights throughout the country because of their vulnerability to theft. Streetlight panels in Calcutta also went missing, leading city leaders to abandon a plan to expand their use. And throughout Latin America, thieves frequently plunder banks of mountain-top solar panels that power telecom and Internet services. "They end up destroying the system," complains Romulo Bisetti, regional sales director for Kyocera, a tech company that produces solar products.

Construction of the panels is complex, so thieves are unlikely to melt them for minerals or metals. Instead, the stolen panels are most often sold on the black market and reused.

In poorer countries where electricity is expensive or scarce, the panels have grown in popularity thanks to their reputation as reliable energy sources—useful for resurrecting dead car batteries, recharging cellphones, and fueling a night of television viewing. Between 1999 and 2005, electricity generated from solar power increased 300 percent in India. Across Africa, it jumped 2,500 percent, compared with just 11 percent in North America. "Due to the lack of infrastructure, sometimes solar is the only alternative for people in these countries," Bisetti explains.

To ward off thieves, many solar companies now recommend antitheft protection, from barbed-wire fences to elaborate surveillance systems. In South Africa, one of the most popular methods is to paint the unused side of the panels neon pink or orange to tip off police to theft. More bright ideas are sure to follow if solar power remains the rage.

Light it up: **Solar use has skyrocketed in poorer countries.**

Epiphanies: Tony Blair

I WENT TO SEE Gen. [Pervez] Musharraf in Islamabad about four years ago. I remember going into his room, just the two of us. We were trying to get Pakistan's help in the war against terrorism. And I said to him, 'So, what can we do to help you?' And he just said, 'Palestine. A peace between the Israelis and the Palestinians.' I expected to hear that in Riyadh or Cairo or Ramallah, but I didn't expect to hear that in Islamabad.

THE BIG THING FOR ME [as Middle East envoy] has been to go there and experience the life of the Israelis, the life of the Palestinians. It's only when you get out, and you see it with your own eyes and hear it with your own ears, and you touch and feel and smell the politics, that you get a sense of how to resolve [the problem].

THE FIRST THING you've got to contradict is the belief that [Middle East peace] is hopeless. The second thing you've got to contradict is the belief that if you lock people in a room, they're going to come out with [a] peace settlement. They're not. It's gone too far for that.

[WHAT DO I MISS LEAST?] You mean, besides Prime Minister's Questions?

THERE'S MASSIVE SYMBOLIC POWER in resolving this dispute. Elements within the region and within Palestine try so hard to stop the resolution because they know the symbolic power of peace. They know that if America and Europe were involved in peacemaking between Israel and Palestine, it'd be very hard to rouse up their people against the iniquities of America.

THE PROBLEM FOR THE WORLD today is that globalization is pushing people together. Actually, I think that's a good thing. There will, however, be reactionary forces against that. And if religious faith becomes the focal point of reaction, it would be very dangerous. So, to me, [interfaith dialogue] is a major part of making the world work.

I ENTERED POLITICS because I realized I was not going to play for Newcastle United and I was never going to be Mick Jagger.

Tony Blair, special envoy to the Middle East, was prime minister of Britain from 1997 to 2007.

FROM TOP TO BOTTOM: MALCOLM LINTON/GETTY IMAGES; ISTOCKPHOTO.COM; ISTOCKPHOTO.COM; JASON DECROW/AP PHOTOS

An Rx for Chinese Health

For decades, China has been content to let the invisible hand of the market work its magic on the country's economy. But there's one area where the government wants to reassert state control: healthcare. The government recently developed a strategy to provide affordable medical insurance to 90 percent of its population by 2010 and 100 percent by 2020.

Today, 500 million Chinese—or nearly 40 percent of the population—can't afford to see a doctor. Respondents in a January 2008 poll of 101,000 households around the country named healthcare their top worry. Since the free market reforms initiated by Deng Xiaoping in 1978, out-of-pocket healthcare payments have ballooned from 20 percent of medical spending in 1980 to 49 percent in 2006. By comparison, Japanese pay just 15 percent of their medical spending out of pocket. The average hospital stay in China costs nearly as much as an individual's annual per capita income in the country.

Frustration with the high cost and low quality of care has recently reached fever pitch. Healthcare grievances have been at the heart of thousands of organized protests countrywide in recent years. Some hospitals have even had to hire police to protect medical staff from angry mobs. The dissatisfaction has caught the attention of the government, which is beginning to address social development now that it has met many of its economic goals.

In an unusual sign of its commitment, the government posted its "Healthy China 2020" plan online in October and allowed public comments until November 14. "To meet the demand of the public, the government this time tried to please the public, say[ing], 'We want to release this draft reform plan, seek your comments and suggestions, and try to be more democratic,'" says Shenglan Tang of the World Health Organization's Beijing office. More than 25,000 comments were left online, and the government plans to synthesize them into a report for the State Council.

Out of reach: 500 million Chinese can't pay for a doctor.

Many of the comments are personal stories, especially from farmers, of frustrating experiences with the healthcare system. Addressing such woes is bound to give any government a headache. Still, the effort might be just what the doctor ordered.

The *FP* Quiz

Are you a globalization junkie? Test your knowledge of global trends, economics, and politics with 8 questions about how the world works.

1 After the United States and India, which country has the world's largest film industry?

- A Britain
- B Brazil
- C Nigeria

2 Other than the United States, how many countries use the U.S. dollar as their official currency?

A 2 B 7 C 12

3 What percentage of the world's seafood comes from farms?

- A 21 percent
- B 33 percent
- C 42 percent

4 How much of an increase in cocaine seizures has Africa seen since 2000?

A 5x B 15x C 30x

5 How many countries do not have standing armies?

- A 9
- B 24
- C 45

6 How many trees per person are there in the world?

A 0.6 B 6 C 61

7 How many of the corporations on *Fortune*'s 500 List are run by women?

A 4 B 12 C 36

8 What is the world's most popular newspaper?

- A *Bild* (Germany)
- B *Yomiuri Shimbun* (Japan)
- C *People's Daily* (China)

For the answers, turn to page 94.

TOP: AFP/GETTY IMAGES; ALL QUIZ IMAGES: ISTOCKPHOTO.COM

By Bill McKibben

Climate Change

Act now, we're told, if we want to save the planet from a climate catastrophe. Trouble is, it might be too late. The science is settled, and the damage has already begun. The only question now is whether we will stop playing political games and embrace the few imperfect options we have left.

"Scientists Are Divided"

No, they're not. In the early years of the global warming debate, there was great controversy over whether the planet was warming, whether humans were the cause, and whether it would be a significant problem. That debate is long since over. Although the details of future forecasts remain unclear, there's no serious question about the general shape of what's to come.

Every national academy of science, long lists of Nobel laureates, and in recent years even the science advisors of President George W. Bush have agreed that we are heating the planet. Indeed, there is a more thorough scientific process here than on almost any other issue: Two decades ago, the United Nations formed the Intergovernmental Panel on Climate Change (IPCC) and charged its scientists with synthesizing the peer-reviewed science and developing broad-based conclusions. The reports have found since 1995 that warming is dangerous and caused by humans. The panel's most recent report, in November 2007, found it is "very likely" (defined as more than 90 percent certain, or about as certain as science gets) that heat-trapping emissions from human activities have caused "most of the observed increase in global average temperatures since the mid-20th century."

If anything, many scientists now think that the IPCC has been too conservative—both because member countries must sign off on the conclusions and because there's a time lag. Its last report synthesized data from the early part of the decade, not the latest scary results, such as what we're now seeing in the Arctic.

In the summer of 2007, ice in the Arctic Ocean melted. It melts a little every summer, of course, but this time was different—by late September, there was 25 percent less ice than ever measured before. And it wasn't a one-time accident. By the end of the summer season in 2008, so much ice had melted that both the Northwest and Northeast passages were open. In other words, you could circumnavigate the Arctic on open water. The computer models, which are just a few years old, said this shouldn't have happened until sometime late in the 21st century. Even skeptics can't dispute such alarming events.

Bill McKibben is scholar in residence at Middlebury College and author of Deep Economy: The Wealth of Communities and the Durable Future *(New York: Times Books, 2007).*

Tall order: It may already be too late to save the planet from a human-made catastrophe.

MOMATIUK: EASTCOTT/CORBIS

"We Have Time"

Wrong. Time might be the toughest part of the equation. That melting Arctic ice is unsettling not only because it proves the planet is warming rapidly, but also because it will help speed up the warming. That old white ice reflected 80 percent of incoming solar radiation back to space; the new blue water left behind absorbs 80 percent of that sunshine. The process amps up. And there are many other such feedback loops. Another occurs as northern permafrost thaws. Huge amounts of methane long trapped below the ice begin to escape into the atmosphere; methane is an even more potent greenhouse gas than carbon dioxide.

Such examples are the biggest reason why many experts are now fast-forwarding their estimates of how quickly we must shift away from fossil fuel. Indian economist Rajendra Pachauri, who accepted the 2007 Nobel Peace Prize alongside Al Gore on behalf of the IPCC, said recently that we must begin to make fundamental reforms by 2012 or watch the climate system spin out of control; NASA scientist James Hansen, who was the first to blow the whistle on climate change in the late 1980s, has said that we must stop burning coal by 2030. Period.

All of which makes the Copenhagen climate change talks that are set to take place in December 2009 more urgent than they appeared a few years ago. At issue is a seemingly small number: the level of carbon dioxide in the air. Hansen argues that 350 parts per million is the highest level we can maintain "if humanity wishes to preserve a planet similar to that on which civilization developed and to which life on Earth is adapted." But because we're already past that mark—the air outside is currently about 387 parts per million and growing by about 2 parts annually—global warming suddenly feels less like a huge problem, and more like an Oh-My-God Emergency.

"Climate Change Will Help as Many Places as It Hurts"

Wishful thinking. For a long time, the winners-and-losers calculus was pretty standard: Though climate change will cause some parts of the planet to flood or shrivel up, other frigid, rainy regions would at least get some warmer days every year. Or so the thinking went. But more recently, models have begun to show that after a certain point almost everyone on the planet will suffer. Crops might be easier to grow in some places for a few decades as the danger of frost recedes, but over time the threat of heat stress and drought will almost certainly be stronger.

A 2003 report commissioned by the Pentagon forecasts the possibility of violent storms across Europe, megadroughts across the Southwest United States and Mexico, and unpredictable monsoons causing food shortages in China. "Envision Pakistan, India, and China—all armed with nuclear weapons—skirmishing at their borders over refugees, access to shared rivers, and arable land," the report warned. Or Spain and Portugal "fighting over fishing rights—leading to conflicts at sea."

Of course, there are a few places we used to think of as possible winners—mostly the far north, where Canada and Russia could theoretically produce more grain with longer growing seasons, or perhaps explore for oil beneath the newly melted Arctic ice cap. But even those places will have to deal with expensive consequences—a real military race across the high Arctic, for instance.

Want more bad news? Here's how that Pentagon report's scenario played out: As the planet's carrying capacity shrinks, an ancient pattern of desperate, all-out wars over food, water, and energy supplies would reemerge. The report refers to the work of Harvard archaeologist Steven LeBlanc, who notes that wars over resources were the norm until about three centuries ago. When such conflicts broke out, 25 percent of a population's adult males usually died. As abrupt climate change hits home, warfare may again come to define human life. Set against that bleak backdrop, the potential upside of a few longer growing seasons in Vladivostok doesn't seem like an even trade.

"It's China's Fault"

Not so much. China is an easy target to blame for the climate crisis. In the midst of its industrial revolution, China has overtaken the United States as the world's biggest carbon dioxide producer. And everyone has read about the one-a-week pace of power plant construction there. But those numbers are misleading, and not just because a lot of that carbon dioxide was emitted to build products for the West to consume. Rather, it's because China has four times the population of the United States, and per capita is really the only way to think about these emissions. And by that standard, each Chinese person now emits just over a quarter of the carbon dioxide that each American does. Not only that, but carbon dioxide lives in the atmosphere for more than a century. China has been at it in a big way less than 20 years, so it will be many, many years before the Chinese are as responsible for global warming as Americans.

What's more, unlike many of their counterparts in the United States, Chinese officials have begun a concerted effort to reduce emissions in the midst of their country's staggering growth. China now leads the world in the deployment of renewable energy, and there's barely a car made in the United States that can meet China's much tougher fuel-economy standards.

For its part, the United States must develop a plan to cut emissions—something that has eluded Americans for the entire two-decade history of the problem. Although the U.S. Senate voted down the last such attempt, Barack Obama has promised that it will be a priority in his administration. He favors some variation of a "cap and trade" plan that would limit the total amount of carbon dioxide the United States could release, thus putting a price on what has until now been free.

Despite the rapid industrialization of countries such as China and India, and the careless neglect of rich ones

such as the United States, climate change is neither any one country's fault, nor any one country's responsibility. It will require sacrifice from everyone. Just as the Chinese might have to use somewhat more expensive power to protect the global environment, Americans will have to pay some of the difference in price, even if just in technology. Call it a Marshall Plan for the environment. Such a plan makes eminent moral and practical sense and could probably be structured so as to bolster emerging green energy industries in the West. But asking Americans to pay to put up windmills in China will be a hard political sell in a country that already thinks China is prospering at its expense. It could be the biggest test of the country's political maturity in many years.

"Climate Change Is an Environmental Problem"

Not really. Environmentalists were the first to sound the alarm. But carbon dioxide is not like traditional pollution. There's no Clean Air Act that can solve it. We must make a fundamental transformation in the most important part of our economies, shifting away from fossil fuels and on to something else. That means, for the United States, it's at least as much a problem for the Commerce and Treasury departments as it is for the Environmental Protection Agency.

And because every country on Earth will have to coordinate, it's far and away the biggest foreign-policy issue we face. (You were thinking terrorism? It's hard to figure out a scenario in which Osama bin Laden destroys Western civilization. It's easy to figure out how it happens with a rising sea level and a wrecked hydrological cycle.)

Expecting the environmental movement to lead this fight is like asking the USDA to wage the war in Iraq. It's not equipped for this kind of battle. It may be ready to save Alaska's Arctic National Wildlife Refuge, which is a noble undertaking but on a far smaller scale. Unless climate change is quickly de-ghettoized, the chances of making a real difference are small.

"Solving It Will Be Painful"

It depends. What's your definition of painful? On the one hand, you're talking about transforming the backbone of the world's industrial and consumer system. That's certainly expensive. On the other hand, say you manage to convert a lot of it to solar or wind power—think of the money you'd save on fuel.

And then there's the growing realization that we don't have many other possible sources for the economic growth we'll need to pull ourselves out of our current economic crisis. Luckily, green energy should be bigger than IT and biotech combined.

Almost from the moment scientists began studying the problem of climate change, people have been trying to estimate the costs of solving it. The real answer, though, is that it's such a huge transformation that no one really knows for sure. The bottom line is, the growth rate in energy use worldwide could be cut in half during the next 15 years and the steps would, net, save more money than they cost. The IPCC included a cost estimate in its latest five-year update on climate change and looked a little further into the future. It found that an attempt to keep carbon levels below about 500 parts per million would shave a little bit off the world's economic growth—but only a little. As in, the world would have to wait until Thanksgiving 2030 to be as rich as it would have been on January 1 of that year. And in return, it would have a much-transformed energy system.

Unfortunately though, those estimates are probably too optimistic. For one thing, in the years since they were published, the science has grown darker. Deeper and quicker cuts now seem mandatory.

But so far we've just been counting the costs of fixing the system. What about the cost of doing nothing? Nicholas Stern, a renowned economist commissioned by the British government to study the question,

concluded that the costs of climate change could eventually reach the combined costs of both world wars and the Great Depression. In 2003, Swiss Re, the world's biggest reinsurance company, and Harvard Medical School explained why global warming would be so expensive. It's not just the infrastructure, such as sea walls against rising oceans, for example. It's also that the increased costs of natural disasters begin to compound. The diminishing time between monster storms in places such as the U.S. Gulf Coast could eventually mean that parts of "developed countries would experience developing nation conditions for prolonged periods." Quite simply, we've already done too much damage and waited too long to have any easy options left.

"We Can Reverse Climate Change"

If only. Solving this crisis is no longer an option. Human beings have already raised the temperature of the planet about a degree Fahrenheit. When people first began to focus on global warming (which is, remember, only 20 years ago), the general consensus was that at this point we'd just be standing on the threshold of realizing its consequences—that the big changes would be a degree or two and hence several decades down the road. But scientists seem to have systematically underestimated just how delicate the balance of the planet's physical systems really is.

The warming is happening faster than we expected, and the results are more widespread and more disturbing. Even that rise of 1 degree has seriously perturbed hydrological cycles: Because warm air holds more water vapor than cold air does, both droughts and floods are increasing dramatically. Just look at the record levels of insurance payouts, for instance. Mosquitoes, able to survive in new places, are spreading more malaria and dengue. Coral reefs are dying, and so are vast stretches of forest.

None of that is going to stop, even if we do everything right from here on out. Given the time lag between when we emit carbon and when the air heats up, we're already guaranteed at least another degree of warming.

The only question now is whether we're going to hold off catastrophe. It won't be easy, because the scientific consensus calls for roughly 5 degrees more warming this century unless we do just about everything right. And if our behavior up until now is any indication, we won't. FP

[Want to Know More?]

Bill McKibben's classic work ***The End of Nature*** (New York: Anchor Books, 1989) remains required reading for anyone interested in the causes and consequences of climate change. In **"Carbon's New Math"** (*National Geographic*, October 2007), he suggests how policymakers can fight back.

The Intergovernmental Panel on Climate Change's latest assessment, ***Climate Change: 2007*** (Nov. 17, 2007), offers a sobering diagnosis of the ways humans are harming their planet. In **"Stabilization Wedges: Solving the Climate Problem for the Next 50 Years with Current Technologies"** (*Science*, Aug. 13, 2004), authors Stephen Pacala and Robert Socolow argue science already has the tools it needs to fight climate change.

The Council on Foreign Relations' online section **"Crisis Guide: Climate Change"** offers an interactive database of climate change commentary, background, and news analysis. The American Meteorological Society runs a climate change blog, **climatepolicy.org**, as do a group of American and European scientists at **realclimate.org**.

McKibben argues that the world must draw a firm line on carbon emissions in **"21 Solutions to Save the World: 450 Ways to Stop Global Warming"** (FOREIGN POLICY, May/June 2007). In **"How Cap-and-Trade Could Replace Foreign Aid"** (ForeignPolicy.com, February 2007), Alex Evans suggests that a carbon-trading policy could make poor countries rich.

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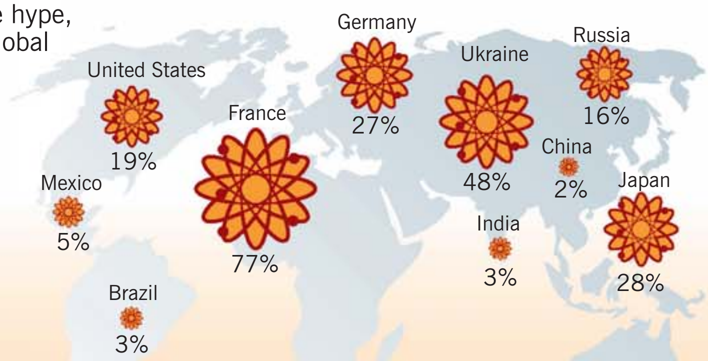
The Nuclear Option

After a decades-long slowdown, nuclear power once again dominates the global energy debate. Dozens of countries are vying to join the nuclear power club and hundreds of new reactors are on the drawing board. But despite the hype, it will not be the miracle cure for energy dependence or global warming that boosters promise.

| By Charles D. Ferguson and Michelle M. Smith

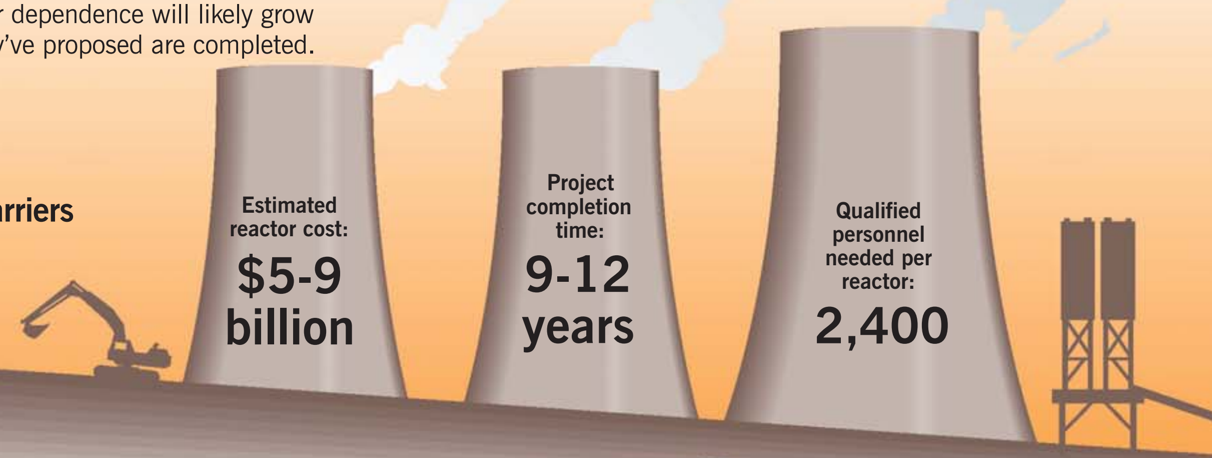
Nuclear Power Use
(as a percentage of domestic electricity use)



Atoms at Work

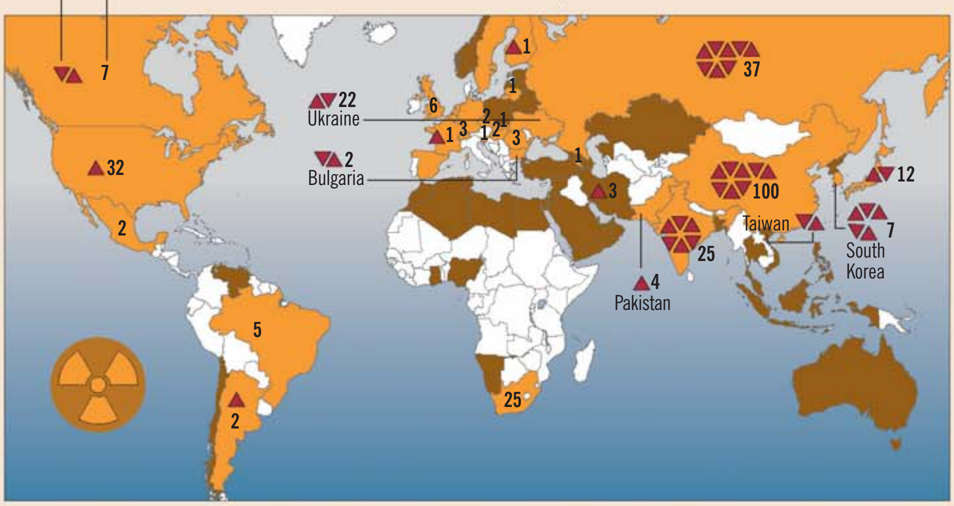
A country's use of nuclear power has much to do with government intervention, whether through state loans or streamlined regulations. Brazil, China, and India rely on reactors for just tiny fractions of their energy needs, but their dependence will likely grow if the many plants they've proposed are completed.

A few of the barriers to building:



Countries with Nuclear Power
▲ # of Nuclear Reactors Under Construction
# of Reactors Proposed

Countries with Stated Plans to Acquire Nuclear Power



A Nuclear Family

After more than 30 years without building a nuclear plant, U.S. utility companies are seeking licenses for over 30 new reactors. In addition, more than 300 reactors have been proposed worldwide. Some 40 reactors are already under construction, though many have been underway for decades with no end in sight. Countries such as Egypt, Nigeria, Saudi Arabia, and Venezuela are among the more than 30 countries with serious plans to build their first nuclear plant.

GRAPHICS BY DAVE MERRILL
SOURCES: IAEA-PRIS; AUTHORS' CALCULATIONS; WNA; U.S. STATE DEPARTMENT

Power Trip

Nuclear power's champions promise many things, but two above all: that nuclear power is a major solution to the world's growing electricity needs, and that increased nuclear use can substantially lower greenhouse gas emissions and fight climate change. For either to be true, the world would have to embark on an unrealistic reactor-building spree.

Can Nuclear Power Provide More Electricity?

Global electricity demand is estimated to nearly double by 2030, with nuclear power currently accounting for about 15 percent of global use.

Global Electricity Demand
(in billion kilowatt hours)

2005	15,750
2010	19,050
2015	21,700
2020	24,370
2025	27,130
2030	30,120

Nuclear: 15% (2005); 15% (2030)

For nuclear to do nothing more than maintain its current share of global electricity to 2030—15 percent—a 1,000-megawatt reactor must be built …

…every 16 days for the next 21 years.

Can Nuclear Power Reduce Emissions?

Annual emissions of greenhouse gases are similarly expected to double by 2050, from a current 7 billion tons of carbon dioxide each year to more than 14 billion tons.

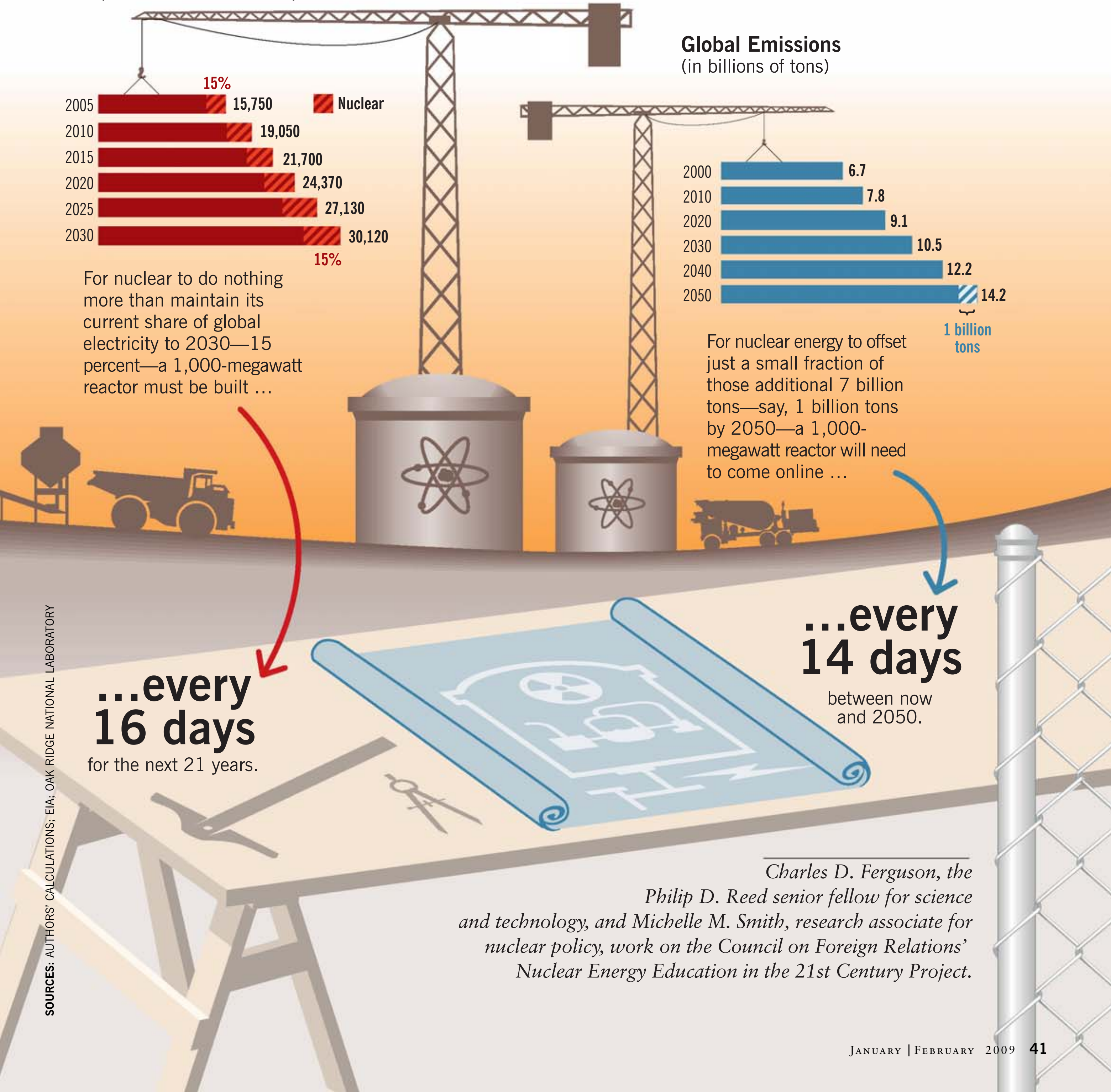
Global Emissions
(in billions of tons)

2000	6.7
2010	7.8
2020	9.1
2030	10.5
2040	12.2
2050	14.2

1 billion tons

For nuclear energy to offset just a small fraction of those additional 7 billion tons—say, 1 billion tons by 2050—a 1,000-megawatt reactor will need to come online …

…every 14 days between now and 2050.



Charles D. Ferguson, the Philip D. Reed senior fellow for science and technology, and Michelle M. Smith, research associate for nuclear policy, work on the Council on Foreign Relations' Nuclear Energy Education in the 21st Century Project.

SOURCES: AUTHORS' CALCULATIONS; EIA; OAK RIDGE NATIONAL LABORATORY

THE U.S. ARMY ★ MARINE CORPS

Counterinsurgency Field Manual

AFGHANISTAN EDITION

★

BY NATHANIEL C. FICK AND JOHN A. NAGL

WITH AN INTERVIEW OF GEN. DAVID H. PETRAEUS

Two years ago, a controversial military manual rewrote U.S. strategy in Iraq. Now, the doctrine's simple, powerful—even radical—tenets must be applied to the far different and neglected conflict in Afghanistan. Plus, David Petraeus talks to FP about how to win a losing war.

For the past five years, the fight in Afghanistan has been hobbled by strategic drift, conflicting tactics, and too few troops. The chairman of the Joint Chiefs of Staff, Adm. Michael Mullen, got it right when he bluntly told the U.S. Congress in 2007, "In Iraq, we do what we must." Of America's other war, he said, "In Afghanistan, we do what we can."

It is time this neglect is replaced with a more creative and aggressive strategy. U.S. Central Command, which oversees operations in Afghanistan and Pakistan, is now headed by Gen. David Petraeus, the architect of the U.S. military's counterinsurgency strategy widely credited with pulling Iraq from the abyss. Many believe that, under Petraeus's direction, Afghanistan can similarly pull back from the brink of failure.

SCOTT NELSON FOR GETTY IMAGES

Two years ago, General Petraeus oversaw the creation of a new counterinsurgency field manual for the U.S. military. Its release marked a definitive break with a losing strategy in Iraq and reflected a creeping realization in Washington: To avoid repeating the mistakes of the Vietnam War, the U.S. military would have to relearn and institutionalize that conflict's key lessons. At the time, the doctrine the manual laid out was enormously controversial, both inside and outside the Pentagon. It remains so today. Its key tenets are simple, but radical: Focus on protecting civilians over killing the enemy. Assume greater risk. Use minimum, not maximum force.

For a military built on avoiding casualties with quick, decisive victories, many believe such precepts veer far too close to nation-building and other political tasks soldiers are ill-equipped to handle. Still others attack the philosophy as cynically justifying the United States' continued presence in Iraq—neocolonialism dressed up in PowerPoint. Either way, the manual's critics recognize a singular fact: The new counterinsurgency doctrine represents a near total rethinking of the way the United States should wage war.

But such a rethinking has never been more necessary. Technological advances and demographic shifts point to the possibility of an increasingly disorderly world—what some military strategists are calling "an era of persistent irregular warfare." The United States' conventional military superiority has pushed its enemies inevitably toward insurgency to achieve their objectives. And in a multipolar world where small wars proliferate, there is reason to believe that this doctrine will shape not only the next phase of the fights in Afghanistan and Iraq, but the future of the U.S. military.

The surge in Iraq has been a primary consequence of the new counterinsurgency doctrine's influence, and it has clearly succeeded in improving security there. The conventional wisdom about what

Nathaniel C. Fick, a fellow at the Center for a New American Security, served as a U.S. Marine infantry officer in Afghanistan and Iraq. John A. Nagl, a senior fellow at the Center for a New American Security, served as a U.S. Army officer in Iraq and helped write The U.S. Army/Marine Corps Counterinsurgency Field Manual.

to do in Afghanistan is now coalescing around two courses of action that mirror steps taken during the past 18 months in Iraq: a similar surge of more troops and a willingness to negotiate with at least some of the groups that oppose the coalition's presence.

HANS STAKELBEEK/FMAX FOR THE NETHERLANDS MINISTRY OF FOREIGN AFFAIRS

If it is true that a new plan is needed in Afghanistan, it is doubly true that Afghanistan is not Iraq. Conflating the two conflicts would be a dangerous oversimplification. The Iraq war has been mostly urban, largely sectarian, and contained within Iraq's borders. The Afghan war has been intrinsically rural, mostly confined to the Pashtun belt across the country's south and east, and inextricably linked to Pakistan. Because the natures of the conflicts are different, the strategies to fight them must be equally so. The very fact that Pakistan serves as a sanctuary for the Taliban and al Qaeda makes regional diplomacy far more necessary than it was in Iraq. Additional troops are certainly needed in Afghanistan, but a surge itself will not equal success.

Two myths persistently hamper U.S. policy in Afghanistan. First is the notion that the notorious border region between Pakistan and Afghanistan is ungovernable. The area, whose terrain resembles the front range of the U.S. Rocky Mountains along a border roughly the distance from Washington to Albuquerque, New Mexico, is home to the international headquarters of al Qaeda as well as much of the Taliban insurgency. However, the absence of a Western-style central government there should not be misconstrued as an absence of governance. The Pashtun tribes along the border have a long history of well-developed religious, social, and tribal structures, and they have developed their own governance and methods of resolving disputes. Today's instability is not the continuation of some ancient condition; it is the direct result of decades of intentional dismantling of those traditional structures, leaving extremist groups to fill the vacuum. Re-empowering local leaders can help return the border region to an acceptable level of stability.

Second, Afghans are not committed xenophobes, obsessed with driving out the coalition, as they did the British and the Soviets. Most Afghans are desperate to have the Taliban cleared from their villages, but they resent being exposed when forces are not left behind to hold what has been cleared. They also cannot understand why the coalition fails to provide the basic services they need. Afghans are not tired of the Western presence; they are frustrated with Western incompetence.

On a recent helicopter flight above the razor-sharp ridges of the Afghan southeast, a U.S. general noted to one of us that, just as the United States had failed to conduct counterinsurgency in Iraq effectively until 2007, it had similarly failed in Afghanistan by focusing too much on the enemy and not enough on providing security for the Afghan people.

It is almost too late. In the next phase of the Afghan war, the U.S. military must finally do what it has often failed to do in the past: follow some of the basic precepts of counterinsurgency, as detailed in the field manual, no matter how paradoxical they may appear.

Paradox 1: Some of the best weapons do not shoot.

1-1. Afghanistan is one of the poorest and least developed countries in the world. Per capita GDP is $350, just one tenth of Iraq's. Life expectancy is 44 years. Nearly three quarters of the population is illiterate. The country has 50 percent more land than Iraq, but a fifth of the paved roads. Security is crucial, but it is development—enabled by responsible governance—that will secure a lasting peace.

1-2. Afghans' greatest concerns, according to polling by the Asia Foundation, are access to electricity, jobs, water, and education. Those who think the country is moving in the right direction can rightly cite instances of successful reconstruction efforts as the primary cause for optimism. For these reasons, security must not be seen simply as a necessary precondition for development efforts. Development often creates security by bolstering people's confidence in their government and providing a positive, tangible alternative to the Taliban. Take the National Solidarity Program. Under this initiative, villages elect a community council to oversee a development project chosen by village vote. Local people contribute a portion of the capital, labor, or materials, and allocated aid funds are distributed transparently. The results of this bottom-up process have been remarkable: Although the Taliban has burned hundreds of schools across Afghanistan, almost no schools built under this program have been destroyed, largely because the Taliban knows it would win no allies by destroying them.

The U.S. general pointed at Afghanistan's ring road from his Black Hawk helicopter and declared, 'Where the road ends, the Taliban begins.'

1-3. Although all development is critical in this impoverished country, roads are the single most important path to success in Afghanistan. In Ghazni province last summer, one of us spoke with an Afghan road builder whose shirt was covered in dried blood. He'd been shot by the Taliban a day earlier for working with the coalition, but he was back the next morning with his paving crew because he thought that finishing that road was the best way to bolster security in his village. Indeed, the U.S. general who was critical of U.S. counterinsurgency efforts in Afghanistan pointed at Afghanistan's ring road from the window of his Black Hawk helicopter, and declared, "Where the road ends, the Taliban begins."

Paradox 2: Sometimes the more you protect your force, the less secure you may be.

2-1. The U.S. military, designed to inflict overwhelming and disproportionate losses on the enemy, tends to equate victory with very few body bags. So does the American public. The new counterinsurgency doctrine upends this perceived immunity from casualties by demanding that manpower replace firepower. Soldiers in Afghanistan must get out among the people, building and staffing joint security stations with Afghan security forces. That is the only way to disconnect the enemy from the civilians. Persistent presence—living among the population in small groups, staying in villages overnight for months at a time—is dangerous, and it will mean more casualties, but it's the only way to protect the population effectively. And it will make U.S. troops more secure in the long run.

2-2. This imperative to get out among the people extends to U.S. civilians as well. U.S. Embassy staff are almost completely forbidden from moving around Kabul on their own. Diplomacy is, of course, about relationships, and rules that discourage relationships fundamentally limit the ability of American diplomats to do their jobs. The mission in Afghanistan is to stabilize the country, not to secure the embassy.

2-3. Counterinsurgency strategy suggests that victory requires 20 to 25 counterinsurgents for every 1,000 residents. Current troop strength in Afghanistan, including Afghan forces, are about a third of that level. The stark alternatives are to deploy more troops or to change the mission.

Paradox 3: The hosts doing something tolerably is often better than foreigners doing it well.

3-1. The United States and its allies cannot remain in Afghanistan indefinitely. Building a capable Afghan security force and a credible Afghan government is the fastest, most responsible exit strategy. U.S. efforts so far have been mixed. An army can only be as good as its government, and the government of President Hamid Karzai has been crippled by corruption and connections to narcotrafficking. His recent decision to replace the much-reviled minister of the interior is a sign that persistent U.S. complaints about poor governance might be getting through. National elections scheduled for this year provide an incentive for the Afghan government to continue to improve, and serve as a major point of leverage for U.S. policy.

3-2. At the end of the day, the coalition's performance is less important than how well the Afghans themselves perform. Every coalition decision and every operation should be guided by two questions: Does this further the legitimacy of the Afghan government? And is that government deserving of our support? As tribal elders in Ghazni province recently said, they feel "slapped on one cheek by the government, and on the other cheek by the Taliban." The United States can and should take the lead in training Afghan soldiers and bureaucrats to be more effective, but even this task is not being given the commitment it deserves. Currently, the U.S. teams advising the Afghan Army are staffed at just half their authorized strength; the police mentor teams are manned at barely a third of the necessary staff. The low priority assigned to this keystone of any successful counterinsurgency strategy is an unacceptable flaw of U.S. policy to date.

Paradox 4: Sometimes the more force is used, the less effective it is.

4-1. In 2005, the coalition conducted 176 close air support missions (in which aircraft conduct bombing or strafing in support of ground troops) in Afghanistan. In 2007, it completed 3,572 such missions. Bombs—even "smart" bombs—are blunt instruments, and they inevitably kill people other than their intended targets. Each civilian death at the hands of the coalition further diminishes the finite amount of goodwill toward the United States among the Afghan people. Each civilian death undermines the legitimacy of the Afghan government the United States seeks to support. Each civilian death, when refracted through the Taliban's propaganda campaign, strengthens the narrative of America's enemies.

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4-2. If military units commit to using less force, then it is imperative that others on the battlefield, particularly civilian security contractors, do the same. One of us had a nightmarish experience recently while riding in a convoy protected by Afghan security contractors on a dark highway near Jalalabad. We repeatedly hurtled through national police checkpoints without stopping and finally crashed into a stopped minibus filled with people. The momentum of our heavily armored SUV threw the bus off the roadway, but the guards refused our orders to stop and help, citing fears of ambush. Afghan civilians do not distinguish between excessive force used by soldiers and excessive force used by contractors. In a war where perception creates reality, we all suffer the consequences.

Paradox 5: Sometimes doing nothing is the best reaction.

5-1. Cross-border raids into Pakistan to pursue insurgents have strained U.S. relations with Pakistan at this critical juncture in the Afghan campaign. Pakistan is, of course, inextricably connected to the Afghan insurgency. The Pashtun belt, as the border area between the two countries is known, constitutes the real battleground in this war. Counterinsurgency operations in Pakistan, therefore, are a necessary component of any strategy in Afghanistan. Without Pakistani support, however, unilateral cross-border raids will create more blowback than they are worth.

5-2. A better strategy for persuading Pakistan to act as an ally—and not a spoiler—in Afghanistan involves giving up the short-term tactical gains of such raids in favor of the regional diplomacy necessary to broaden and deepen the U.S.-Pakistan relationship. Even after Islamist extremists bombed the Marriott Hotel in Islamabad in September in an attempt to assassinate the new civilian leadership of Pakistan, the Pakistani Army remains more focused on the perceived threat from India than on the actual threat from inside its own country's borders. U.S. and international efforts to broker confidence-building measures between India and Pakistan are likely to have a far greater impact on Pakistani counterinsurgency efforts than any number of unilateral U.S. raids.

5-3. More U.S. troops are absolutely necessary to turn the tide in Afghanistan, but American troops are a short-term answer to a lasting set of problems. Supporting Afghan and Pakistani governments that can meet the needs of their own people—including security—must be the long-term solution. The paradoxes of counterinsurgency detailed here, counterintuitive though they may be, provide the best guideposts on the rocky trail toward success. It will not be the death or capture of every last enemy fighter that wins this war, but creating a position of strength from which to negotiate a lasting political solution to a cycle of conflict with no other end in sight. FP

[Want to Know More?]

Nathaniel Fick's ***One Bullet Away: The Making of a Marine Officer*** (Boston: Houghton Mifflin, 2005) offers an account of the wars in Iraq and Afghanistan from a soldier's perspective. In **"Knowing the Enemy"** (*The New Yorker*, Dec. 18, 2006), George Packer wonders how social sciences will transform the U.S. military's counterinsurgency strategies.

Steve Coll explains Afghanistan's struggles in the run-up to 9/11 in ***Ghost Wars*** (New York: Penguin Press, 2004). In **"Taliban Propaganda: Winning the War on Words?"** (Brussels: July 24, 2008), the International Crisis Group warns that the Taliban has adeptly manipulated public opinion against the Afghan government. Linda Robinson explains which lessons of Iraq should be applied to Afghanistan—and which should be left behind—in **"What Petraeus Understands"** (ForeignPolicy.com, September 2008).

The General's Next War

The FP Interview with Gen. David H. Petraeus

As America's most famous warrior-scholar looks to export his Big Ideas about fighting wars from Iraq to the arguably even tougher battlefield of Afghanistan, FP*'s executive editor, Susan Glasser, spoke with him in the Pentagon days after he took over his new command.*

Gen. David Petraeus: In looking at which lessons learned in Iraq might be applicable in Afghanistan, it is important to remember a key principle of counterinsurgency operations: Every case is unique. That is certainly true of Afghanistan (just as it was true, of course, in Iraq). While general concepts that proved important in Iraq may be applicable in Afghanistan—concepts such as the importance of securing and serving the population and the necessity of living among the people to secure them—the application of those 'big ideas' has to be adapted to Afghanistan. The 'operationalization' will inevitably be different, as Afghanistan has a very different history and very different 'muscle memory' in terms of central governance (or lack thereof). It also lacks the natural resources that Iraq has and is more rural. It has very different (and quite extreme) terrain and weather. And it has a smaller amount of educated human capital, due to higher rates of illiteracy, as well as substantial unemployment, an economy whose biggest cash export is illegal, and significant challenges of corruption. Finally, it lacks sufficient levels of basic services like electricity, drinking water, and education—though there has been progress in a number of these areas and many others since 2001.

One cannot adequately address the challenges in Afghanistan without adding Pakistan into the equation. In fact, those seeking to help Afghanistan and Pakistan need to widen the aperture even farther, to encompass at least the Central Asian states, India, Iran, and even China and Russia.

FP: Defense Secretary Robert Gates has said that U.S. efforts in Afghanistan were really on the verge of failure. What's your incoming assessment?

DP: I told [then] Secretary Donald Rumsfeld in September 2005 that Afghanistan would be the longest campaign in the so-called 'long war.' That judgment was based on an assessment I conducted in Afghanistan on my way home from my second tour in Iraq. And having been back to Afghanistan twice in recent months, I still see it that way. Progress there will require a sustained, substantial commitment. That commitment needs to be extended to Pakistan as well, though Pakistan does have large, well-developed security institutions and its leaders are determined to employ their own forces in dealing with the significant extremist challenges that threaten their country.

FP: I was rereading an account of an Afghan veteran from Soviet operations there. After every retaliatory strike, he said, 'Perhaps one mujahideen was killed. The rest were innocent. The survivors hated us and lived with only one idea—revenge.' Clearly [U.S.] engagement in Afghanistan didn't start out in the same way as the Soviets' did, but one of the questions is whether all these occupations wind up similarly after seven years.

DP: A number of people have pointed out the substantial differences between the character of Soviet involvement in Afghanistan and that of the coalition forces in Afghanistan, especially in the circumstances that led to the respective involvement, as well as in the relative conduct, of the forces there. Foremost among the differences have been the coalition's objectives: not just the desire to help the Afghans establish security and preclude establishment of extremist safe havens, but also to support economic development, democratic institutions, the rule of law, infrastructure, and education. To be sure, the coalition faces some of the same challenges that any of the previous forces in Afghanistan have faced: the same extreme terrain and weather, tribal elements

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that pride themselves on fighting, lack of infrastructure, and so on. In such a situation, it is hugely important to be seen as serving the population, in addition to securing it. And that is why we're conducting counterinsurgency operations, as opposed to merely counterterrorism operations.

FP: Tell me where you see lessons from Iraq that might not apply in Afghanistan, and things that you will export.

DP: We cannot just take the tactics, techniques, and procedures that worked in Iraq and employ them in Afghanistan. How, for example, do you communicate with the Afghan people? The answer: very differently than the way you communicate with the Iraqi people, given the much lower number of televisions and a rate of illiteracy in the Afghan provinces that runs as high as 70 to 80 percent. Outside Kabul and other big Afghan cities, Afghans don't watch much television; they don't have televisions. In Iraq, one flies over fairly remote areas and still sees satellite dishes on many roofs. In Afghanistan, you not only won't see satellite dishes; you also won't see electrical lines, and you may not even find a radio. Moreover, you can't achieve the same effect with leaflets or local newspapers because many Afghans can't read them. So, how do you communicate with them? The answer is, through tribal elders, via hand-crank radios receiving transmissions from local radio stations, through shura councils, and so on.

FP: What people most want to know, of course, is: Where does this end? The counterinsurgency principles, your own statements in the past, have focused on the idea that such wars end with political solutions—you don't kill your way out of it.

DP: One of the concepts we embraced in Iraq was recognition that you can't kill or capture your way out of a complex, industrial-strength insurgency. The challenge in Afghanistan, as it was in Iraq, is to figure out how to reduce substantially the numbers of those who have to be killed or captured. This includes creating the conditions in which one can have successful reconciliation with some of the elements fighting us. Progress in reconciliation is most likely when you are in a position of strength and when there are persuasive reasons for groups to shift from being part of the problem to becoming part of the solution. In Iraq, that was aided by gradual recognition that al Qaeda brought nothing but indiscriminate violence, oppressive practices, and an extremist ideology to which the people really didn't subscribe. Beyond that, incentives were created to persuade the insurgents that it made more sense to support the new Iraq.

The challenge in Afghanistan, of course, is figuring out how to create the conditions that enable reconciliation, recognizing that these likely will differ somewhat from those created in Iraq.

FP: Do you think that does involve speaking with warlords, people like [Gulbuddin] Hekmatyar, who up to now have been absolute non-starters?

DP: Any such outreach has to be an Afghan initiative, not the coalition's. In Iraq, frankly, it was necessary for the coalition to take the lead in some areas where there was no Iraqi government or security presence.

FP: Do you think there is something qualitatively or quantitatively new and different about the insurgencies that U.S. forces have encountered in Iraq and Afghanistan?

DP: We looked at this issue closely when we were drafting the counterinsurgency manual. And we concluded that some aspects of contemporary extremist tactics are, indeed, new. If you look, as we did, at what [French military officer] David Galula faced in Algeria, you find, obviously, that he and his colleagues did not have to deal with a transnational extremist network enabled by access to the Internet. Today, extremist media cells recruit, exhort, train, share expertise, and generate resources in cyberspace. The incidence of very lethal suicide bombers and massive car bombs is vastly higher today. It seems as if suicide car bombs have become the precision-guided munition of modern insurgents and extremists. And while there has been a religious component in many insurgencies, the extremist nature of the particular enemy we face seems unprecedented in recent memory.

FP: The counterinsurgency manual, an object of huge praise, is seen as a key moment in the rethink that put the war in Iraq on a different course. But it has not been uncontroversial. There are people on the left who see it as a form of neocolonialism; conservatives are skeptical of anything they see as nation-building, while others believe that by organizing to fight this kind of war, the United States risks not being prepared for a more conventional conflict in the future. How much of an intellectual debate have these principles stirred up? What do you say to these critics?

DP: It's important to recognize the most important overarching doctrinal concept that our Army, in particular, has adopted—the concept of 'full spectrum operations.' This concept holds that all military operations are some mix of offensive, defensive, and stability and support operations. In other words, you've always got to be thinking not just about the conventional forms of combat—offensive and defensive operations—but also about the stability and support component. Otherwise, successes in conventional combat may be undermined by unpreparedness for the operations often required in their wake.

The debate about this has been a healthy one, but we have to be wary of arguments that imply we have to choose—or should choose—between either stability-operations-focused or conventional-combat-focused training and forces. It is not only possible to be prepared for some mix; it is necessary.

We should avoid notions that we can pick and choose the wars in which we want to be involved.

A wonderful essay that I read as a graduate student captures the essence of my view on this. The essay discussed the different schools of international relations theory, and it concluded that 'the truth is not to be found in any one of these schools of thought, but rather in the debate among them.' That is probably the case in this particular discussion. We would do well to avoid notions that we can pick and choose the kinds of wars in which we want to be involved and prepare only for them.

FP: You said [that] even in 2005 when you were in Afghanistan, you reported to Secretary Rumsfeld that this could be the longest part of the long war.

DP: I didn't say it could be. I said it would be. My assessment was that Afghanistan was going to be the longest campaign of the long war. And I think that assessment has been confirmed by events in Afghanistan in recent months.

FP: Just how long did you have in mind?

DP: Those are predictions one doesn't hazard. FP

The Making of George W. Obama

The 2008 U.S. election was all about change. But that's not what we're going to get on foreign policy, says the longtime speechwriter for Condoleezza Rice. Instead of a radical departure from Bush, we're likely to end up with a lot more of the same. And that may be just what we need. | **By Christian Brose**

On December 1, Barack Obama, who won the U.S. presidency as the candidate of "change," announced his national security team: President George W. Bush's secretary of defense (Robert Gates), Secretary of State Condoleezza Rice's special envoy for Middle East security (James Jones), and the doyenne of Democratic centrism (Hillary Clinton). Some saw this as the political cover Obama needs to lead U.S. foreign policy in an entirely different direction after Bush. Perhaps. But I doubt it. My hunch, and my hope, is that Obama will be a successful president, not because he'll totally change the foreign policy he'll inherit from Bush, but because he'll largely continue it.

Until just a few weeks ago, I was a part of that foreign policy. As Rice's chief speechwriter and policy advisor, I traveled with her to 24 countries. And I helped write (and rewrite) her remarks—a body of work I'd estimate to be north of 150,000 carefully chosen words. For four years, I watched as a foreign policy took shape that was quite different from that of Bush's first term. It was a pragmatic internationalism based on enduring national interests and ideals for a country whose global leadership is still indispensable, even as the world is becoming more multipolar.

Unfortunately, the election didn't shed much light on what this inheritance means for Obama. The campaign was a two-year referendum on the Bush presidency in which Obama ran against a caricature of Bush's first term and John McCain ran desperately away from the whole thing. It was as if the past four years never happened.

But because they did, Obama will inherit a foreign policy that is better than many realize. Yes, there will be changes ahead—most likely, to energy and climate change policy (thankfully), to the war in Iraq (winding it down), to the war in Afghanistan (winding it up), and to the detention facility at Guantánamo Bay, Cuba (closing it, which some in the Bush administration tried to do but couldn't). But despite all that, Obama's foreign policy likely won't depart radically from Bush's.

Take the three states Bush once labeled an "axis of evil"—Iran, Iraq, and North Korea. After changing the

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regime in Baghdad, his administration in the second term fully committed to changing the behavior of Pyongyang and Tehran. As a result, Obama will receive the baton on a multilateral negotiation with North Korea that has been and will be a frustrating marathon, but he will likely pick up where Bush leaves off, simply because there are no practical alternatives. On Iran, Obama will almost surely proceed with Bush's policy of sticks and carrots that seeks a diplomatic solution—a third option between acquiescing to Iran's behavior or attacking Iran to change it. To have a better chance of success, this policy will need sharper sticks and sweeter carrots, including the direct engagement Obama has advocated. And if that fails, Obama will have to weigh his options—none of which, he has said, he's taking off the table.

As for Iraq, Obama will inherit a war that Iraqis themselves are mostly ending for him. The pace and size of the U.S. troop reduction may be hotly debated, but few in Baghdad or Washington dispute that such a withdrawal is now appropriate. This effort to end the war in Iraq will enable Obama to try to save the war in Afghanistan, employing many of the lessons learned from the surge strategy he opposed in Iraq.

A challenge for Obama will be to knit the Iraq endgame into a broader approach to the Middle East. But here, too, it likely won't look all that different from Bush's: support for an independent Lebanon; attempts to elicit responsible behavior from Syria; and security cooperation with Sunni Arab regimes that may not love freedom, but definitely hate what Iran, and al Qaeda, are doing to the region.

Another part of this strategy for Obama is continuing Bush's engagement on the Middle East peace process. A real insight of Bush's first term had been that the Israeli-Palestinian conflict was more than a border dispute, as Bill Clinton had framed it. Bush argued that peace required a successful Palestinian state and economy. But the first-term policy amounted to telling the Palestinians to put their house in order first, and then the United States would talk about ending the Israeli occupation. Only in the second term were both efforts pursued simultaneously. And because of it, Obama will inherit a Middle East peace process finally proceeding on both tracks at once: state-building and peacemaking.

Just as importantly, Obama will find a changing Middle East where freedom, opportunity, and the longing for dignity are bubbling up in ways that no one can control, Washington included. Something tells me that the leader of the Democratic Party isn't going to give up on supporting democracy, both in terms of institutions and elections. Obama may rebrand Bush's poorly named "freedom agenda"—he may expand it, as some of his advisors suggest, into a "dignity agenda"—but the basic approach will likely continue.

Regime change: As the reins of power pass to Obama, don't expect a major shift in U.S. foreign policy.

JIM WATSON/AFP/GETTY IMAGES

So, too, will there be little change on issues of global grand strategy. A refrain from the campaign was rebuilding damaged ties with America's allies. But those ties have largely been rebuilt already—in Asia, Europe, and Latin America. Obama can certainly improve these relations further, especially with real action on climate change. But another challenge may be managing the bubbles of overinflated expectations for his presidency that will soon begin bursting in allied capitals.

Bush will also bequeath to Obama a realistic strategy for managing the rise of great powers. By pushing China, India, Japan, Brazil, and others to be responsible stakeholders in the international order, the Bush administration showed that "the rise of the rest" need not be synonymous with America's decline. In fact, it might actually enhance U.S. influence. In Asia, the most geopolitically dynamic part of the world, the United States now has better relations with each major power than they do with one another.

Every state wants to hedge against the others, and the partner of choice is Washington. Obama's task will be to continue inducing these emerging powers to share a greater burden of managing a new set of global challenges that no country, including the United States, can manage alone.

The asterisk here is less a rising China (though the question is still open) than a resurgent Russia. And with Russia, too, Obama will inherit a strategy that he's likely to continue, simply because it's better than the alternatives. It seeks neither to isolate Russia (which is impossible) nor to give Russia the blank check it wants in its old imperial stomping grounds (which is irresponsible). Rather, this policy seeks to balance cooperation with Russia on many shared interests with competition when interests diverge. Maybe this balance could have been struck better on issues such as Kosovo or missile defense, but that doesn't signal the need for a new policy, just a recalibration of the current one. And if anything, the Georgia war showed that, if the United States wants Russia to be a responsible stakeholder, encouragement won't be enough.

There will even likely be a great deal of continuity in the fight against al Qaeda. There's a consensus now that preemption is necessary to fight terrorism; Obama himself has advocated for it. But in Bush's second term, the administration basically converged on a new mantra: "We can't kill our way to victory," a key tenet of counterinsurgency strategy. The focus became not just fighting terrorists but building conditions of security, opportunity, and justice for the societies that terrorists seek to radicalize. It was even accepted that the United States might have to reconcile with some terrorists, as it did in Iraq and as some now support doing in Afghanistan. Obama most likely—and correctly—will not refer to a "war on terror" as the organizing principle of U.S. foreign policy, but that doesn't mean he won't approach terrorism in much the same way.

Such a strategy depends, as the Bush administration eventually conceded, on embracing nation-building as a national interest. There is now a consensus that the United States is threatened as much by failing and poorly governed states as strong, aggressive ones. Obama's challenge will be to continue the Bush administration's effort to make nation-building a civilian-led effort—to demilitarize U.S. foreign policy by trying to prevent states from failing in the first place. This effort will require a transformation of U.S. institutions of "soft power"—a goal that former Secretary of State Colin Powell, then Rice, and most famously Gates made into a personal crusade. Obama will inherit the start of it—an enlarged diplomatic corps, a rudimentary civilian expeditionary force, and foreign assistance that has been increased more than at any time since the Marshall Plan—and he looks poised to carry the torch.

The pragmatic internationalism that Bush will pass to Obama was largely defined through changes made during the past four years. And for that reason, there might be more continuity between the second term of Bush and the first term of Obama than between the two terms of Bush himself. This foreign policy is a valuable inheritance. And if Obama avoids spending his early years in office pursuing change for the sake of change—simply trying to disassociate himself from his predecessor, as Clinton and Bush too often did—he could create the makings of a new bipartisan consensus on foreign policy.

There might be more continuity between the second term of Bush and the first term of Obama than between the two terms of Bush himself.

Obama might realize this, but the Democratic and Republican parties, I fear, will not. They could each pretend as if Bush's second-term foreign policy never happened. At worst, Democrats could swagger righteously into power, believing their predecessors were rubes who screwed everything up, and now is the chance to do everything differently. For their part, Republicans could tell themselves the comforting lie that they lost because Bush abandoned a real conservative foreign policy—that his second term was all capitulation to the striped-pants appeasers of the State Department.

One of my regrets about my work at the State Department is that we were unable to convince the American people that Bush's pragmatic internationalism had within it the makings of a strong, sustainable global leadership for the 21st century—and that, as such, it had the potential to heal some of the fraught divisions over America's role in the world that have plagued the country since the end of the Cold War. My hope is that Obama will not only continue this foreign policy, but strengthen it and expand support for it among all Americans. Were he able to do that, it would truly be a change I could believe in. FP

The Other Housing Crisis

Why can't Israel and the Palestinians make peace? There are many complicated reasons, but the facts on the ground point to a simple answer: It's the settlements, stupid. | **By Gershom Gorenberg**

Each time I drive out of Jerusalem into the West Bank, it strikes me: The hills are changing. Israeli settlements are redrawing the landscape—daily, insistently. While governments change, while diplomatic conversations murmur on and stop and begin again, the bulldozers and cranes continue their work.

From my home in West Jerusalem, the road that Israelis use to head south toward Hebron runs through two tunnels in the mountains. Known simply as the Tunnel Road, it was built in the mid-1990s during the Oslo peace process, when Bethlehem was turned over to Palestinian rule and Israelis wanted a way to bypass the town on their way to settlements that remained in Israeli hands.

A turn from the Tunnel Road takes you past the Palestinian village of Hussan to Beitar Illit, a settlement covering two hills. The streets are lined with apartment buildings, faced in rough-cut, yellowish-white stone, all with red-tile roofs, so alike they could have been turned out by the same factory. In 1993, when Yitzhak Rabin and Yasir Arafat shook hands and peace seemed close enough to touch, about 4,000 people lived in Beitar Illit. Now, 34,000 live here, and more will soon move in.

The message written on the landscape is simple: Every day, the settlements expand. Every day, Israel grows more entangled in the West Bank. To a large degree, the Israeli and Palestinian publics have accepted the need for a two-state solution. But time, and the construction crews, are working against it. No one knows exactly where the point of no return is—when so many Israelis will have moved into so many homes beyond the pre-1967 border that there is no going back. But each passing day brings that tipping point nearer. If a solution is not achieved quickly, it might soon be out of reach.

The failure of slow-motion diplomacy can be told in numbers. In 1993, when the Oslo process began, 116,000 Israelis lived in the Gaza Strip and the West Bank (excluding Israeli-annexed East Jerusalem). Seven years later, when negotiations collapsed, the settler population had risen to 198,000.

Watching this steady march, Ehud Olmert, then Ariel Sharon's deputy prime minister, stunned Israelis in late 2003 by renouncing his lifelong commitment to keeping Gaza and the West Bank under Israeli rule.

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HOWARD DAVIES/CORBIS

"We are approaching a point where more and more Palestinians will say: 'There is no place for two states between the Jordan and the sea,'" he warned. Instead, he said, they would demand equal rights in a single, shared political entity—one person, one vote. The only way to preserve a Jewish state was to withdraw, he argued. By then, according to the Israeli Interior Ministry, there were 236,000 settlers.

Olmert's declaration presaged Sharon's decision to withdraw from Gaza. In 2006, Olmert was elected prime minister. Despite the Gaza evacuation, the settler population was then more than 253,000.

Last year, when Olmert resigned and elections were announced, the number of settlers in the West Bank had passed 290,000, living alongside 2.2 million Palestinians. (Another 187,000 Israelis lived in annexed East Jerusalem, next to 247,000 Palestinians.) By the time the next prime minister takes office, more than 300,000 Israelis are likely to be living in the West Bank, with the number continuing to climb.

Why do the settlements keep growing? In part, because it has been hard for Israelis to accept the pre-1967 borders. Successive leaders have hoped to hold onto significant pieces of the territory seized in the Six Day War. Olmert, despite his warning in 2003, came to office seeking a border that would roughly follow the security barrier that Israel is building through the West Bank. Officially intended to keep Palestinian suicide bombers out of Israel, the barrier loops around clusters of large suburban settlements, putting places such as Beitar Illit on the Israeli side of the de facto border. While negotiating with the Palestinians, Olmert encouraged building in settlements inside the fence.

But building has also continued in smaller settlements beyond the fence—the strongholds of the settlers most committed to permanent Israeli rule of the West Bank. They have taken the initiative in expanding their communities. But they also enjoy backing from within the civil service. The Housing Ministry, for instance, still provides subsidized mortgages for homes in such settlements. An entrenched bureaucratic culture trumps orders from the top.

Olmert lacked the strength to crack down on that bureaucracy or risk confrontation with the settlers. Of his potential successors, Benjamin Netanyahu is the candidate of the pro-settlement right, and Tzipi Livni, the candidate of Olmert's Kadima Party, has shown no signs that she is willing or able to stop the building in the absence of a peace deal.

The settlers' growing power makes it harder for any Israeli leader to act. The head of the Shin Bet security agency recently described "very high willingness" among settlers "to use violence—not just stones, but live weapons—in order to prevent or halt a diplomatic process." He was articulating a country's half-spoken fears: Withdrawal involves more than the social and financial costs of moving hundreds of thousands of people. It poses the danger of civil conflict, of battles pitting Jews against Jews.

The more settlers, the greater the danger. The longer the wait, the more settlers. The more settlers, the more hesitant politicians are to talk about evacuating them, much less do anything else about them. It's anybody's guess where the point of no return lies.

No one knows knows exactly where the point of no return is—when so many Israelis have moved into the West Bank that there is no going back.

But there are no good alternatives to pulling back. Olmert's plan to redraw the borders, with fingers of Israeli land extending to major settlements, would slice up Palestinian territory, while the smaller, more radical settlements would need to be evacuated. Some observers still cling to a one-state solution—a fantasy held by those who believe that nationalism is about to fade away. Such a state would teeter between communal violence and mere political deadlock as Jews and Palestinians would try and fail to form a stable government.

So, time is in short supply. As U.S. President Barack Obama enters office, he might be tempted to put off dealing with the Israeli-Palestinian conflict. But delay may mean finding the road to a solution closed. The alternative is to exert pressure on the Israeli government to freeze settlement—and then move quickly toward a final-status agreement.

Of course, the greatest responsibility falls on Israeli leaders. The next prime minister will have the choice of learning from Olmert's unfulfilled pledge or repeating his failure to act. If Israel is to withdraw from the West Bank, the essential first step is to order an immediate stop to settlement construction. Confronting the settlers will require great courage. Yet failing to do so risks Israel's existence as a Jewish state. That's the lesson written on the hills. FP


THE UNITED STATES OF AMERICA

Five economists whose prophetic warnings went unheeded preview the next stage of the global financial crisis. They tell us:

THE WORST IS YET TO COME

ILLUSTRATIONS BY NENAD JAKESEVIC FOR *FP*

NOURIEL ROUBINI

Warning: More Doom Ahead

Last year's worst-case scenarios came true. The global financial pandemic that I and others had warned about is now upon us. But we are still only in the early stages of this crisis. My predictions for the coming year, unfortunately, are even more dire: The bubbles, and there were many, have only begun to burst.

The prevailing conventional wisdom holds that prices of many risky financial assets have fallen so much that we are at the bottom. Although it's true that these assets have fallen sharply from their peaks of late 2007, they will likely fall further still. In the next few months, the macroeconomic news in the United States and around the world will be much worse than most expect. Corporate earnings reports will shock any equity analysts who are still deluding themselves that the economic contraction will be mild and short.

Nouriel Roubini is professor of economics at New York University's Stern School of Business and chairman of RGE Monitor (www.rgemonitor.com), an economic and financial consultancy.

Severe vulnerabilities remain in financial markets: a credit crunch that will get worse before it gets any better; deleveraging that continues as hedge funds and other leveraged players are forced to sell assets into illiquid and distressed markets, thus leading to cascading falls in asset prices, margin calls, and further deleveraging; other financial institutions going bust; a few emerging-market economies entering a full-blown financial crisis, and some at risk of defaulting on their sovereign debt.

Certainly, the United States will experience its worst recession in decades. The formerly mainstream notion that the U.S. contraction would be short and shallow—a V-shaped recession with a quick recovery like the ones in 1990–91 and 2001—is out the window. Instead, the U.S. contraction will be U-shaped: long, deep, and lasting about 24 months. It could end up being even longer, an L-shaped, multiyear stagnation, like the one Japan suffered in the 1990s.

As the U.S. economy shrinks, the entire global economy will go into recession. In Europe, Canada, Japan, and the other advanced economies, it will be

> **"Because the United States is such a huge part of the global economy, there's real reason to worry that an American financial virus could mark the beginning of a global economic contagion."** *– Nouriel Roubini, March 2008*

severe. Nor will emerging-market economies—linked to the developed world by trade in goods, finance, and currency—escape real pain.

What constitutes a "recession" will depend on the country in question. For China, a hard landing would mean annual growth falls from 12 to 6 percent. China must grow by 10 percent or more each year to bring 12 to 15 million poor rural farmers into the modern world. For other emerging markets, such as Brazil or South Korea, growth below 3 percent would represent a hard landing. The most vulnerable countries, such as Ecuador, Hungary, Latvia, Pakistan, or Ukraine may experience an outright financial crisis and will require massive external financing to avoid a meltdown.

For the wealthiest countries, a debilitating combination of economic stagnation and deflation might happen as markets for goods go slack because aggregate demand falls. Given how sharply production capacity has risen due to overinvestment in China and other emerging markets, this drop in demand would likely lead to lower inflation. Meanwhile, job losses would mount and unemployment rates would rise, putting downward pressure on wages. Weakening commodity markets—where prices have already fallen sharply since their summer peak and will fall further in a global recession—would lead to still lower inflation. Indeed, by early 2009, inflation in the advanced economies could fall toward the 1 percent level, too close to deflation for comfort.

This scenario is dangerous for many reasons. A number of central banks will be close enough to setting interest rates of zero that their economies fall into a triple whammy: a liquidity trap, a deflation trap, and debt deflation. In a liquidity trap, the banks lose their ability to stimulate the economy because they cannot set nominal interest rates below zero. In a deflation trap, falling prices mean that real interest rates are relatively high, choking off consumption and investment. This leads to a vicious circle wherein incomes and jobs are falling, with demand dropping still further. Finally, in debt deflation, the real value of nominal debts rises as prices fall—bad news for countries such as the United States and Japan that have high ratios of debt to GDP.

As orthodox monetary tools become ineffective, policymakers will turn to unorthodox approaches. We'll see traditional fiscal policy, in the form of tax cuts and spending increases, but also worldwide bailouts of lenders, investors, and financial institutions, as well as borrowers. Central banks will inject massive amounts of cash into financial systems to unclog the liquidity crunch. More radical actions, such as outright purchases of corporate and government bonds or subsidization of mortgage rates, might also be necessary to get credit markets functioning properly again.

This crisis is not merely the result of the U.S. housing bubble's bursting or the collapse of the United States' subprime mortgage sector. The credit excesses that created this disaster were global. There were many bubbles, and they extended beyond housing in many countries to commercial real estate mortgages and loans, to credit cards, auto loans, and student loans. There were bubbles for the securitized products that converted these loans and mortgages into complex, toxic, and destructive financial instruments. And there were still more bubbles for local government borrowing, leveraged buyouts, hedge funds, commercial and industrial loans, corporate bonds, commodities, and credit-default swaps—a dangerous unregulated market wherein up to $60 trillion of nominal protection was sold against an outstanding stock of corporate bonds of just $6 trillion.

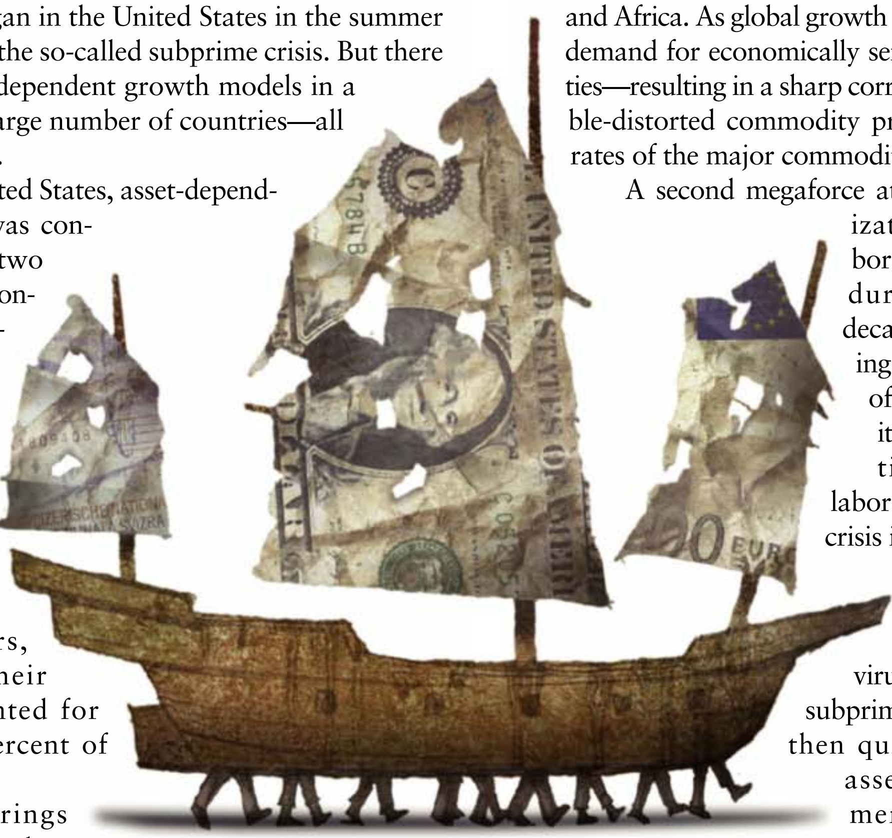
Taken together, these amounted to the biggest asset and credit bubble in human history; as it goes bust, the overall credit losses could reach as high as $2 trillion. Unless governments move with more alacrity to recapitalize banks and other financial institutions, the credit crunch will become even more severe. Losses will mount faster than companies can replenish their balance sheets.

Thanks to the radical actions of the G-7 and others, the risk of a total systemic financial meltdown has been reduced. But unfortunately, the worst is not behind us. This will be a painful year. Only very aggressive, coordinated, and effective action by policymakers will ensure that 2010 will not be even worse than 2009 is likely to be.

STEPHEN S. ROACH

A Lethal Shakeout

Before the year is over, no major region of the world will remain unscathed by recession. Indeed, I suspect that 2009 will go down in history as the first truly global recession of the modern economy.



Yes, it began in the United States in the summer of 2007 with the so-called subprime crisis. But there were bubble-dependent growth models in a surprisingly large number of countries—all now bursting.

In the United States, asset-dependent growth was concentrated in two parts of the economy: homebuilding activity and personal consumption. Sustained weakness is now likely in both sectors, which at their peak accounted for nearly 80 percent of U.S. GDP.

That brings export-dependent Asian economies into the equation. In effect, they were driven by export bubbles, which, in turn, were a levered play on the U.S. consumption bubble. Asia was also aided and abetted by sharply undervalued currencies. And to keep their currencies cheap, countries such as China had to recycle massive amounts of foreign exchange reserves into dollar-based assets—suppressing U.S. interest rates and sustaining the very asset and credit bubbles that fueled a bubble-dependent U.S. economy. That virtuous circle has now been broken. And because Asian economies lack vigorous support from internal private consumption, regional growth risks have tipped decisively to the downside.

A similar verdict is likely for the commodity-producing regions of the world—not just the oil-dependent Middle East, but also the resource-intensive economies of Australia, Canada, Brazil, Russia, and Africa. As global growth slows, so does the demand for economically sensitive commodities—resulting in a sharp correction in the bubble-distorted commodity prices and growth rates of the major commodity producers.

A second megaforce at work is globalization—the cross-border linkages that during the past decade have increasingly taken the form of trade flows, capital flows, information flows, and labor flows. The credit crisis itself is essentially a powerful cross-product contagion—a virus that began with subprime mortgages but then quickly spread to asset-backed commercial paper, mortgage-backed and auction-rate securities, and other instruments throughout the credit markets. But because financial engineers were so adept at distributing the complex products they created, there is a critical cross-border dimension to this crisis as well. Little wonder this is the worst financial crisis in 75 years.

Driven by the confluence of post-bubble shakeouts and increasingly robust global linkages, this recession is likely to be the worst of the post-World War II era. That means it could be more severe than

Stephen S. Roach is chairman of Morgan Stanley Asia.

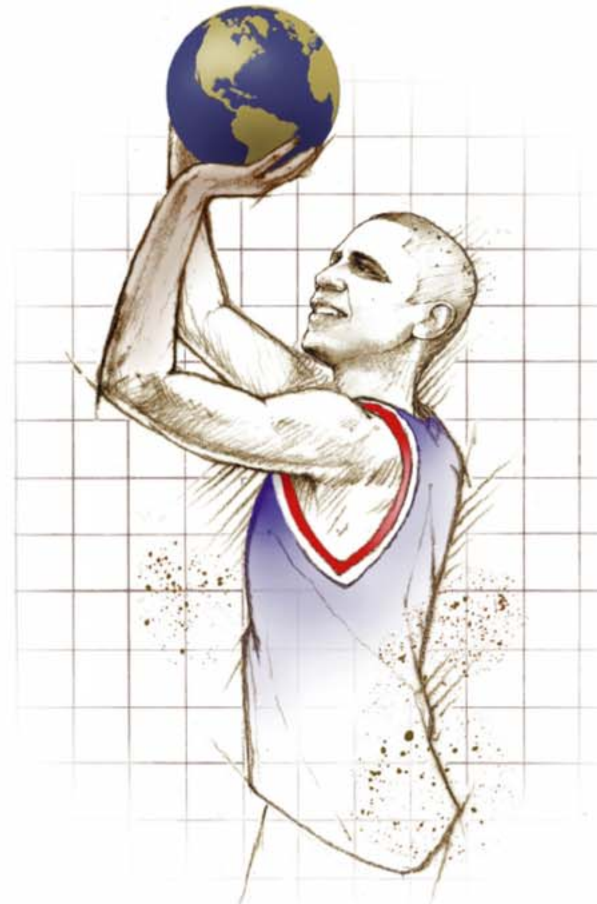
> **"If, as I suspect, the American consumer now enters a sustained slowdown, there will be unmistakable reverberations on U.S.-centric export flows in many major regions of the world."** *– Stephen S. Roach, October 2006*

the sharp downturns of the mid-1970s and early 1980s. Back then, it was the aggressive anti-inflation resolve of central banks that led to deep recessions. This time, an implosion of bubble-dependent global imbalances has done the trick.

But don't count on a vigorous (V-shaped) rebound from the post-bubble global recession of 2009. With no other major consumer likely to step up and fill the void left by the United States, a lopsided, bubble-distorted world will experience an anemic recovery at best. It will be a long time before global growth returns to the nearly 5 percent rate of the four and a half years that ended in mid-2007. Post-bubble shakeouts are lethal for any individual economy—to say nothing for the world as a whole.

DAVID M. SMICK

Good Luck, Barack



Barack Obama arrives at the White House with an ambitious agenda. But with the global economy in the midst of a brutal financial deleveraging—in which virtually every asset in the world is seeing its value decline—he and his international counterparts are in for a world of pain.

Begin with U.S. domestic policy. Obama's first budget deficit could easily exceed $1.5 trillion. Various bailout packages and fiscal stimulus plans will push up spending, while the economic contraction will lead to lower tax receipts. State governments are lining up for federal aid. Private pension funds will be next. The FDIC, dealing with the mortgage mess, will no doubt need a healthy injection of capital from Uncle Sam. And that's before you tally up Obama's spending and tax cut promises.

The bill for all this debt will likely come due before 2012. Mortgage interest rates quickly rose after the U.S. Treasury introduced its bailout plan, and the Federal Reserve's balance sheet liabilities have jumped 100 percent. Financial markets are essentially projecting that three to four years from now, the world's central banks, after a period of disinflation, will be forced to confront this massive increase in debt.

Obama could be confronting a banking nightmare reminiscent of Japan in the 1990s. Today, U.S. banks are flush with capital ($400 billion on the sidelines at last count, much of it taxpayer-provided), but they aren't lending. It's a bit of a chicken-and-egg problem. The banks aren't lending because of the weakening U.S. economy. The economy is weakening because the banks aren't lending. Short of nationalization, Obama can do little to force their hand.

David M. Smick is editor of The International Economy *magazine and author of* The World Is Curved: Hidden Dangers to the Global Economy *(New York: Penguin, 2008).*

"The size of the financial markets ... has become so monstrously huge, there is no other means of maintaining stability than to establish a psychology of confidence. The governments themselves can only project to the markets a sense they know what they're doing." *– David M. Smick, March 2008*

> “I am worried that the collapse of home prices might turn out to be the most severe since the Great Depression.” *– Robert J. Shiller, September 2007*

Globally, the brief period of schadenfreude toward the United States' economic woes is over. That's because Europe's exposure to risky, emerging-market trade debt turns out to be six times its exposure to U.S. subprime mortgages. In some economies, including Britain's, banks' exposure dwarfs the national GDP.

Here's why this is a huge problem: Developing economies allowed themselves to become dangerously export dependent, while tying their currencies to the U.S. dollar and building mountains of excess savings. That growth model is crumbling fast as global demand is plummeting. But if too many of these emerging markets go down, the IMF lacks the necessary resources to mount rescue operations. To put things in perspective, Austrian banks have emerging-market financial exposure exceeding $290 billion. Austria's GDP is only $370 billion.

The one silver lining is that the world does not lack capital. It's simply sitting on the sidelines, including $6 trillion in global money market funds alone. The faster Obama and his global counterparts can fashion credible financial reforms that enhance transparency while preserving capital and trade flows, the sooner that sidelined capital will reengage. In the end, markets crave certainty—in this case, certainty that our leaders have a credible game plan. That plan is not yet in place.

ROBERT J. SHILLER

Are We There Yet?

Speculative bubbles are ultimately a matter of psychology. People develop extravagant expectations about the wealth their investments will bring them, forgetting the valuable lessons of financial crises long past, and a dangerous bubble builds.

But the psychology of the ride down can be just as perilous. As asset prices now decline, markets might overshoot. Some indicators show that we are already approaching pre-bubble price levels. The price-to-earnings ratio in the U.S. stock market is about at its long-run average. Housing prices are probably more than halfway back down to their late-1990s level, when the bubble began. In some U.S. cities, they are almost completely back down.

No one can say, though, when exactly the market will bottom out. In some sense, the process is a self-fulfilling prophecy. The euphoria ends, and negative expectations lead to plunging asset prices, which in turn seem to justify those expectations. Given the poor outlook on the economy for the next year, housing prices might continue to decline well into 2010, as the futures markets in Chicago suggest.

History tells us there is some precedent for a protracted, weak housing market. After the last housing boom in the United States peaked in 1989, it took a typical city five years to hit bottom. This time, prices have only been going down for two years. We might look with caution to Japan, where urban land prices fell for 15 consecutive years, from 1991 to 2006.

When the market does reach bottom, it may be with a whimper, not a thud. Generally, there are no sharp turning points. Home prices might remain flat for a few years before they start rising again. Along the way, it will be hard to identify the road markers with any certainty until we have spotted them in the rearview mirror.

So far, the measures we've taken to resolve this crisis have thrown the rational principles of finance out the window. We are going on a crash diet—contradicting mortgage contracts on an ad hoc basis and giving away handfuls of money—when we should be coming up with an eating regime we can live on indefinitely. Instead of making whatever short-term patches seem necessary, we might take a more systemic, market-based approach, such as stipulating that mortgage values always be linked to housing prices and adjusted each month.

Speculative excesses are an endemic problem of the market system, but capitalism also provides its own self-correcting mechanisms. There's no reason to abandon those tools now.

Robert J. Shiller is professor of economics at Yale University and chief economist at MacroMarkets LLC. He is the author of The Subprime Solution *(Princeton: Princeton University Press, 2008).*

> **"If housing prices fall back in line with the overall rate price level ... it will eliminate more than $2 trillion in paper wealth and considerably worsen the recession. The collapse of the housing bubble will also jeopardize the survival of Fannie Mae and Freddie Mac."** – *Dean Baker, September 2002*

DEAN BAKER

Watch the Dollar

The housing bubble was the first to burst, but it will not be the last in this global recession. These days, it's the impending bust of the dollar bubble that should be getting more attention.

The U.S. dollar has been severely overvalued since the late 1990s, which has led to an enormous trade deficit that peaked at almost 6 percent of U.S. GDP in 2006 ($900 billion in today's economy). This is unsustainable. Eventually, it will force the dollar to fall to a level where trade is close to balance.

That process was already gradually underway. The recent crisis, however, has sent investors scrambling to the dollar for safety, causing it to soar against most other currencies. The rising dollar, coupled with recessions in much of the rest of the world, will cause the trade deficit to rise again.

But once the financial situation begins to return to normal (which might not be in 2009), investors will be unhappy with the extremely low returns available from dollar assets. Their exodus will cause the dollar to resume the fall it began in 2002, but this time, its decline might be far more rapid. Other countries, most notably China, will be much less dependent on the U.S. market for their exports and will have less interest in propping up the dollar.

For Americans, the effect of a sharp decline in the dollar will be considerably higher import prices and a reduced standard of living. If the U.S. Federal Reserve becomes concerned about the inflation resulting from higher import prices, it might raise interest rates, which could lead to another severe hit to the economy.

As for 2009, the ongoing collapse of the housing bubble, the coming collapse of the commercial real estate bubble, and the ensuing wave of bad debt will all be major sources of drag on the U.S. economy—even if the dollar bust happens later.

Indeed, subprime mortgages were just the trigger for a much broader crisis. Plunging house prices are now leading to record default rates on prime loans as well, with most of the fallout ahead of us. We'll also see much higher default rates on car loans, credit card debt, and other forms of consumer debt, because homeowners can no longer draw on their home equity to pay other debt.

Commercial real estate faces its own reckoning. When the housing market began to fade at the end of 2005, it kicked off a boom in nonresidential construction. In less than three years, this sector expanded more than 40 percent. There is now considerable excess capacity in retail space, office space, hotels, and other nonresidential sectors—leading to falling prices, plunging construction, and another major source of bad debts for banks.

In short, beware the happy talk from those who say we are "turning the corner," ignore the daily ups and downs of the market, and tighten your belts. This is going to hurt. FP

Dean Baker is codirector of the Center for Economic and Policy Research.

FAITH IN THE MARKET

The champions of Islamic finance—banking and investing based on the Koran—believe that if Islamic principles had been applied to Wall Street, the global economic crisis never would have happened. The handful of men who decide which mortgages, car loans, and credit cards are spiritually sound are cashing in. But critics smell a con. | **By Carla Power**

Amid the worst economic crisis in nearly a century, Yusuf Talal DeLorenzo sells peace of mind. A Muslim convert who is the product of both a Massachusetts prep school and a Karachi madrasa, DeLorenzo issues pronouncements on the spiritual soundness of modern finance for the world's Muslims.

Islamic law, or *sharia*, forbids pious Muslims from paying interest or investing in morally questionable companies. So, DeLorenzo serves as a well-paid counsel to the international hedge-fund managers, bankers, and asset managers who are determined to invest in line with the Koran's principles.

Carla Power is a London-based writer on Islamic and social issues.

With his rare ability to move easily between medieval Islamic texts and 21st-century financial instruments, DeLorenzo has emerged as one of the world's chief gatekeepers for the fast-growing market in Islamic finance.

He's a member of an elite group of fewer than 20 top-tier experts. Sheikh Nizam Yaquby issues *fatwas* for blue-chip institutions such as Dow Jones and HSBC from the back office of an electronics shop in a Bahraini bazaar. "There is no sin in the Koran—not even drinking, not even fornicating, not even homosexuality—which could be as abhorrent and serious as dealing in *riba* [interest]," he has said. Pakistan-born Muhammad Taqi Usmani, with the trademark cap of a religious scholar and his beard stained henna red, bears little resemblance to the Wall Street bigwigs who eagerly seek his advice.

ILLUSTRATIONS BY ALEX NABAUM FOR *FP*

He is the chair of the powerful sharia board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a Bahrain-based regulatory institution that sets standards for the global industry. DeLorenzo and Yaquby sit on the board, too, just as they both sit on the sharia board of the Dow Jones Islamic Market Index, which screens companies for Muslim investors to make sure they don't peddle in the defense or entertainment industries or are in any way connected to forbidden activities such as pornography, gambling, and pork production.

That the same few names appear again and again on sharia boards—Yaquby sits on more than 60, according to the Islamic Finance Information Service—reflects the unlikely name-brand status these Islamic scholars have attained in the world of modern finance. "It's only natural that if it's a big bank going out with a big product, they want to make a big splash," DeLorenzo says. "I would rather have Tiger Woods endorse my product than some no-name golfer."

To their critics, many Islamic finance scholars are nothing more than rent-a-sheikhs.

Until the credit crunch of 2008, Islamic finance was a fast-growing, if still relatively obscure, new specialty of international finance. But after Wall Street's implosion, Islamic finance's champions have begun to promote the sector as a safe haven from the ills of the global economy. At a Doha conference in late 2008, Sheikh Yusuf al-Qaradawi, arguably the world's most influential Islamic scholar, asserted that "the collapse of capitalism . . . shows that the Islamic economic philosophy is holding up." DeLorenzo is even more sweeping in his claims. "If you had *sukuk* [or interest-free bonds based on actual assets], the subprime crisis never would have happened," he says.

But how truly Islamic is the Islamic finance these men promote? To their critics, many are nothing more than rent-a-sheikhs, willing to give the spiritual nod to just about any financial product for the right price. Within their own ranks, the top sheikhs debate vigorously over which new products and transactions are permissible—and which have been unjustly allowed. One recent study from the AAOIFI concluded that 85 percent of bonds marketed as sharia-compliant were illegitimate. And the fees many of these scholars take in—at times, six figures for a single decision—only add to such critiques.

"There's a whole industry now—supported by a show of religious authority provided by Islamic scholars—with banks promoting conventional products as Islamic," says Mahmoud El-Gamal, a professor at Rice University and author of *Islamic Finance: Law, Economics, and Practice*. "They're preying on the religiously insecure." And as the financial crisis continues to unwind, there are a lot of insecure people out there.

THE BUSINESS OF ALLAH

Whether scholars like DeLorenzo and Yaquby offer merely pious packaging or a genuine reconciliation of sharia and modernity, demand is growing enormously for their services. What began several decades ago with a few Middle Eastern banks trying to circumvent the Koran's ban on interest has become one of the world's fastest-growing financial sectors. And it has been propelled by record oil revenues in the Gulf, deepening Islamic sentiment in countries from Pakistan and Egypt to Britain and France, and the flight of Arab capital out of the United States after September 11.

Islamic finance accounts for just 1 percent of the global market, but the industry's yearly value is estimated at about $500 billion, with annual growth of 15 percent. In five years, it could hit $4 trillion, according to a 2008 report from Moody's Investors Service. And its potential could be even greater.

Islam is the world's fastest-growing religion, with 1.3 billion adherents, many of whom are young and new to personal finance. Standard & Poor's estimates that in the Muslim countries of Asia and the Gulf, 1 in 5 banking customers would opt for Islamic financial products over conventional ones if given the opportunity. By 2012, nearly a third of all business deals in the Gulf will be done through Islamic finance, according to the *Middle East Economic Digest*. Add a booming Muslim middle class and non-Muslims eager to profit, and it is easy to understand why some of the world's biggest banks are spending millions to enter the market. The 300 dedicated Islamic banks and funds worldwide, operating in 75 countries, are beginning to face stiff competition from top-tier global firms such as Deutsche Bank, HSBC, and Citibank.

This competition is fueling even grander aspirations among scholars such as DeLorenzo. Islamic finance, he says, is not just a way for Muslims to turn an honest profit; it is the vehicle that will make Islamic law relevant for the 21st century, a far cry from debates over "marrying and burying" that dominated his own madrasa education in the 1970s.

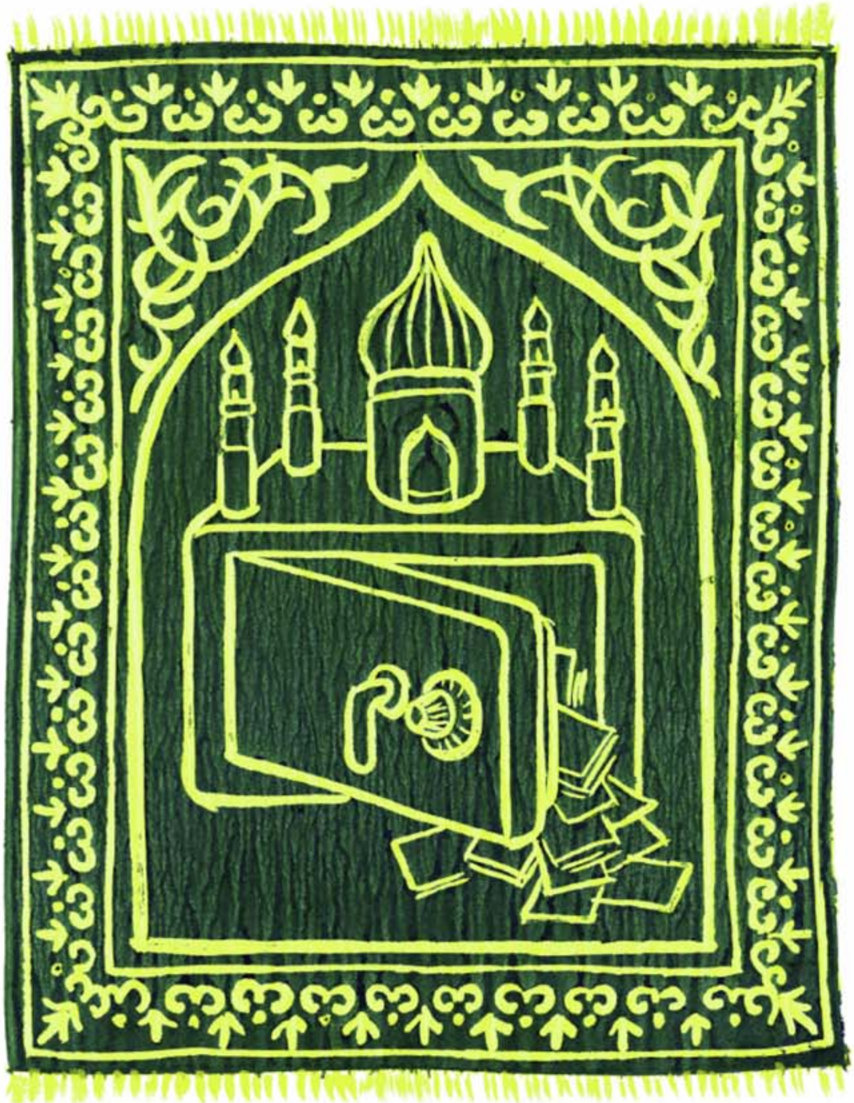
"Islamic finance scholars say that what's happening in the conventional world of finance is at the heart of the difference between Islamic and ordinary finance," says Davide Barzilai, a partner specializing in Islamic finance at the international law firm Norton Rose. Muslim investors haven't suffered from falling bank stocks, Islamic scholars point out, because their faith forbids investment in financial institutions. Since the Koran bans gambling, the related practice of risk is forbidden. So too is the short-selling of stocks (on the grounds that you can't sell what you don't own) and the sale of debt. Indeed, the practice of repackaging and trading debt, as well as credit-default swaps, both so central to the financial crisis, never could have happened under Islamic law.

MARKET FUNDAMENTALISM

Sharia scholars such as DeLorenzo see Islamic finance as the path to a distinctly spiritual end. Like political Islam, Islamic finance began as a search for authenticity and independence from the West. Its origins lie in the postcolonial Islamic identity that emerged in the 1950s and 1960s, when Muslim economists returned to the Koran to develop what they called Islamic economics.

The central concept is justice. Transactions that could be unjust for either the borrower or the lender are discouraged. For any financial undertaking, risks must be shared. To get around the Koran's ban on interest, Islamic banking has relied heavily on what is called *murabaha*: a loan or sale in which a markup is added to the transaction's cost. So when a Muslim borrower goes to a bank to buy a car or house, he agrees to a contract in which he pays back the cost of the item, plus a certain amount of profit. The bank is technically a partner, rather than just a financier. These methods are believed to meet the spirit of the law because they avoid the exploitation of the borrower.

Using this model, Islamic banks have created scores of financial products for Muslims to avoid Western-style interest or risk. The result is a parallel system of Islamic offerings that mirror those available from conventional banks: Islamic mortgages, Islamic car loans, Islamic credit cards, Islamic insurance. An *ijara*, or Islamic lease, allows a bank to buy a car or a house for a customer and then earn a profit by renting it to them. An Islamic investor who wants to start a business can go to a bank and embark on a *mudharaba*, or partnership, in which the bank supplies the money and the customer brings the business skills. Profits are shared in a predetermined ratio; losses are borne by the bank. For insurance, companies offer policies in which a group of subscribers creates a pool of funds that can then be invested and drawn on in cases of legitimate claims. Unclaimed profits are then distributed among policyholders.



offered them. Saturna Capital, a Washington-based investment firm, estimates that 60 percent of customers for its sharia-compliant mutual funds aren't Muslim. All of which raises the ironic possibility that Islamic finance, in its quest to develop a more spiritually pure alternative to modern materialism for the world's Muslims, may have ended up creating a large and attractive market for Western investors.

PIETY FOR A PRICE

But not everyone is convinced. Take the claim of Islamic finance as a safe haven from the global economic crisis. "Now is a golden opportunity for Islamic finance to provide an alternative model . . . just what the world needs right now," Islamic finance conference organizer Swati Taneja recently told *Emirates Business 24/7*. "There has never been a more interesting time for cautious investors burned in the conventional credit crunch to begin looking at what the Islamic markets have to offer." But even someone as bullish as Taneja concedes that a globalized market means Islamic investments are exposed along with mainstream ones. According to Standard & Poor's, sharia-compliant stocks lost 23 percent of their value during the first three quarters of 2008, compared with a 25 percent fall for non-sharia-sanctioned stocks. And Islamic finance, just like conventional finance, is vulnerable to sloppy vetting of customers' creditworthiness.

Potential pitfalls for Islamic finance, then, are the same as those for conventional finance: greed and lax regulation. So, at what point do the scholars' fatwas only serve to perpetuate the industry that feeds them, thereby consolidating their own power? "They're not going to kill the goose that lays the golden egg," El-Gamal says. "[By issuing bans on certain financial products], they want to continue to build up the religious insecurity of people who are afraid to use conventional [finance]." And banks that

To many, including some Islamic scholars, such offerings look a lot like conventional finance in disguise. But for many devout Muslims, the fact that they are technically avoiding interest makes such practices acceptable. Under sharia, money must be exchanged for a real good or service. "Money itself creates no value," observes Mohamed Elgari, a top sharia scholar. "[Under Islamic law], it is only a medium of exchange." It's a nimble balancing act, and for those banks willing to attempt it, there are plenty of willing customers.

In Britain alone, the value of the Islamic mortgage market has topped $900 million, up 50 percent between 2006 and 2007. The global Islamic insurance market is growing 25 percent annually and is slated to reach $14 billion a year by 2010, according to HSBC. And non-Muslims are increasingly keen takers. Half of HSBC's Islamic mortgages in Malaysia went to non-Muslims the first year the company benefit are happy to see the current system maintained. Very few scholars dominate the field, says Tarek El Diwany, an analyst at Zest Advisory, a London-based Islamic financial consultancy, because "there's a shortage of scholars who will give the judgments that the banks are looking for."

The industry's chief critics see in Islamic finance the same rhetorical spin as Islamist politics. "The whole idea of giving [finance] a religious identity is just a form of identity politics," says El-Gamal. "The claim that Islam has the perfect solution is questionable in economics, just as in politics." Still others see outright deception. Mohammad Akram Nadwi, a prominent Britain-based scholar of Islamic jurisprudence, advises his students against taking out Islamic mortgages, because he thinks their structure is merely interest-bearing debt in disguise. "At least conventional mortgages are honest," he shrugs.

At industry conferences, there have been mutterings about too few sheikhs serving on too many boards, and even advising direct competitors. Malaysia, which arguably has the world's best-developed legal framework for sharia finance, banned scholars in 2005 from serving on more than one bank board at a time. And in an effort to groom more young sheikhs to enter the field, Malaysia's central bank and the Saudi-based Islamic Development Bank recently created a $53 million endowment to support sharia scholarship. But, in an industry that respects longevity and seniority, especially among Wall Street investors unfamiliar with the nuances of madrasa education, breaking in can be tough.

A larger issue is whether Islam and the modern economy can be reconciled at all. Is it enough to create banking products that mimic those of traditional finance but also meet the letter of Islamic law? Or must the goals of the financial system itself be reworked fundamentally? The question, in short, is whether a growing Islamic financial sector can really bring about the material and spiritual justice that its advocates claim it will—or whether it will enrich a select few.

Such a debate cuts to the heart of whether Koranic admonitions must be strictly applied or can be subject to greater interpretation. That the Islamic financial sector has largely been designed by a small group of men paid handsomely for their services has led some observers to declare that much of what passes for Islamic finance today fails to meet the intentions of sharia.

For every observer who thinks that sharia scholars have become too reckless in their judgments, there are many more who believe that a broad rethink of the financial system should carry the day. "To date, most Islamic financiers have been looking at . . . examples of financing in Islamic history and figuring out how to apply them today," says El Diwany, the London-based Islamic financial consultant. "That's a very narrow way of doing things. There's potentially much more innovation we could be doing—and potentially, much less." It may not win Islam more converts, but it could provide an entirely new generation of customers. FP

[Want to Know More?]

In ***Islamic Finance: Law, Economics, and Practice*** (Cambridge: Cambridge University Press, 2006), Mahmoud A. El-Gamal recommends reorganizing Islamic finance to follow the spirit—rather than the letter—of the Koran. He also blogs on the subject at **elgamal.blogspot.com**. The **"Shariah Report 2008"** (Chicago: Failaka Advisors) offers biographical profiles of the most active scholars in the field, including their education, experience, and employers.

For an in-depth look at Islamic finance's growing pains and the emerging hubs of the industry, see a recent special report on the industry from the *Financial Times* (June 19, 2008). *Forbes* offers an overview of the people, places, and prohibitions central to the movement in a similar multi-article special report (April 21, 2008). Joanna Slater's **"When Hedge Funds Meet Islamic Finance"** (*Wall Street Journal*, Aug. 9, 2007) describes how sheikhs are advising hedge funds on attracting capital from the Middle East.

Additional resources on the industry are available at the Web site of Harvard Law School's **Islamic Finance Project.** Publicly listed companies that are compliant with Islamic finance are found on the **Dow Jones Islamic Market Index**.

THE POOR MAN'S BURDEN

Eighty years ago, a depression changed the way we think about poverty. It took decades for the world to recover and to remember that if people are given freedom, they will prosper. Now, in the wake of another massive meltdown, the fear that shocked us into depending on government to fix poverty is spreading once again—and threatening to undo many of the gains we've made. | **By William Easterly**

Will Richard Fuld, the disgraced CEO of the now defunct Lehman Brothers, go down in history as the father of Bolivian socialism? If we learn the wrong lessons from the global financial Crash of 2008, he very well could.

That's because the crash arrived at a crucial moment in the global fight to reduce poverty. For Bolivia—and so many other countries like it—the crash represents much more than a temporary downturn; it could mean the end of one of the greatest openings for prosperity in decades. Amid today's gloom, it is easy to forget we have just witnessed half a century of the greatest mass escape from poverty in human history. The proportion of the world's population living in extreme poverty in 2008 (those earning less than a $1 a day) was a fifth of what it was in 1960. In 2008, the income of the average citizen of the world was nearly three times higher than it was in 1960. But those tremendous gains are now in peril. For this crash hit many poor countries from Asia to Africa to Latin America that are still experimenting with political and economic freedom—but have yet to fully embrace it and experience its benefits. For decades, these countries have struggled tremendously to realize the potential of individual creativity as opposed to the smothering hand of the state. And it even seemed that the power of individual liberty might be winning.

It wasn't happening because experts had handed out some blueprint for achieving economic growth to governments and then down to their people. What happened instead was a Revolution from Below—poor people taking initiative without experts telling them what to do. We saw such surprising success stories as the family grocer in Kenya who became a supermarket giant, the Nigerian women who got rich making tie-dyed garments, the Chinese schoolteacher who became a millionaire exporting socks, and the Congolese entrepreneur who started a wildly

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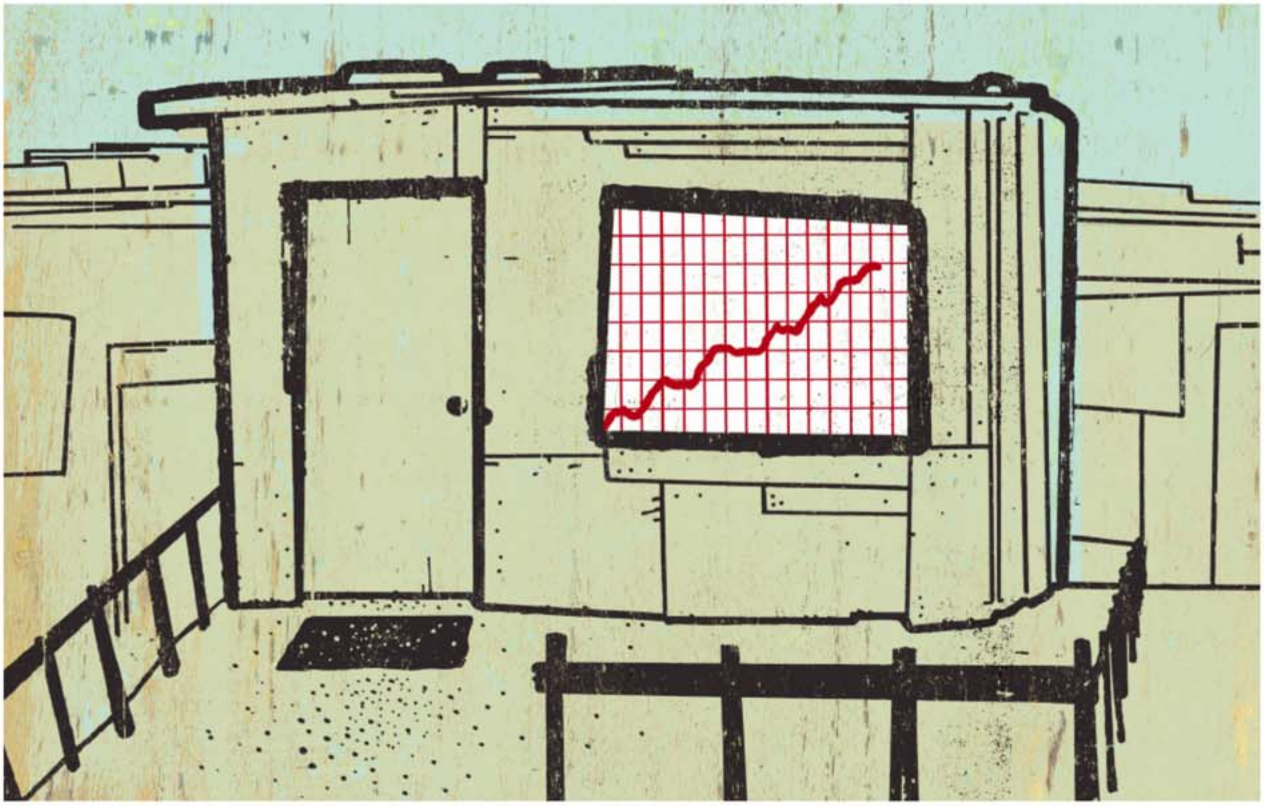

successful cellphone business in the midst of his country's civil war. Perhaps not coincidentally, the share of countries enjoying greater levels of economic and political freedom steadily and simultaneously shot upward.

Then came the crash.

Today, global economic calamity risks aborting that hopeful Revolution from Below. As India's Prime Minister Manmohan Singh warned late last fall, "It would be a great pity if this growing support for open policies in the developing world is weakened" because of the crash. Singh understands that the risk of a backlash against individual freedom is far more dangerous than the direct damage to poor countries caused by a global recession, falling commodity prices, or shrinking capital flows. We're already seeing this dangerous trend in Latin America. In Bolivia, President Evo Morales has openly crowed about the failure of Fuld's Lehman Brothers and other Wall Street giants: The capitalist "models in place are not a good solution for humanity . . . because [they are] based on injustice and inequality." Socialism, he said, will be the solution—in Bolivia, the state "regulates the national economy, and not the free market." The leaders of Argentina, Bolivia, Brazil, Ecuador, Nicaragua, Honduras, Paraguay, Venezuela, and even tiny Dominica to varying degrees align with these anticapitalist pretensions, all seemingly vindicated by the Crash of 2008. And it's not confined to Latin America: Vladimir Putin blamed the U.S. financial system for his own populist mismanagement of Russia's even more catastrophic crisis. A spreading fire of statism would find plenty of kindling already stacked in the Middle East, the former Soviet Union, Africa, and Asia. And there are many Western "development" experts who would eagerly fan the flames with their woolly, paternalistic thinking.

To Jeffrey Sachs, perhaps the foremost of these experts, the crash is an opportunity to gain support for the hopelessly utopian Millennium Development Goals of reducing poverty, achieving gender equality, and improving the general state of the planet through a centrally planned, government-led Big Push. "The US could find $700 billion for a bailout of its corrupt and errant banks but couldn't find a small fraction of that for the world's poor and dying," he wrote in September. "The laggards in the struggle for the [goals] are not the poor countries … the laggards are the rich world." To Sachs and his acolytes, poor people can't prosper without Western-country plans—and the crash only serves to turn Western governments inward. Therefore, progress on poverty is bound to suffer. To governments of poor countries that have failed to give their people the freedom needed to prosper, the neglect of Western governments is an easy excuse. So the gospel of Sachs and his disciples, though terribly condescending and wrongheaded, could attract many converts in the coming months.

A DEPRESSING HISTORY

At least we've been here before—and we have a chance to avoid the philosophical traps we fell into after the last calamity that did so much harm to our economic system. But so far, there have been strikingly similar reactions to the crashes of 1929 and 2008. In both cases, when stocks registered some of their largest percentage declines on record, highly leveraged firms and individuals who had placed large bets using complex financial securities that few understood lost everything. The failure of gigantic financial firms spread panic. Complaints about the greedy and reckless rich escalated; a shift toward protectionism and government interventionism appeared inevitable even where free markets once reigned supreme. Authoritarian populists abroad mocked the U.S. system. The catastrophe seemed to threaten democratic capitalism everywhere.

The difference is today we know that after a long and scary Great Depression, democratic capitalism did survive. And the U.S. economy returned to exactly the same long-run trend path it was on before the Depression.

We also know that, for another important part of the world, democratic capitalism did not hold up so well. In many ways, that failure stemmed from a misguided overreaction on the part of a new, influential field of economics that was highly skeptical of capitalism, was deeply traumatized by economic calamity, and considered much of the world "underdeveloped." Born in the aftermath of the Depression, "development economics" grew on a foundation of bizarre misconceptions and dangerous assumptions.

This approach to poor-country development, promulgated by the economists who took up its cause in the 1950s, had four unfortunate lasting consequences, the effects of which we're still reckoning with today in the midst of the latest big crash.

First, seeing Depression-style unemployment in every part of the world led these economists to assume that poor countries simply had too many people who were literally producing nothing. A U.N. report in 1951, produced by a group of economists, including future Nobel laureate Arthur Lewis, estimated that fully half of the farming population of Egypt produced nothing. The insulting assumption that poor people had "zero" productivity led these economists to think that individual freedoms for the poor should not be the foundation for wealth creation, as they had been during the Industrial Revolution, when the state had played a secondary, supportive role. And because governments seemed to successfully take on a larger role during the Depression, development economists assumed that granting extensive powers to the state was the surest path to progress. A 1947 U.N. report on development gave equivalent approval to state action in democratic capitalist countries like Chile, enslaved Soviet satellites like Poland, African colonies of the British and French, and apartheid South Africa, ignoring the vast differences in individual liberty between these places.

Second, these thinkers lost faith in bottom-up economic development that was "spontaneous, as in the classical capitalist pattern" (as a later history put it), preferring instead development "consciously achieved through state planning." After all, the Five-Year Plans of the 1930s Soviet Union had avoided the Depression, at an appalling but then ignored cost in lives and human rights. This thinking was so universal that Gunnar Myrdal (who would later win a Nobel Prize in economics) claimed in 1956: "Special advisors to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problem . . . all recommend central planning as the first condition of progress."

So far, there have been strikingly similar reactions to the crashes of 1929 and 2008.

Third, these economists grew to believe that the most important factor in reducing poverty was the amount of money invested in the tools to do so. After all, if there were simply too many people, they reasoned, the binding constraint on growth must be the lack of physical equipment. As a result, this line of economic philosophy would forever stress the volume of investment over the efficiency of using those resources; would be stubbornly indifferent as to whether it was the state or individuals who made the investments; would always stress the total amount of aid required to finance investment as the crucial ingredient in escaping poverty; and would ignore the role of a dynamic financial system in allocating investment

resources to those private uses where they would get the highest return.

Fourth, the collapse of international trade during the Depression made development economists skeptical about trade as an engine of growth. So in Africa, for example, they pushed for heavy taxes on export crops like cocoa to finance domestic industrialization. In Latin America, Raúl Prebisch pushed import-substituting industrialization instead of export-led growth. This strategy was supposed to help developing countries in Africa and Latin America escape a presumed "poverty trap." But the only "trap" it kept them out of was the greatest global trade boom in history following World War II, which fueled record growth in Asia, Europe, and the United States.

By the 1980s, the state-led plans had clearly failed. The wreckage of unsuccessful state enterprises, bankrupt state banks, and inefficient hothouse industries behind protectionist walls—all of which culminated in African and Latin American debt crises that destroyed growth—became too obvious to ignore. These factors, plus East Asia's rise to power in global markets, finally fueled a counterrevolution in development thinking that favored free markets and individual liberty. By the new millennium, the long record of failure of the top-down development experts triggered a well-deserved collapse of confidence in top-down planning. It had taken nearly 50 years for the world to recognize the damage that the state-led, expert-directed, antifreedom agenda had done to the world's poor. Today, the only remaining holdouts among the top-down experts are so utopian that they are safely insulated from reality.

A 5(0)-YEAR PLAN

Today, just when we were getting over the long, toxic legacy of the Depression and its misguided emphasis on statist plans to fight poverty, this financial crash threatens to take us back to the bad old days. To avoid such a return, we must keep some principles in mind.

First, we must not fall into the trap of protectionism—neither unilaterally nor multilaterally, neither in rich countries nor poor. Protectionism will just make the recession spread further and deeper, as it did during the Depression.

Second, when changing financial regulations to repair the excesses of the past several years, don't strangle the financial system altogether. You can't have a Revolution from Below without it. This lesson is especially salient as Washington bails out Wall Street banks and failing industries and intervenes in the U.S. financial sector to an unprecedented degree. This bailout might turn out to be the bitter medicine that saves "finance capitalism" from a stronger form of anticapitalism, but in developing countries, open economies are still an open question.

Third, keep slashing away at the enormous red tape that is left over from previous harebrained attempts at state direction of the economy. Learn from the combined dismal track record of state-owned enterprises but also from the unexpected success stories: Private entrepreneurs are far better than the government at picking industries that can be winners in the global economy. Although fierce opposition will be inevitable, to adopt these policies would be to turn the bad hand we've been dealt into an outright losing one.

Fourth, don't look to economists to create "development strategies," and don't back up such experts with external coercion like IMF and World Bank conditions on loans. Such efforts will be either a waste of local politicians' time or positively harmful. Jeffrey Sachs alone can take partial credit for the rise of two xenophobic rulers hostile to individual liberty—Evo Morales and Vladimir Putin—after his expert advice backfired in Bolivia and Russia. If like-minded experts couldn't get it done in the 50 years after the Great Depression, they can't do it in the next 50 years. Nothing in the current crash changes these common-sense principles.

DRIVING THE RIGHT WAY

In the coming months and years, the world's economists, politicians, and average consumers could find it incredibly easy to fall again for the wrongheaded policies of the past century. But if we are truly to continue the miraculous exodus from poverty that was under way before this traumatic crash, we ought to keep in mind stories like that of Chung Ju-yung.

The son of North Korean peasant farmers, Chung had to leave school at 14 to support his family. He held jobs as a railway construction laborer, a dockworker, a bookkeeper, and a deliveryman for a rice shop in Seoul. At 22, he took over the rice shop, but it failed. He then started A-Do Service garage, but that failed, too. In 1946, at age 31, Chung tried once again to start an auto repair service in Seoul. At last, his enterprise succeeded, largely through the contracts he won to repair U.S. Army vehicles. As his success continued, Chung diversified into construction, and his company kept growing rapidly. In 1968, he started manufacturing cars.

He named his company Hyundai. It became one of the largest companies contributing to South Korea's rise. His first effort to export cars to the United States in 1986 brought ridicule because of the cars' poor quality. The Asian crisis of 1997-98 led to a partial breakup of the Hyundai Group, but the Hyundai Motor Company continues to thrive. Chung died in 2001, but his dreams for the U.S. market came true. By 2008, Hyundai cars had received awards in the United States for the highest level of quality from *Consumer Reports*.

However terrifying the latest crash may be, let's never forget that it is the Chungs of the world that will end poverty—not the Depression-inspired regression into statism. FP

[Want to Know More?]

William Easterly's most recent book, ***The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*** (New York: Oxford University Press, 2006), criticizes Western approaches to global poverty. In **"The Ideology of Development"** (FOREIGN POLICY July/August 2007), Easterly warns of the dangers of "Developmentalism."

Easterly's chief economic adversaries, Jeffrey Sachs and Paul Collier, take a more aid-oriented approach. Sachs's ***Common Wealth: Economics for a Crowded Planet*** (New York: Penguin Press, 2008) and Collier's ***The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It*** (New York: Oxford University Press, 2008) offer policy solutions for the world's most pressing problems.

For a look at one of the earliest and most prescient (and now forgotten) economists to advocate the potential of free markets as a tool for development, read S. Herbert Frankel's ***Some Conceptual Aspects of International Economic Development of Underdeveloped Territories*** (Princeton: Princeton University, 1952). For a more well-known early critique of development, see P.T. Bauer's ***Dissent on Development*** (Cambridge: Harvard University Press, 1976).

The Think Tank Index

It's no accident that Barack Obama plucked his transition chief from a think tank. The world's idea factories are charged with brainstorming solutions to everything from global warming to Wall Street's implosion to the war on terror. In the first index of its kind, FP ranks the world's best think tanks. | By James McGann

In Washington, it's not for nothing that think tanks are called "governments in waiting." Presidents seek them out because they are critical to the global ideas industry. Far more than simply churning out endless papers, think tank wonks generate and fine-tune solutions to some of the most complex and vexing issues of the day. Leaders around the world need them to provide independent analysis, help set policy agendas, and bridge the gap between knowledge and action.

But not all think tanks are created equal. There are some 5,500 think tanks worldwide, in nearly 170 countries. Some organizations specialize in security; others in the environment. Some are intensely partisan; others fiercely independent. Some have budgets in the tens of millions of dollars; others are one-person operations. Some are already changing the world with their big ideas; others merely aspire to.

Until now, there has been no guide to this rapidly growing global industry. The **Think Tank Index** is the first comprehensive ranking of the world's top think tanks, based on a worldwide survey of hundreds of scholars and experts. Think of it as an insider's guide to the competitive marketplace for ideas that matter.

The Think Tank Field Guide

As think tanks have grown in number and influence, a handful of distinct breeds have emerged. Here's a guide to telling the wonks from the water carriers.

The Policymakers

These organizations enjoy a competitive advantage over their rivals when it comes to government contracts and research. They have the know-how and PR skills that ministers, bean counters, and bureaucrats seek.

- **Rand Corporation**, *United States*
- **Urban Institute**, *United States*
- **Overseas Development Institute**, *Britain*
- **Fundação Getulio Vargas**, *Brazil*
- **Institute for Research on Public Policy**, *Canada*

The Partisans

These ideology-driven organizations generate the leading ideas on the right and left, develop new political talent, and offer a home to out-of-power party leaders.

- **Heritage Foundation**, *United States*
- **Center for American Progress**, *United States*
- **Adam Smith Institute**, *Britain*
- **Civitas**, *Britain*

The Phantoms

Designed to look like NGOs, these organizations are in fact arms of the government. They've emerged as a favorite strategy for authoritarians to mask their diktats as flourishing civil society.

- **China Development Institute**, *China*
- **Institute for Democracy and Cooperation**, *Russia*
- **Center for Political Studies**, *Uzbekistan*

The Scholars

The stars of the think tank world, these powerhouses of policy are regularly relied upon to set agendas and craft new initiatives.

- **Brookings Institution**, *United States*
- **Council on Foreign Relations**, *United States*
- **Chatham House**, *Britain*
- **Danish Institute of International Studies**, *Denmark*

The Activists

These do-gooders don't simply advocate for important causes. They've become top-notch policy and research hubs in their own right.

- **Human Rights Watch**, *United States*
- **Centre for Conflict Resolution**, *South Africa*
- **Amnesty International**, *Britain*

James McGann is assistant director of the international relations program at the University of Pennsylvania and director of the Think Tanks and Civil Societies Program.

Top 15 U.S. Think Tanks

1 Brookings Institution
Location: Washington
Annual budget: $60.7 million
Specialties: U.S. foreign policy, Middle East
Boldface names: Strobe Talbott, Kenneth Pollack, Alice Rivlin

2 Council on Foreign Relations
Location: New York
Budget: $38.3 million
Specialties: U.S. foreign policy, national security
Boldface names: Richard Haass, Michael Gerson, Walter Russell Mead, Angelina Jolie

3 Carnegie Endowment for International Peace
Location: Washington
Budget: $22 million
Specialties: Nuclear nonproliferation, China
Boldface names: Jessica T. Mathews, Robert Kagan, Minxin Pei

4 Rand Corporation
Location: Santa Monica, Calif.
Budget: $251 million
Specialties: Military strategy, political economy
Boldface names: James Dobbins, Gregory Treverton, William Overholt

5 Heritage Foundation
Location: Washington
Budget: $48.4 million
Specialties: Tax policy, missile defense
Boldface names: Edwin Meese, Peter Brookes, James Jay Carafano

6 Woodrow Wilson International Center for Scholars
Location: Washington
Budget: $34.5 million
Specialties: Regional studies, democracy promotion
Boldface names: Lee Hamilton, Haleh Esfandiari

7 Center for Strategic & International Studies
Location: Washington
Budget: $29 million
Specialties: Defense policy, diplomacy
Boldface names: John Hamre, Richard Armitage, Zbigniew Brzezinski, Anthony Cordesman

8 American Enterprise Institute
Location: Washington
Budget: $23.6 million (2006)
Specialties: Trade, defense
Boldface names: Newt Gingrich, David Frum, Richard Perle

9 Cato Institute
Location: Washington
Budget: $19 million
Specialties: Libertarianism, deregulation
Boldface names: David Boaz, Edward Crane, Christopher Preble

10 Hoover Institution
Location: Stanford, Calif.
Budget: $34.1 million
Specialties: Defense policy, conservatism
Boldface names: Larry Diamond, Michael McFaul, Victor Davis Hanson

11 Human Rights Watch
Location: New York
Budget: $35.5 million
Specialties: Human rights, international justice
Boldface names: Kenneth Roth

12 Peterson Institute for International Economics
Location: Washington
Budget: $9.5 million
Specialties: Trade, globalization
Boldface names: C. Fred Bergsten, Anders Åslund, William Cline

13 United States Institute of Peace
Location: Washington
Budget: $24.7 million
Specialties: Conflict resolution, postconflict stability
Boldface names: Richard Solomon, Scott Lasensky, J. Alexander Thier

14 National Bureau of Economic Research
Location: Cambridge, Mass.
Budget: $29.8 million
Specialties: Economic growth, empirical research
Boldface names: James Poterba, Robert Lipsey, Martin Feldstein

15 Center for Global Development
Location: Washington
Budget: $9.8 million
Specialties: Globalization, inequality
Boldface names: Nancy Birdsall

Top 10 Non-U.S. Think Tanks

1 Chatham House
Location: London
Budget: $12.4 million
Specialties: International economics, regional studies

2 International Institute for Strategic Studies
Location: London
Budget: $15.3 million
Specialties: Nonproliferation, counterterrorism

3 Stockholm International Peace Research Institute
Location: Solna, Sweden
Budget: $5.3 million
Specialties: Arms control, conflict management

4 Overseas Development Institute
Location: London
Budget: $25.9 million
Specialties: International development, humanitarian issues

5 Centre for European Policy Studies
Location: Brussels
Budget: $8.6 million
Specialty: EU affairs

6 Transparency International
Location: Berlin
Budget: $13.3 million
Specialty: Anticorruption

7 German Council on Foreign Relations
Location: Berlin
Budget: $6.4 million
Specialties: German foreign policy, international relations

8 German Institute for International and Security Affairs
Location: Berlin
Budget: $16.4 million
Specialties: German foreign policy and security

9 French Institute of International Relations
Location: Paris
Budget: $8.1 million
Specialties: Trans-Atlantic relations, European affairs

10 Adam Smith Institute
Location: London
Budget: $500,000
Specialties: Free-market and social policies

The Policymakers · The Partisans · The Phantoms · The Scholars · The Activists

Top Think Tanks for Innovative Ideas

1 Cato Institute
Cato's libertarian stance, once viewed as fringe, is now considered respectable. With its anti-incumbent, anti-Washington attitude, Cato has antagonized liberals with its push to privatize Social Security, as well as conservatives with its vigorous opposition to the Iraq war.

2 Brookings Institution
From heathcare reform to recommendations on closing the prison at Guantánamo Bay, Brookings has a breadth of expertise that allows it to offer innovative fixes for nearly every critical issue facing the United States today.

3 Carnegie Endowment for International Peace
Carnegie's role in opposing the invasion of Iraq and providing critical research on issues such as Iran's and North Korea's nuclear weapons programs places it at the heart of some of Washington's defining policy debates.

Best New Think Tanks

(of the past 5 years)

1 European Council on Foreign Relations
Populated by European heavyweights like Nobel Peace Prize laureate Martti Ahtisaari and former German Foreign Minister Joschka Fischer, the ECFR aims to craft a common foreign policy for an increasingly integrated Europe.

2 Bruegel
Funded by EU member states and located in Brussels, Bruegel specializes in driving European economic growth and making the continent more competitive in the global economy.

3 Center for American Progress
Thanks to its all-star roster of experts and savvy use of new media, CAP has emerged as the intellectual center of Democratic D.C.

Most Impact on Public Policy Debates

1 Brookings Institution
When important debates occur in Washington—whether over Middle East peace, global finance, or urban strategy—it's a fair bet that Brookings is driving the conversation.

2 Heritage Foundation
A partisan approach, obsession with the latest policy issues, an effective marketing strategy, and proximity to the seat of power (it is steps away from the U.S. Congress) give Heritage an influential edge.

Best Think Tanks By Region

Latin America:
Consejo Argentino para las Relaciones Internacionales, *Argentina*

Middle East & North Africa:
Al-Ahram Center for Political And Strategic Studies, *Egypt*

Asia:
Chinese Academy of Social Sciences, *China*

Sub-Saharan Africa:
Centre for Conflict Resolution, *South Africa*

For More Online:
For the complete Think Tank Index, including more rankings, go to **ForeignPolicy.com/extras/ThinkTankIndex.**

India's Chinese Wall

By Jeffrey N. Wasserstrom

Smoke and Mirrors: An Experience of China
By Pallavi Aiyar
288 pages, New Delhi: HarperCollins India, 2008

To most readers, comparisons of China and India are nothing new. Whether it's the breathless pace of China's economy versus India's slower, more measured growth, or China's communist political system rated against India's complicated democracy, the two countries are endlessly dissected in relation to one another. Yet amid all the hand-wringing over which country is "beating" the other in their race to industrialize, one simple question sums up very pointedly the debate over which one is making life better for its citizens. It's a question few dare to ask in polite circles: If you were born today, would you rather be Chinese or Indian?

Delhi-born Pallavi Aiyar, the first Chinese-speaking Indian journalist based in Beijing and author of an engaging new book about the two countries, takes on the charged question. The best option, she contends, is to be a high-caste Indian man. His political freedom would certainly outweigh the economic opportunities of any Chinese citizen, she argues. But if that weren't possible, she'd choose to be a wealthy Chinese woman, because she wouldn't be as constrained as her Indian counterparts by low literacy rates and limits on female participation in the public sphere. If she had to be poor, she'd go with China. An Indian latrine cleaner may get to vote, she says, but a Chinese one is far less likely to be viewed as completely subhuman.

If it sounds like Aiyar's five years in Beijing have left her reluctant to give a definitive answer to this question—one she poses often in her book, *Smoke and Mirrors: An Experience of China*—she is. Like so many other foreigners who gradually discover China, her opinions are constantly evolving. What makes her unfolding view of a booming and globalizing China special is the mix of experiences she brings to bear: She has lived both in Asia and the West, worked in Beijing not just as a journalist but also as a teacher, and knows what her compatriots think of the Chinese as well as what the Chinese think of her homeland. She is, to borrow a term coined by another cosmopolitan writer, Pico Iyer, just the sort of "global soul" we need to guide us into a China that is transforming and being transformed by the world. And her book, which was released in September in India to generally positive reviews, has fresh things to say about the usually overlooked issues between these countries, such as the true experience of expats in both nations.

Part memoir and part reportage, the book covers the period from 2002 to 2007 and describes everything from the unique business opportunities that a booming China offered entrepreneurial yoga instructors, to the SARS scare, to the high-tech, high-altitude train to Tibet, on which Aiyar was an early passenger. After studying in Britain and the United States, she arrived in Beijing to teach English and went on to become the China correspondent for *The Hindu*.

Every foreign writer's perspective on China is shaped by the country where he or she grew up. But Aiyar is refreshingly honest about this fact. She knows that her Indian background gives her a lens that's more interesting than

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most through which to watch China's rise. To many Indians, China is close to home geographically, yet mysterious and distant philosophically, often generating mixed emotions—including disgust (the "strange" foods), scorn (the limited freedom), and envy (the skyscrapers, the roads, the Olympics). Aiyar is a bit dismissive of some of these attitudes. When it comes to envy of China's transformation into a land with spectacular airports and highways free of potholes, though, her own awestruck reaction helps us understand the nature of South Asian anxieties about the surging country to the east.

ILLUSTRATION BY KOREN SHADMI 2008, LEVI CREATIVE MANAGEMENT NYC FOR *FP*

Throughout *Smoke and Mirrors*, Aiyar alternates between describing Chinese people, places, and events, and ruminating on their Indian counterparts. She also lets us eavesdrop on other Indians commenting on China and on Chinese airing their views on India. We meet Jayesh, a "buyer from Mumbai" working in the button trade: "What we need is a government like these Chinese. No unions, no nonsense." And we hear from Nigami, a representative of an Indian bank, who complains about all the smoking and drinking involved in Chinese business transactions, which makes it "difficult for us Indians to adjust here. The Europeans, of course, enjoy themselves here. . . . Many even marry Chinese girls and the food is fine for them."

From a Western perspective, it might seem that Aiyar's book, with its reflections on Chinese-Indian tensions, the two countries' differences, and their economic booms, has arrived a bit too late. A year ago, the totemic pairing of China and India dominated the Western press. Scores of articles fretted over how the joint rise of "the Dragon" and "the Elephant" would challenge the West—or salivated over the countries' massive markets. Alternatively, some took a Dragon vs. Elephant approach. Overstating the contrasts between Chinese and Indian development paths (and overlooking the parallels between, for example, the two countries' shared passion for five-year plans since the 1950s), commentators ranging from Danish political scientist Georg Sorensen to American business guru Jack Welch to various Indian public figures often used the two countries to support overly simplistic theses about globalization, democracy, and authoritarianism.

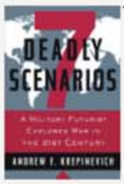
Of course, that was before the global financial crisis, the U.S. presidential election, and the devastating terror attacks in Mumbai. Now, the ways that China and India have remade themselves no longer have the same hold on short attention spans they did just a few months ago. Today, the sound of cascading market crashes seems to be drowning both the fretful and the exuberant China-India chatter—but not completely, probably not for long, and not equally in all places.

As for the "not completely," consider this: A recent Google search for "Dragon and Elephant" yielded nearly 5 million hits, compared with just 531,000 for "Eagle and Bear," a once dominant pair. On the "not for long": However the financial crisis shakes out, we'll surely see these two economies continue to claim a more central place in global markets, and some analysts have begun to speculate that the crashes might ultimately give these rising powers opportunities to narrow the gap between themselves and the United States, Britain, Germany, and Japan. And "not equally in all places"? Keep this in mind: The front sections of American newspapers might have ignored it, but in late October the front page of *The Hindu* featured Russia's announcement that it plans to move toward having China and India displace European countries as its main trading partners.

In that sense, the timing of *Smoke and Mirrors* is just fine. When the obsession with China and India's mutual, competitive, and thrilling rise comes back into vogue in the West—and it will—we will benefit from having Aiyar's cultural vantage point and nuanced lens. She will certainly serve as a better guide to exploring those issues that don't easily fit into the already hackneyed "Dragon vs. Elephant" cliché. And when it comes to answering that all-important question of how these countries are improving the future for their citizens, who better to help us understand than someone who knows them both with the love of a native and the curiosity of a traveler? FP

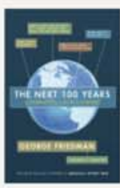
THE EARLY READ ON THE FUTURE

FP's new section, The Early Read, will highlight upcoming new books with big ideas. In this inaugural edition, we examine a few picks from the reliable crop of books about the future that appears every new year. These take a slightly longer view, with bold forecasts for the next century: which brewing conflicts will erupt into wars, which states will dominate, and what it will mean to live in a completely digitized world.



7 Deadly Scenarios: A Military Futurist Explores War in the 21st Century
By Andrew Krepinevich (January 27, Bantam)
As president of the Center for Strategic and Budgetary Assessments and consultant to the likes of the CIA and the Homeland Security Council, Krepinevich has studied everything from China's ambitions to Internet warfare to the puzzle of Pakistan. Now, he answers the question: What's the worst that could happen? Whether it's the detonation of black-market nuclear weapons in major cities or a global pandemic, his scenarios are deeply unsettling.

A Brief History of the Future
By Jacques Attali (March 11, Arcade)
For another harrowing forecast, one of France's top intellectuals (and an *FP* contributing editor) argues that history shapes the future with intrinsic, predictable patterns—and then uses them to foreshadow the period on deck. So what does Attali see? A massive reshaping of the global landscape, with democracy ultimately prevailing but at great expense in lives and money.



The Next 100 Years: A Forecast for the 21st Century
By George Friedman (January 27, Doubleday)
Friedman, founder of the geopolitical intelligence firm Stratfor, spins his day-job assessments into a map for the future. If he's right, we'll see a war between the United States and Russia, a new space race, an internal crisis in China, and the rise of Mexico as a major player.

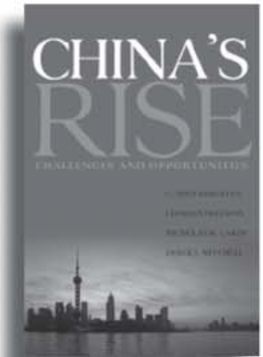
The Tyranny of Dead Ideas: Letting Go of the Old Ways of Thinking to Unleash a New Prosperity
By Matt Miller (January 6, Times Books)
Fortune columnist and Center for American Progress fellow Matt Miller predicts that America will only remain competitive by adopting a new approach to the future. The United States must, Miller argues, adopt a new set of "destined ideas": Only business can save liberalism, only government can save business, and there's no longer room to fear great policy ideas from abroad.

Carbon Shift: How the Twin Crises of Oil Depletion and Climate Change Will Define the Future
By Thomas Homer-Dixon (April 14, Random House Canada)
With the help of six of Canada's leading experts, Thomas Homer-Dixon argues that the dual crises of the future—climate change and peak oil—are really just one addressable problem with one simple answer: clean, low-carbon energy.

The Best in International Economics

Peterson Institute for International Economics

China's Rise: Challenges and Opportunities

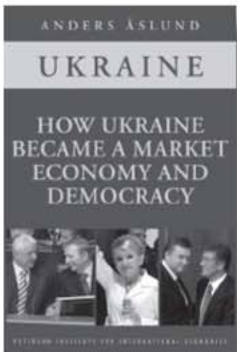


C. Fred Bergsten, Charles Freeman,
Nicholas R. Lardy & Derek J. Mitchell

"…designed to clarify contemporary China and advise how U.S. 'engagement' with China may best move ahead. There's lots here, but clearly presented, with a great chronology."

Library Journal

September 2008 • ISBN hardcover 978-0-88132-417-4 • **$26.95**



How Ukraine Became A Market Economy and Democracy

Anders Åslund

In this fast-paced, easy-to-read book, noted expert on postcommunist transformation, Anders Åslund traces Ukraine's transition into a market economy and democracy and assesses the repercussions of this gradual political rebirth on Ukraine's governmental and societal architecture.

March 2009 • ISBN paper 978-0-88132-427-3 • **$26.95**

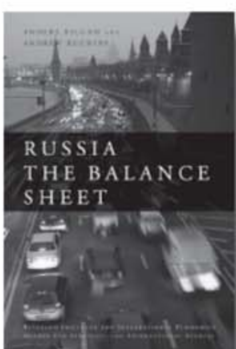
Banking on Basel: The Future of International Financial Regulation

Daniel K. Tarullo

"[Banking on Basel] is thorough, erudite, and well written. It will become a classic on this important topic of international bank regulation."

Robert Litan, Kauffman Foundation

September 2008 • ISBN paper 978-0-88132-423-5 • **$26.95**



Russia The Balance Sheet

Anders Åslund & Andrew Kuchins

This collaboration between the Peterson Institute and CSIS provides information on all key aspects of Russia and discusses what its status means for the US and other nations. The book develops a cohesive, overarching framework that analyzes economic reforms and integration, domestic politics and society, foreign business partnerships, and energy demands. It suggests constructive policies for Russia and the next US administration.

April 2009 • ISBN paper 978-0-88132-424-2 • **$24.95**

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NET EFFECT

[HOW TECHNOLOGY SHAPES THE WORLD]

Neighborhood Watch

When a rush of violence broke out last January after Kenya's presidential election, many wondered why it was so unexpected. Electoral rigging set off the attacks, but surely tensions simmered before. Could Kenya have seen the outburst coming and perhaps done something to prevent it?

Prediction, at least, was possible—and Web-based nonprofit Ushahidi (Swahili for "testimony") did just that. Funded by grants and individual donations, Ushahidi had already developed software that allowed any mobile-phone user in Kenya to report incidents of community tension. "[T]here were a lot of rumors going around way before the violence," says Ushahidi's founder, Ory Okolloh.

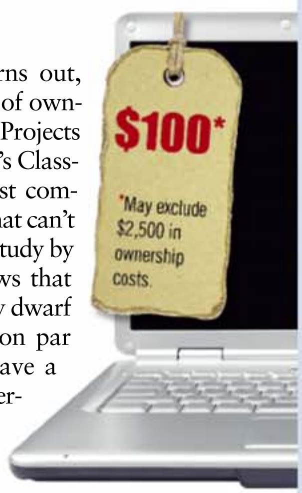
Okolloh's group operates one of a growing number of conflict early warning systems that are springing up online. They work because they are simple and fast. An Ushahidi user, for example, sends details of turmoil by text or posts directly to ushahidi.com. Once a local NGO verifies the account, the incident gets entered into the Ushahidi database and plotted on a map, tagged with a description of the event and with space for pictures and video. In Kenya, reports of violence were texted back to local leaders, who could mediate community conflict. International observers could monitor the reports, too.

E-alert: Conflict early warning systems are catching on.

For years, creating an effective means of alerting the world to brewing conflicts has been the dream of humanitarians. The African Union has been intent on creating its own system since the early 1990s. But none of the ideas was Internet-based. As the South Africa-based Institute for Security Studies put it, Web-based approaches "would have been patently inappropriate for an organization that only recently achieved a moderate level of external e-mail connectivity."

With Ushahidi, information is available within minutes, and Okolloh says censorship isn't a problem because governments "are more interested in what's in newspapers than what's online." Kenya was the first testing ground, and now Ushahidi is jumping into other conflict countries as well. As of November, the group was already receiving an average of four reports a day from the Democratic Republic of the Congo. This growing breadth could make Ushahidi something like the Wikipedia of conflicts, wrote Harvard researchers Joshua Goldstein and Juliana Rotich in a recent paper. "They are tools that allow cooperation on a massive scale." Ushahidi hopes to become a history worth contributing to. —*Elizabeth Dickinson*

Sticker Shock

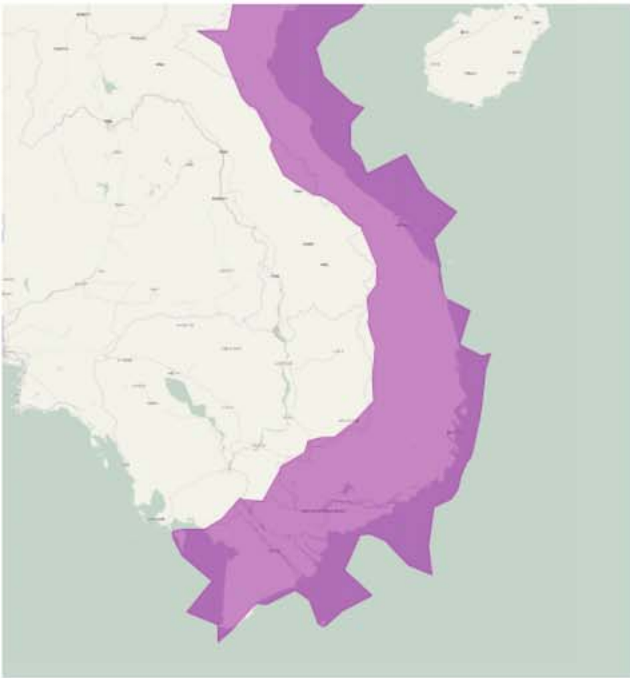


Remember the $100 laptop? Turns out, when you add up the total costs of ownership, the tab can actually top $2,600. Projects such as One Laptop per Child and Intel's Classmate PC have sought to bring low-cost computers to classrooms in poor countries that can't afford mainstream technology. A recent study by Vital Wave Consulting, however, shows that training and support expenses eventually dwarf the initial outlay, putting total costs on par with conventional machines. "You have a cheaper device, but you still need to understand those other costs," says Vital Wave's Karen Coppock. The ultracheap devices might not even last as long as ordinary computers, leading to sizable replacement bills. Classmate PC and One Laptop per Child hope to boost computer life spans with rugged, kid-friendly designs, but so far, the end product hasn't quite caught up with the hype. —*Jerome Chen*

Caught in the Net: Bank Customers

The financial crisis may have caught most of us flat-footed, but there's one group that has easily adapted to the new economic order: cybercriminals. Capitalizing on popular fears with new phishing campaigns, scammers are enjoying something of a bull market, according to the FBI. In a particularly clever ruse, criminals sent a fraudulent e-mail instructing Wachovia customers to hand over their online banking credentials ahead of a prospective merger with Citigroup. One cybercrime expert, who detected a jump in malicious software as U.S. stocks first headed south, told *Information Week* that economic anxiety could be causing nervous users to make bad decisions: "If the stock market is crashing, there's not a lot of confidence." Unless you're a thief, apparently.

TOP: URIEL SINAI/GETTY IMAGES; BOTTOM LEFT: ISTOCKPHOTO.COM; BOTTOM RIGHT: TIM BOYLE/GETTY IMAGES



A bright shining map: **Vietnam, generated by Flickr.**

Picture (Im)perfect

A picture may be worth a thousand words. But, as it turns out, it takes almost 100 million pictures to make a map.

The inventive engineers at Flickr—a popular Web site that allows users to upload and share photos online—have discovered a way to harness the data provided by their millions of users to create a constantly changing picture of the world itself.

When a user uploads a photo onto Flickr, he or she can pinpoint, or "geotag," the location where that photo was taken on an interactive map. GPS-enabled camera phones, such as Apple's iPhone, can do this automatically. Flickr then uses these coordinates to create a "Where on Earth" ID for the photo that includes the neighborhood or town where it was taken, right up to the continent, a process known as reverse-geocoding. The actual content of the photo itself is irrelevant; it's simply being used for its geographical data.

With 90 million geotagged photos and counting, the company's development team realized that these locations could be plotted on a map to create an outline.

Not all locations are equally easy to plot. "Within the first few weeks [of geotagging] there were probably enough photos to map San Francisco," says Flickr's Dan Catt, the senior engineer spearheading the project. But, he says, "there are still places in the world," such as the upper reaches of North America, "that we don't have enough photos to do." It takes about 10,000 photos for Flickr to map just one location.

Reverse-geocoding is also a lot harder than it sounds. Attendees at a 2007 technology conference in San Diego uploaded their photos only to see them tagged as being taken at the San Diego County jail. Flickr allows users to correct the geographical data that the company's software provides, but that creates its own set of problems. London residents, for instance, might have conflicting ideas about where Soho ends and Covent Garden begins.

For now, Catt considers the maps a "cool side project," but he hopes that by publishing the maps on its site, Flickr can "give people back" the ability to define their surroundings and trace how these definitions change over time. "Most of the data we have for Where on Earth comes from government sources. That doesn't always correspond with what people are seeing on the ground," he says. Geography, in other words, just became user-generated. —*Joshua Keating*

Expert Sitings

Barry Ritholtz is CEO and director of equity research at Fusion IQ, an online quantitative research firm. He blogs at ritholtz.com, a top-ranked financial Web site, and is a frequent television commentator.

calculatedrisk.blogspot.com

Run by a retired senior executive with deep expertise in housing finance (in a good way), this blog is a great source for the latest news and overlooked insights on the financial crisis and the folks in charge who keep screwing everything up.

stlouisfed.org

There's a simple mathematical beauty in a well-constructed chart. The St. Louis Fed's monthly *Monetary Trends* newsletter may not be flashy, but it's clean, clear, and always chock full of interesting data. The bank's research division produces a prodigious volume of expert analysis, too.

flowingdata.com

For some real numbers porn, surf around on this graphics-rich site. Whether it's a computer simulation of worldwide air-traffic patterns or a map showing global "friend" activity on Facebook, the guys at Flowing Data are brilliant at making complex visualizations look deceptively simple.

economagic.com

When I want to get the latest unemployment figures, survey trends in the three-month London interbank offered rate, or delve into the consumer price index, Economagic offers a much clearer starting point than the byzantine Web sites of the U.S. government or foreign central banks.

Elizabeth Dickinson is an assistant editor, Jerome Chen is a researcher, and Joshua Keating is an editorial assistant at FOREIGN POLICY.

Answers to the *FP* Quiz

(From page 30)

1) **C, Nigeria.** Hollywood may produce all the blockbusters, and India's Bollywood has the market cornered when it comes to song and dance, but Nigeria's Nollywood rakes in cash by churning out low-budget, direct-to-video flicks. Movies are filmed in less than two weeks for about $10,000 to $25,000, edited in a day or two, and sold dirt cheap by street hawkers. With 2,400 films produced every year, the movies pull in nearly $290 million in revenue across Africa.

2) **B, 7.** The greenback may be weak, but it is still the official currency in East Timor, Ecuador, El Salvador, the Marshall Islands, Micronesia, Palau, and Panama. Guatemala permits use of the dollar and other currencies, but businesses aren't required to accept them. Meanwhile, the U.S. dollar is the de facto currency in many other countries, such as Cambodia, Cuba, and Liberia.

3) **C, 42 percent.** As wild fish stocks are overexploited worldwide, the percentage of farmed seafood is predicted to rise to more than half of the world's total in the next decade, according to the Worldwatch Institute. Presently, the most farmed seafoods are those that are low on the food chain, such as carp, tilapia, and shellfish. China produced a whopping 70 percent of the world's farmed seafood in 2004, the most recent year for which figures are available. The world's top 10 countries for aquaculture are all in Asia, except No. 10, Chile.

4) **C, 30 times.** West and Central African countries such as Ghana and Guinea-Bissau have become increasingly popular transit points for cocaine trafficked from South America to European countries such as Portugal and Spain. According to the 2008 U.N. *World Drug Report*, seizures of cocaine in Africa increased from 0.5 metric tons in 2000 to 15 metric tons in 2006. And these numbers surely underestimate the extent of trafficking due to unreported data and weak law enforcement.

5) **B, 24**. Almost all countries without regular military forces, such as Liechtenstein, Iceland, and Samoa, are landlocked or island countries with small populations. But also on the list are Costa Rica, whose constitution prohibited the armed forces in 1949 in the wake of its civil war; Haiti, whose then president, Jean-Bertrand Aristide, demobilized the army in 1995; and Panama, which abolished the military in 1990.

6) **C, 61.** Using NASA satellite data and estimates of the number of trees typically found in different environments, an ecologist at Evergreen State College in Washington state has calculated that in 2005, there were approximately 400 billion trees on Earth. Divided by a world population of 6.5 billion people at the time, that's 61 trees per person.

7) **B, 12.** Women served as the heads of just 12 of the world's top 500 corporations last year. The group includes Angela Braly of health insurer WellPoint, Patricia Woertz of Archer Daniels Midland, and Indra Nooyi of PepsiCo. And though having women in the corner office of just 2 percent of the world's top businesses is hardly news to celebrate, signs point to an increasing number of cracks in the glass ceiling. In 2005, just six of the top 500 companies were led by women.

8) **B, *Yomiuri Shimbun*.** With a circulation of 10 million, Japan's *Yomiuri Shimbun* is the world's most-read newspaper, according to the World Association of Newspapers. Germany's *Bild* ranks as the No. 4 paper with 3.5 million in circulation, and China's *People's Daily* comes in at No. 9 with 2.8 million. Of the world's top 10 newspapers, five are from Japan, perhaps because Japanese newspapers typically put just 20 percent of their content online.

Continued from page 96

Continuing to assume, for example, that corporations always behave as profit maximizers and dismissing the importance of the self-interested behavior of their unaccountable managers will become much harder after this crash. Prolonged good times encourage bad habits and complacency not only among corporations and consumers but also among economists. The crash will stimulate creativity and the new thinking that comes from recognition of failure; the years ahead are bound to replenish the intellectual capital on which economists base their influence.

Certainly, the intellectual failures and the policy mistakes that led to the Great Depression produced a surge of innovative economic thinking. Thanks to the insights of John Maynard Keynes and others, governments now know that battling a crisis with tight money, spending cuts, and trade barriers fuels the economic fires instead of dousing them. So, they've put in place humongous bailouts and even larger fiscal stimulus packages that we are all hoping will work. If they do, economists will earn back some of their tarnished reputation.

Regaining intellectual respectability will be sorely needed to reverse some of the bad policy ideas that are gaining currency in the present crisis. Deriding deregulation, for example, is commonplace in the new blame game; so is bashing the rise of risk-spreading financial instruments. But economists know that deregulation does not always lead to reckless behavior and that financial derivatives are not always a scam. No matter. In many influential circles, saying that credit-default swaps can be beneficial or that deregulation can lift people out of poverty is now sacrilegious. It will take years for the pendulum to swing back to a desirable middle ground between the excessive and damaging deregulation of the past decade and the equally damaging regulatory exaggerations that we are bound to see in response to the justified indignation over the catastrophe. Economists can help in this rebalancing, but their current disrepute undermines their ability to persuade an angry public that they know what they are talking about.

This crisis of confidence comes as credible economists are urgently needed to deal with other nefarious consequences of the crash. Consider the alarming concentration of the financial industry. As banks and other companies go out of business or are absorbed by their rivals, only a handful of giant corporations remain with a disturbing concentration of assets and overall market share. Bank of America is now the bank for about half of all American families. Globally, Citigroup and UBS have been deeply damaged, allowing JPMorgan Chase to become a largely unchallenged behemoth. Typically, such markets with a few large players are vulnerable to collusion and other anticompetitive practices; in such a world, it's the customers who suffer.

Deregulation does not always lead to reckless behavior, and financial derivatives are not always a scam.

Competition is also being inhibited by financial protectionism. While economists worry that the crisis will spur countries into raising barriers to international trade in goods, significant restrictions on international financial integration have already been quietly created in recent months. Trade protectionism is a risk; financial protectionism is already here. The measures governments are taking to salvage banks and buttress their financial sectors have the side effect of making it very hard for newcomers to compete with existing players. Unfortunately, lessened competition is one of the costs we will all be paying for years to come.

Worrying about this collateral damage while the fire is still burning might seem a diversion. But it is worth remembering that our current mess was caused in large part by the "solutions" used to minimize the end of the dot-com bubble, the Asian financial crisis, and other crashes. These economic maladies were "cured" using medicines that weakened the patient and brought us the current catastrophe. We did not have a Keynes to alert us to the toxicity of the cure. Let's hope that we will soon get one—or many—of his successors, not only to bail out their profession but, more importantly, to save us from a new crisis created by the solutions to this one. FP

Moisés Naím is editor in chief of Foreign Policy.

An Intellectual Bailout

We must add another field to the list of those in need of rescuing—economics itself.

By Moisés Naím

The financial crisis has killed the claim that economics deserves to be treated as a science. The measure of a science is its capacity to explain, predict, and prescribe. And most economists not only failed to anticipate the nature and evolution of the catastrophe, but their conflicting recommendations on how to stabilize the situation exposed the unreliability of their knowledge. As much as Wall Street and Main Street, the economics profession needs a bailout of its own.

Policy gyrations and faulty calls have revealed that economics itself is in crisis: The experts simply have no idea what to do. No less an expert than U.S. Federal Reserve Chairman Ben Bernanke repeatedly declared the worst was over, only to admit with chagrin much later that "I and others were mistaken early on in saying that the subprime crisis would be contained." As recently as mid-November, Bernanke told the U.S. Congress that he thought the measures that had been taken "appeared to stabilize the situation," a pronouncement that proved wrong almost as soon as it was made. The fault lies less with Bernanke for trying to calm the markets than with the accumulated body of economic knowledge that failed miserably to equip him and other policymakers with more reliable tools to anticipate and navigate the crisis.

So, along with banks and brokerages, mortgage holders and emerging markets, it's time to add another rescue effort to the list—for economics itself. This intellectual bailout will force economists to revise the models and methods unquestioned during the boom years. It will force them to produce new tools suited to a new era and reinvigorate their thinking by borrowing more intensively from other disciplines, such as psychology and political science.

Continued on page 95

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