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The Business

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HOT AIR COOL HEADS

20 September 2004

It should have been a great news story: July 2004 was the coolest month in four and a half years and the coolest July in roughly 12 years, according to a team of eminent and well-respected scientists. The global temperature was 0.21°C below the 20-year average, satellite measurements reveal. This follows a June temperature about 0.02°C below average; there is plenty of evidence that August was cooler than usual.

Had the report discovered a massive increase in global warming, its findings would have made every television news bulletin in the world. But the report from the University of Alabama in Huntsville's Earth System Science Centre disappeared without a trace, simply because it went against one of the modern establishment's most dearly held prejudices: that the earth is getting warmer and that man is to be blamed for it, and the consequences will be catastrophic.

A similar short-sightedness has plagued Europe media's coverage of the terrible tornados that have hit Florida in recent weeks: few serious scientists believe they had anything to do with global warming, a point that even the New York Times acknowledges. The scientific consensus is that there are periods when there are a lot of hurricanes, and others with far fewer, and that these cycles are the result of natural forces. The worst decade for hurricanes was the 1940s.

The truth is that while the earth is probably getting a little bit warmer, we still don't know whether any of this is being caused by man-made activity, or whether it is mostly up to natural fluctuations. And even if the latter is true, a hard-headed economic analysis shows that we would be better off doing nothing about global warming for the time being. Only one thing is clear in the debate on global warming: the science and economics are fiendishly complex.

Needless to say, this view is shared by few leading politicians, especially in Europe. Last week, Prime Minister Tony Blair and Michael Howard, the Conservative Leader, called for reductions in carbon dioxide emissions, the implementation of the Kyoto treaty and a shift to costly and unreliable renewable energy.

Mr Howard's speech was especially disappointing, filled with meaningless sound bites such as "no one can opt out of the fight against global warming". Sadly, he refused to examine any of the scientific or economic evidence. "Climate change has happened in the past through a variety of natural causes. But I am persuaded that human activity is a major factor in the changes we see today," he said.

Why exactly he didn't explain. Presumably in the 1950s, 1960s and 1970s, when the earth went through a bout of global cooling, Mr Howard would have been "persuaded" by the conventional wisdom of the time (encapsulated by the famous Newsweek story of 28 April 1975 entitled "A Cooling World") that we were due for a devastating new ice age.

Unquestionably, there has been a rise in the amount of carbon dioxide in the atmosphere compared with pre-industrial times: levels are up from about 280 parts per million by volume (ppmv) to approximately 375ppmv today, with the bulk of the increase occurring since 1950, when it was 310mmpv.

Standard thermometer-based recordings have also recorded an increase in temperature at or near the surface of the earth over the past 100 years or so. The rise is probably about 0.6 degrees Celsius, which so far is not particularly significant. The evidence of a close link between carbon dioxide emissions and

temperature is weak: the bulk of the increase in surface temperature took place before 1950, suggesting that it was largely formed by natural phenomena.

In the popular imagination, the increase in so-called greenhouse gases will be accompanied by a proportional rise in the greenhouse effect and hence a rise in temperatures. This is not necessarily true. Of course, carbon dioxide traps infrared radiation and enhances the greenhouse effect of water vapour, thus keeping the earth form cooling down.

But after a certain concentration of greenhouse gas is reached in the atmosphere, its effect may begin to wane – a bit like a sponge, which ceases to suck up additional water after it is full. And according to a study in Geophysical Research Letters, the greenhouse effect may be weakening due to changes in cloud cover.

Even more radically, Richard Lindzen of the Massachusetts Institute of Technology believes that cloudiness may be responding to climate change: high altitude clouds that block outgoing radiation decrease as temperatures increase, suggesting that the earth operates a self-regulatory mechanism of astonishing complexity. Dozens of recent research papers have postulated related theories or found other problems with the standard view; clearly, we remain far from understanding how the atmosphere works and retains heat.

We don't even know if the earth is heating up: it will simply not do to rely exclusively on traditional thermometer measurements. These are incapable of providing an accurate gauge of global temperature because they ignore large parts of the earth's surface, especially the oceans.

Average temperatures in places such as London, Paris or New York are undoubtedly higher today then they were 100 years ago; there has also been an undoubted significant change in the climate of southern England. But this is hardly surprising. It doesn't prove that the temperatures are warming globally: there has been an explosion in the output of heat from central heating and cars in modern cities, creating what scientists call an urban heat island effect. This fatal flaw in the traditional data can be remedied by using balloon and satellite measurements instead of ground data. At worst, satellites show that the climate is currently 0.3 degree hotter then during the 1951 to 1980 average, itself distorted given the global cooling of the time.

There is also plenty of evidence that changes in the intensity of the sun's radiation plays a very important role in changing the earth's climate. In fact, leading scientists now agree that solar variability has emerged as the most plausible explanation for the Medieval warming of the 11th and 12th century: as well as for the little ice age of the 17th century.

In recent work, Gerard Bond and a research team at the Lamont-Doherty Earth Observatory in Palisades, New York, studied iceberg debris on the floor of the North Atlantic. They found that the world has gone through nine global warmings, followed by nine global coolings in the past 12,000 years.

It now seems likely that they were all caused by a 1,500-year cycle in the intensity of the sun's radiation. The correlation between earth climate (measured by iceberg debris) and solar activity (gauged by tree rings and ice cores) is remarkably high. It could well be the case that the current slight increase in global temperature is due exclusively to more intense solar activity.

What remains unknown, however, is the exact mechanism the sun uses to influence the climate. An earlier hypothesis – that variations in North Atlantic Ocean currents were responsible for global climate change – is now being incorporated into the more general sunspot theory: currents probably amplify fluctuations in the sun's intensity.

Even the standard claim that man-made global warming is leading glaciers and ice caps to melt, threatening a huge rise in sea levels, is open to question. One study found that sea ice has declined by about 33% over the past 135 years, but that most of this took place before man-made carbon dioxide emissions rose significantly.

Another mystery: Mount Kilimanjaro's ice cap 4,000 to 11,000 years ago was much larger then it is today, at a time when Africa was much warmer. Kilimanjaro lost 45% of its cap in the first half of the 20th century, a period of natural warming. From 1953 to 1976, when the earth cooled, Kilimanjaro lost another 12% - its slowest rate of the past 100 years. This suggests that the current melting could be due to natural cycles, a theory shared by many scientists.

The simplistic certainty of the global warming crowd is inexcusable: people who have an interest in the environment need to do the hard work and read up on the latest research, including that which goes against their prejudices. This is especially important if they are seeking to impose huge taxes on petrol and traditional energy sources which will change the way of life of the western world. It is time for the greens to grow up: they must debate with sceptics, rather then insult their motives.

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PAY HEED TO THE MISERY OF MICAWBER, MS HEWITT

26 September 2004

Patricia Hewitt, Britain's trade and industry secretary, should spend more time reading Charles Dickens – and pay special attention to the wise words of Mr Micawber in David Copperfield.

Micawber, an eternal optimist and one of the cuddlier of Dickens' characters, was nevertheless forced to learn the hard way about the laws of economics: "Annual income twenty pounds, annual expenditure nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds nought and six, result misery", as he famously put it before being thrown into jail for failing to repay his debts.

Today, Micawber's famous quip is more valid then ever; translated into contemporary English, it is a variation on the "no such thing as a free lunch" theme popularized by Milton Friedman, the Nobel-prize winning economist. Micawber's logic can be extended to shed light on a whole range of issues – including the latest proposal from Hewitt to heap yet more costly labour market regulations on the British economy.

In a bid to boost the Labour Party's flagging support among female voters,

Hewitt is calling for a huge extension of maternity and paternity leave. Undoubtedly, the idea will prove appealing to millions of people. But her proposals fall foul of the crucial Micawber test of economic rationality.

A worker who brings in £20 (€ 29.2, $36) an hour in revenue to his employers while costing £19 in wages, training costs and other expenses, will keep his job; but a worker who brings in £20 but costs £21 will be fired. In the labour market, the difference between happiness and misery can be quite small – but Hewitt's thoughtless plan will tip thousands over the edge and into unemployment by increasing wage costs.

To survive, companies must maximise their profits at all times, which means ruthlessly applying cost-benefit analysis to their operations and, sadly, also to their staff. In today's globalised world, where even the most hi-tech western firms are under threat from Chinese or Indian rivals, inefficiencies need to be stripped out fast.

Each time the cost of hiring people is artificially increased by the state, as it was last year when Gordon Brown hiked up national insurance contributions by a percentage point on employers and employees, thousands of jobs are not lost or created. The government fails to understand this: it seems to think that the costs of employing workers can be made to rise indefinitely without any effect on employment, an absurd proposition with which not a single reputable economist in the world would agree.

Until now, the damage to private sector job-creation has largely been masked by public sector recruitment binge, which has seen more than 500,000 people added to the state's payrolls; eventually, however, it will become clear for all to see.

Hewitt's latest proposals will continue to increase labour costs, hitting small businesses hard. At present, the law in the UK allows new mothers to take six months paid maternity leave after the birth of a child. The first six weeks are paid at 90% of usual wages and the next 20 are a flat £102.80 per week. Mothers are also given the option of another six months unpaid leave. After recent reforms, new fathers are allowed two weeks' paternity leave at a maximum of £102.80 a week – but only 20% or so of fathers eligible take up their paternity leave.

Under Hewitt's plans, new mothers would see their paid leave doubled to 12 months, while new fathers would see their paternity pay increased to 90% of their salaries. They may even be granted the right to take six months unpaid leave. In addition, the new rights currently granted to parents of young children to request flexible working patterns would also be extended to those caring for elderly relatives.

It goes without saying that it would be a wonderful thing if parents could take so much time off; unfortunately, in the real world, there will be ugly consequences in terms of reduced jobs and opportunities, as well as greater discrimination against anyone, man or woman, suspected of wanting to have children.

While large multinational companies ought to be able to cope, the impact on small companies will be catastrophic. Hundreds of thousands of businesses in the UK employ fewer then five workers. They will not be able to cope with the disruption of loosing half or a third of their staff for a year; and many will go bankrupt, inflicting untold misery on employees and owners.

Last week, Hewitt hinted that the taxpayers would be asked to foot the bill for the extra payouts – though of course business would not be compensated for the intense disruption and other costs incurred. It would also make it even more likely that taxes will have to rise yet further after the next election.

Although he misunderstood the harsh reality of life, Micawber was always hoping that "something would turn up" to save him from financial crisis. Tragically, for those who will lose their jobs because of Hewitt's misguided policies, there will be little else to do.

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THE SQUALID POLITICS OF SQUANDERED AID

16 January 2005

Peter Bauer, the late British expert on the economics of developing countries, famously quipped that foreign aid is a system by which the poor in rich countries are taxed to subsidise the rich in poor countries. How right he was: since 1951, Western Countries have given developing countries more than $1 trillion (£530bn, €750bn) in economic and humanitarian aid; instead of stimulating economic growth and helping the needy, foreign aid has perpetuated poverty, bred corruption and financed kletocracy.

Gordon Brown, Britain's Chancellor, appears to know nothing of this; he is in South Africa this weekend, completing a tour of the continent to extol the virtues of his plan to double foreign aid to $100bn a year over the next decade, grandly (albeit incorrectly) dubbed a "new Marshall Plan". Under his proposed International Finance Facility, which has failed to garner US and other support and will therefore likely never materalise, bonds will be issues using rich countries' long-term funding commitments as collateral. This is likely to do more for Mr Brown's ambitions to replace Tony Blair as Prime Minister than it is to eradicate poverty in Africa.

When it comes to scandals that is global poverty, Mr Brown undoubtedly has his heart in the right place; but he refuses to see that his old-fashioned approach to helping Africa has already been tried and found disastrously wanting. That around a billion human beings must still survive on under a dollar a day in 2005 is nothing short of an obscenity; it is a terrible blot on all our consciences and must be tackled urgently. But before they waste yet more time and money in feel-good schemes while doing little that actually helps the poor, Mr Brown and those who agree with him that more aid is the solution (including, for reasons which escape us, Michael Howard's Conservative Party) should take a look at the facts.

Zambia, a recipient of foreign aid for over four decades, is a typical horror story: it has received well over $1bn in bilateral economic aid from the US alone and was the beneficiary of 12 adjustment loans from the World Bank and the IMF during the 1980's and 1990's. Yet Zambia's real gross domestic product (GDP) per person has collapsed from $660 to $577 in 2002, in constant terms, a 12% fall. As a result of reduced income and the explosion of diseases, life expectancy in the region has fallen. The region's combined annual economic output is a mere $296bn, about 15% of Britain's. Many countries are poorer today than when they first become

independent, despite $100bn in World Bank Assistance; sub-Saharan Africa routinely receives 8% of its GDP in aid. Excluding Nigeria and South Africa, aid reaches 13% of GDP, more than 4 times greater than the Marshall plans at its peak. There is overwhelming evidence that foreign aid has no real effect on a country's growth rates. Brett Schaefer, a development economist at the Heritage Foundation in Washington, has analysed the 45 sub-Saharan African countries for which detailed numbers are available between 1980 and 2002. He finds that 23 suffered negative annual growth in real per capita GDP; seven experienced growth between 0% and 1%; and 15 growth of more than 1% a year. Of the latter category, only three achieved more than 4%.

Aid's abysmal record is not unique to Africa. Of the 77 countries that received aid of at least 1% of their GDP between 1980 and 2001, 33 suffered decline in real per capita GDP; 15 saw growth of less than 1% a year; and 29 enjoyed growth of more than 1% a year. Even more depressingly, out of these 29 countries, only eight grew by more than 3%.

One reason why aid has had so little effect is that much of it has ended up in Swiss (and London) bank accounts of corrupt politicians. According to the World Bank Institute, more than $1 trillion is paid in bribes each year globally, roughly 3% of global GDP and equivalent to the total value of aid ever paid to the third world. According to the institute, countries that reduce corruption and strengthen their rule of law can boost incomes by as much as four times in the long term, while cutting child mortality by up to 75%, a phenomenon it calls the "400% governance dividend".

Transparency International estimates that General Suharto, the former Indonesian leader, stole between $15bn and $35bn from his country, while Ferdinand Marcos in the Philippines, Mobutu Sese Seko in Zaire and Sani Abacha in Nigeria embezzled up to $5bn each. Robert Mugabe, Zimbabwe's director, is another monstrous tyrant who is still being propped up with Western taxpayers' money. Even though sanctions were slapped on Zimbabwe four years ago, the European Union (EU) has since provided at least €30m in aid to Zimbabwe and Britain a further £62m, while other European countries have also contributed, taking the total channeled to Zimbabwe via Brussels to at least £115m. But while the money was meant to be spent on Aids and helping the poor, an EU audit last year found that 89% of the total had ended up in the pockets of allies of Mr Mugabe and his Zanu-PF Party.

The key drivers of economic and social development are domestic policies and institutions, not foreign aid; as the cases of North and South Korea and East and West Germany proved conclusively. Capitalist economies, with strong attachments to property rights, the rule of law, limited government intervention in the economy and low inflation generate massive growth; socialist economies are a disaster and embed poverty and deprivation, regardless of how much foreign aid they receive.

The fact that national income per person in South East Asia was lower than in sub-Saharan Africa in 1960, but has since surged following the most remarkable and fastest economic turnaround in history, is a natural experiment which demonstrates the superiority of the free-market development model. We are not talking only of runaway success stories such as Singapore, Hong Kong or Taiwan: even relatively unsuccessful Asian countries such as Indonesia have done far better than their African counterparts. In 1960, Indonesia's national income per person was a mere $249, almost the same as Nigeria's $224. Nigeria GDP has increased by only $24 per head after adjusting for inflation, while Indonesia's GDP per person has soared four-fold to over $1,000.

The two countries are on different continents but they share many characteristics; they both enjoy oil reserves, have multi-ethnic populations that are large and growing, suffer from extensive religious tensions, are large geographically and plagued with corrupt and unstable governments. The only difference is that Indonesia, despite many problems, has embraced a freer market economy.

Successful countries, such as Hong Kong, never relied on outside help in the first place, aid to China and India averaged only 0.4% and 0.7% of GDP during the 1980's and 1990's. Their economies only started to surge when they began dumping the failed collectivist nostrums of the past; today's poor countries must do the same. Africa – and the west – have a lot to learn from the two African economies that have bucked the trend and enjoyed some success in recent years. Botswana and Mauritius, which have both enjoyed average growth of 4.4% since 1980 and which boast the freest, most market-friendly economies outside South Africa.

For the West, the first priority must be to push for free trade and the abolition of its scandalous trade barriers and agricultural subsidies. To his credit, Mr Brown supports freer trade; but alone he can do nothing, because the UK's trade and agricultural policies are determined in Brussels, an increasingly intolerable situation.

But trade liberalisation alone won't be enough. The West must help African countries to reform their institutions and especially revolutionise their attitude to property rights and the rule of law, the single most important prerequisites for economic growth. Any aid or debt forgiveness must be subordinated to this goal. Not glamorous enough for Mr Brown and other politicians who like to grandstand with taxpayers' money. Perhaps; but unlike chucking billions at the problem such as policy would actually work – and allow millions of Africans to start enjoying the fruits of prosperity for the first time.

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George Kerevan

The Scotsman

In a Flat World, the Truth is not Economical – 2 August 2004

It is Time to Mourn our Forgotten Son – 9 August 2004

Geldof is Wrong: Aid to Africa has not worked – 19 May 2005

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IN A FLAT WORLD, THE TRUTH IS NOT ECONOMICAL

2 August 2004

A WTO deal to cut trade barriers is sound economics and should benefit everyone - but don't hold your breath waiting for things to improve

Attentive readers will know that I taught the dismal science of economics for years before escaping into journalism. It was not a traumatic break, because I had long realised that economics is one of those subjects folk don't take seriously.

Worldwide, millions of students have attended worthy economics lectures, memorised incomprehensible diagrams and written perfectly acceptable exam answers – all the while blithely refusing to believe any of the stuff as scientific truth. It's as if we nodded comfortingly when the geography teacher told us the world is round, yet went on believing what our eyes told us – that it's flat.

All this comes to mind with the news that the World Trade Organisation talks in Geneva have resulted – theoretically – in an agreement to cut trade barriers, particularly in agriculture. Actually, the decision is wrapped in enough fine print to keep the lawyers busy for years (of which more anon). But if successfully implemented, this will make you personally a lot richer. So why has this taken so long? Because vested political interest doesn't want to be troubled by the elegant simplicities of economic truth.

The EU taxes its citizens £30 billion a year and gives it to farmers. The reasons vary, but the subsidy goes on rising. Once it was a sop to stop French peasants voting communist. Then it was claimed local food production had to be encouraged lest wicked foreigners decided to starve us to death. Now we are kidded into believing if we don't pay this levy "the environment" will suffer, because Mother Nature is incapable of looking after the countryside.

All of this is absolute tosh, if you will forgive a little Monday morning spleen. The supermarkets are groaning with food, nobody in Kenya or Australia is planning to deny us our dinner, and the countryside has never looked trimmer (though it could do with a few more low-density houses). The EU food tax makes us poorer, kills jobs in the industries we'd otherwise spend the cash on, and impoverishes the Third World because we subsidise EU farmers to dump agricultural produce abroad, giving native farmers little recourse but to join al-Qaeda.

You'd have thought all this was common sense. But anyone who has done year-one economics should know it stands up in theory as well. If every nation concentrates on what it is most productive at doing, and trades the result, we maximise world output. If, instead, we subsidise our own industries and put tariffs on cheaper imports, we reduce world output because everybody is diverting productive resources to inefficient ends. A recent study by Michigan University indicates that if the world traded freely, it would add instantly about £400 billion a year to world output (that's about £70 each for everybody on the planet).

Will the deal stitched up in Geneva at the weekend get us on the road to this common sense? In the long run, probably; but in the short run, don't hold your breath. Much of the flowery rhetoric about what transpired at Geneva is PR spin. To understand what really happened, and why no-one believes the economic textbooks, wind the clock back a little.

The Second World War was the most bloody conflict in human history. It had lots of causes, but a major one was the rise of trade barriers in the 1930s. Shutting out imports was thought (erroneously) to create local jobs during the Great Depression. All it did was spread

the misery and provoke some countries to invade others to get raw materials and markets. The world got such a fright that common sense broke out for a bit: to stop another war, the Allies set up the forerunner of the WTO to negotiate systematically a reduction in tariff barriers and subsidies. This policy has been a resounding success, which explains why you are a lot better off than your grandparents were.

However, as the decades have gone on, cutting tariffs and subsidies has become more difficult. One reason is that early trade reforms concentrated on manufacturing goods. Meanwhile, everyone in both the developed and underdeveloped world was busily protecting their agriculture, which is actually small beer in economic terms; and services, which is where, in the age of the internet, the bulk of global business and profits now reside. In other words, reform took place because it was kept to the less important bits of the world economy.

Enter special-interest groups. These can be governments that own their local telecommunications systems and don't want foreign competition reducing graft or influence. Or local private banks worried about being gobbled up by more efficient outsiders. Forget the potential gains for the world as a whole, the special-interest groups are not happy with the idea of free trade.

In this murky world, there are no good guys or bad guys – though the worst of the lobbies are capable of using leftist, anti-globalisation rhetoric to protect their monopolies. Yes, the French, Japanese and Swiss are defending their intrinsic right to subsidise the export of foodstuffs which are ludicrously expensive to produce, bankrupting Third World farmers in the process. This is called protecting one's "way of life". But the biggest culprits in the past two years have been the Brazilians. They lead an intermediate group of semi-industrialised nations anxious to protect their home markets in services and advanced manufactures like computers and aerospace.

The Brazilians effectively scuppered the last round of WTO negotiations at Cancun in Mexico by siding with the poorer agricultural nations. Together, they vetoed a US-EU proposal to link cuts in agricultural subsidies to reciprocal free trade in services. Naïve anti-globalists in Britain thought this was a great moral victory, as it was a poke in the eye for the West. Actually, it was the Brazilian oligarchs blocking any further trade reform in their own self-interest. As it left US-EU farm subsidies intact, how did it help the developing world?

A year on, some sense has returned, largely because the developing countries have realised that if they want free trade in agriculture they are going to have to concede free trade in services. If you have millions of militant peasant farmers demanding work, you eventually make the deal. The fact that the citizens of poor nations might also get a better phone service and banking without corruption is an added bonus, though the bent politicians and their cronies might not be convinced.

Here is the downside. What was decided at Geneva is a "framework package". That jargon means they have only agreed to agree, but the small print has to be sorted out, which could take years. America and the EU have agreed to drop agricultural export subsidies and lower tariff barriers on food and cotton. But expect a switch to "environmental" subsidies. In return, the semi-developed and developing nations will liberalise trade in services. In practice, that will be fought inch by inch. If you remember the French government is still stalling on the 12-year-old decision to liberalise trade in services inside the EU, you'll get the picture.

Still, lip service has been paid to economic truth. But, like my students of yore, I suspect many will not really understand the vast potential for human gain inherent in this agreement, and continue to think that the economic world is flat and free trade a con.

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IT IS TIME TO MOURN OUR FORGOTTEN SON

9 August 2004

The first harbingers of the Edinburgh Festival – people leafleting for Fringe productions in obscure venues – are in town. And, as I walk down the High Street to The Scotsman offices, I am waylaid increasingly by flocks of tourists asking directions.

I'm often surprised by what they are seeking. Not the elegant new palace gallery or even the infamous building site at the bottom of the Royal Mile, but, rather fantastically, the grave of a long-dead economist and son of the Scottish Enlightenment. Some, usually earnest young Asians, want to find the former home of this influential historical personage. There is a discreet plaque pointing the way: lazy Edinburgh never having bothered to introduce any systematic signage to mark where its heroes and heroines passed their days. Who are they seeking? A certain Adam Smith, Esq.

Recently has come the news that some devoted intellectual followers of the great man plan to honour him with a statue in the capital's Royal Mile (Smith is buried in Canongate churchyard). About time, says I. But this begs an intriguing question. Why, in a city replete with statues of the royally obscure, has the citizen who, arguably, most influenced the world we live in, not only been denied visible public honours but had his entire heritage wilfully ignored, to the point where tourists can't easily find either his grave or his house when they are standing only 30 feet away?

For the uninitiated, Smith, this new tourist attraction, was born in Kirkcaldy in 1723. Kirkcaldy was no backwater. In those days, Fife was rich through smuggling and trade with the Baltic, and its merchant class devoted its wealth to intellectual pursuits as well as a little surreptitious hell-raising. This was a frenzied period of modernisation. Feudalism and tribalism were being dumped in favour of urban capitalism. Thinkers such as Smith intellectualised the process – one that was soon extended to the rest of the globe. If television had existed, he would have had his own chat show.

At 28, Smith was an influential professor at Glasgow University. In 1776, the year of the American Revolution, he moved to London (then the world's biggest city) and published the book he is famous for, *The Wealth of Nations*, a manual on how to achieve economic growth through market competition. Two years later, he retreated to Edinburgh where he died in 1790, one of the most influential writers of his day.

On a personal note, it was discovered on his death that he had devoted a large part of his fortune to anonymous acts of charity in his adopted home town. He never married and history is silent on his sex life.

At this point, Smith might have been consigned to the history books, mildly famous for having written works no-one reads any longer. I can vouch that this is not the case, as I was made to read *The Wealth of Nations* at Glasgow University, under the frightening tutelage of his greatest contemporary expositor, Professor Andrew Skinner.

Smith's intellectual longevity results from his prescience in two areas. He was the first to explain in popular language the rudiments of nascent market capitalism, a form of human activity about to dominate the world, thanks in part to Smith's brilliant analysis. (In contrast, hardly anybody reads turgid Karl Marx any more.) But there's much more to him than being the first pro-market economist. He was an important intellectual brick in the Scottish Enlightenment, and – Dr Marx, to the contrary, not withstanding – ideas are what change the world, not economic forces. It was the Scots, especially Smith, who realised a key idea: that men were, indeed, self-interested, but that this self-interest could be channelled to promote social welfare under certain conditions – mainly free exchange, coupled with a rigorous regard for private property rights. The French Enlightenment also believed in the power of self-interest but deemed it inherently bad, and thought a strong political state was needed to civilise mankind.

You could argue, as does the historian Arthur Herman, that the Cold War was a confrontation between the principles of Smith and the Scottish Enlightenment, and those of the French Enlightenment, with its collectivist inheritance. The former was embedded in American values and institutions bequeathed by Scots immigrants; the latter was passed on by utopian French socialists, first to Marx in the 19th century, and then to the Stalinist nightmare as to what human improvement was about. With this historical pedigree, why is Smith so forgotten in Edinburgh, the capital of the Scottish Enlightenment? There's not even a likeness in the Scottish National Portrait Gallery. Would it be churlish to think it has something to do with Smith's strong association with Glasgow University (where I learned my economics in the uncomfortable surrounding of the Adam Smith lecture theatre)? Surely, we are beyond such pettiness.

Again, the lack of recognition may be due to a subtle left-wing bias against what he is presumed to have stood for – a bias on the part of Edinburgh councillors and even the Church of Scotland, where they still remember Mrs Thatcher's sermon on Smith at the 1988 General Assembly. Such naive prejudice misconstrues his powerful moral stance. He believed governments could not make men moral and that even the most well-intentioned prince would be corrupted by power – witness Tony Blair. Equally, he denounced commercial monopoly and the inherent desire of businessmen to cheat customers.

For Smith, the state denied people the right to their own initiative. However, that vital initiative had to be channelled by law and competition. It is the lack of these vital moral ingredients – not a lack of western aid – that condemns Africa and other parts of the developing world to grinding poverty. Because of that, Smith's teachings are as pertinent as ever – which is why Edinburgh should honour its famous son.

Here's how. Smith's Edinburgh home, Panmure House, still exists, just up the road from the new Scottish Parliament building. It is used by Edinburgh's social work department to help young people. A laudable use, but imagine if Mozart's house was similarly used. So, why not turn Panmure House into a permanent museum to honour Smith, his work and the Scottish Enlightenment?

Of course, present activities in the house would have to be relocated. However, they deserve a more modern building, and sponsorship funds from around the globe that would be attracted by a project to create an Adam Smith Museum would fund alternative and superior premises for the social work department. If the council would express a willingness in principle to transfer Panmure House to a trust set up to mastermind the project, subject of course to a suitable relocation being found for the social work department, then everything could get under way.

The museum would be another useful visitor attraction in the Royal Mile and could serve as a centre for scholarly research into Smith's work and influence. And it would do no harm to have the ghost of Mr Smith keeping a weather eye on the goings-on across the way at Holyrood.

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GELDOF IS WRONG: AID TO AFRICA HAS NOT WORKED

19 May 2005

Perhaps I'm just growing old and grumpy but the sight of Bob Geldof parading his millionaire ego at Holyrood was more than I could bear. Yes, the plight of sub-Saharan Africa is desperate, but it will be cured by hard economic logic rather than pop-star emotion.

Geldof thinks African poverty is our fault. He thinks we are not giving Africa enough free financial aid – an extra £50 billion a year, or roughly the entire national income of Scotland, would be handy.

He also wants us to forgive all debt interest owed by African governments – I've seen numerous conflicting estimates, but we're in the billions-a-year category. And he is anxious that the G8 countries open their economies to African imports without expecting the same in return. This is called "fair trade".

Just for a moment, let us ask: what has happened to the half a trillion dollars lent to the independent African countries since the Sixties? We are talking your taxes here. The whole point about borrowing is that you invest and end up richer than you started, even after paying back the loan. How come most of Africa is now poorer than when the loans began?

The answer has nothing to do with the usurious West demanding interest payments. During the Eighties alone, there were at least 92 attempted military takeovers in sub-Saharan Africa, affecting 29 countries. Not to put too fine a point on it, your money was wasted in civil war and corruption.

Remember Geldof's famous Live Aid concert of 1985, to raise donations to end famine in Ethiopia? Well, the Ethiopians

were starving not because you lent them money but because their utterly mad dictator, the odious Mengistu Haile Marium, had butchered at least 100,000 of them in imposing his Marxist dictatorship. Then he launched a series of external wars, with the help of Cuban tanks lent by his fellow nutter, Fidel Castro. That bumped off thousands more, while destroying the local economy. And by the way, much of the food aid paid for by Live Aid ended up being stolen by Mengistu to feed his armies. Never mind, it made Geldof famous, even if it didn't help the Ethiopians.

When your loans were not funding genocide, they were funding Swiss bank accounts. Western aid has corrupted generations of African politicians as it is the fastest route to riches for the local elite.

By 1982, the former Belgian colony of Zaire (now the Democratic Republic of Congo) had accumulated a foreign debt of $5 billion. Not coincidentally, its president, Mobutu Sese Seko, accumulated a personal fortune of $4 billion. I know the Belgians ran Zaire in a despicable way. But I also know that the country is one of the most mineral-rich on the face of the Earth and should be lending money itself by now. The reason it is one of the saddest countries on the planet is not because you don't send them charity.

I'm being this provocative because I want people to stop thinking that aid and writing off debts will, on their own, have any impact. The problem is how to break the perpetual cycle of charity enfeebling sub-Saharan Africa, funding its civil wars, corrupting its politicians and making Africans hate us for our patronising western ways (Geldof, please note).

For the record, given sub-Saharan Africa's current basket-case economies, a strictly short-term Marshall Plan may be necessary. But it has to be linked to a vision that says Africa has to help itself through trade, not aid. Africa needs a bourgeois revolution: the emergence of an entrepreneurial middle class which will create local jobs by making and selling products other folk want to buy.

The model is already there in Asia. In the Fifties, Britain left its African colonies with a solid infrastructure and legal system. GDP per head in many African countries – Ghana, for instance – was better than in many Asian states. But these days, while the African economy has actually stagnated in real terms, much of south-east Asia has undergone an economic revolution and is now richer than Britain was in the Fifties. And the Asian economies did this not through aid but through wicked capitalist borrowing and selling us video recorders.

Consider the contrasting fortunes of Malawi, which the First Minister is about to visit, and South Korea. In the mid-Fifties, Korea had been devastated by war. What was left of the economy of this underdeveloped ex-Japanese colony was based on peasant cultivation of rice. GDP per head was under $100. Meanwhile in Africa, when it became independent in 1964, Malawi could count on a decent legal and physical infrastructure, a capable Asian business class and a modest but thriving economy.

Today, Malawi is one of the world's least-developed nations. After decades of dictatorship from which it only recently escaped, during which the Asian business class was dispossessed, the economy stagnated. GDP per head is now roughly £300. Meanwhile, Korea has industrialised and increased its GDP per capita from virtually nothing to around £9,000.

The first thing the Koreans did was to get rid of their unproductive peasant agriculture – precisely the kind of backward economy that the "fair trade" lobby wishes to entrench in Africa.

Of course, it is true that western countries rig their economies to keep out cheap African agricultural produce. You will get no argument from me against scrapping our daft western agricultural subsidies, importing cheap food from Africa and Ukraine, and cutting my taxes into the bargain.

The developed world funnels nearly one billion dollars a day in subsidies to its own farmers, coincidentally enabling them to dump artificially cheap food in poor countries, resulting in yet more poverty. The World Bank estimates that if the rich nations would only stop their farm subsidies and tariffs, the poor nations would benefit by as much as half a trillion dollars and lift 150 million people out of poverty by 2015. Of course, there's a little matter of persuading western farmers to accept this, but then Sir Bob Geldof has never stood for elected office.

However, why wait for the West? There is an instant solution in Africa's own hands. The nations of sub-Saharan Africa do very little trading with each other. Why not form an African Common Market, raise a universal tariff wall to outsiders, but cut tariffs rapidly between the African states themselves – very much as Europe did?

Next, rather than abolish African debts, why not turn them over to the African equivalent of the European Bank for Reconstruction and Development (owned by the African Union) to use the interest to fund that Marshall Plan?

And by creating a common and interdependent African economy, we begin the process of eliminating the tribal frictions that underpin Africa's recurrent civil wars.

Finally, creating a strong, single African currency, issued by an independent currency board and pegged to the euro, would let individual African countries such as Malawi start to escape their difficulties in raising foreign exchange. The IMF could then lend the currency board the necessary reserves, free in the knowledge the money would not end up in Zurich.

With that vital political and economic infrastructure in place, foreign investment and tourism will start to do the rest. And Bob Geldof can go back to making terrible pop music.

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Deroy Murdock

National Review Online

Pills Don't Grow on Trees – 29 October 2004

Losing Case – 7 June 2005

H.O.T. Tax – 17 June 2005

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PILLS DON'T GROW ON TREES

29 October 2004

WEST POINT, PA. — Politicians of yore promised voters "a chicken in every pot." Today's pols pledge "cheap drugs in every medicine chest." This, oddly enough, has become a largely bipartisan prescription. Democrats and Republicans alike propose reimportation of Canadian pharmaceuticals, faster approval of generic drugs, and other policies designed to reduce medication prices.

The mounting financial and legal woes at Merck only will fuel calls to "get the drug companies." CEO Ray Gilmartin's November 18 Capitol Hill testimony on what Merck knew about Vioxx and when has removed the public's focus from this drug giant's ongoing quest for cures. Merck now faces a prescription-strength headache, thanks to a stock price that has sagged 40 percent and both litigators and regulators who are circling overhead.

Nevertheless, before Congress reconvenes and President Bush begins his second term, leaders from Capitol Hill and the White House should arrange to visit Merck's research facility in this lovely Keystone State hamlet. Set amid rolling hills, scenic mansions, and horse-filled pastures 30 miles from Philadelphia, this 415-acre campus is home to some 10,000 scientists and support personnel, all dedicated to preventing, relieving, and curing disease.

Before seeing room upon room of well-scrubbed laboratories filled with cutting-edge scientific gear and enthusiastic, highly skilled employees, it is easy to wonder how some little capsule the size of a pencil eraser could cost $2.67 each, as does Merck's Crixivan, a life-saving anti-AIDS drug. Who do these people think they are, charging so much for *that?*

Dr. Michael Bogusky helps explain why. Standing in a white lab coat beside a mind-numbingly complex poster of the HIV virus and its deadly components, he says, "It's a high-risk business and many things fail. But we also learn from the failures, and that has an impact all around the world."

Time and again, Bogusky and his three-man team pour mysterious fluids into test tubes, slide them into something that resembles a microbrewer's vat, and then activate a 600-megahertz super conducting electromagnet. It is so strong that the structure that houses it was constructed from high-strength, non-magnetic aluminum, to prevent the damage that would befall a typical room with steel beams and fixtures. This $900,000 apparatus helps these scientists analyze novel molecules with computers, mathematical models, and methods far beyond a mere journalist's comprehension. All told, Bogusky works in a $3 million lab, featuring $2.5 million in instruments and $500,000 in special construction.

Bogusky's team does this every day. And nearly all of what they produce is useless. Last year, of the 300 to 400 molecules tested in this one lab, only three progressed towards clinical trials, with no guarantee of commercialization. Asked how many compounds on which he worked reached consumers during his 15 years with Merck, Bogusky listed three: Aggrastat (an anti-coagulant), and Crixivan and Stocrin, both AIDS drugs. Too bad Merck cannot sell such Herculean patience in pill form.

This (rare) hit and (frequent) miss atmosphere prevails in Dr. Graham Smith's lab. It is filled with large, brown glass bottles. One is marked "HPLC phosphate buffer." A cleaned beaker air-dries on a wooden dowel above a sink.

The bearded Smith stands in shirtsleeves and a Turkish kilim belt in the middle of his $4 million lab. He points to an LCMS Mass Spectrometer that smashes

molecules from test compounds and evaluates them for healing properties. "Of the 1,200 molecules tested here last year," Smith says, "eight went on to the next step. And not all of those will go on to become drugs." That means that Smith and his team of analytic chemists fail steadily, on average, for six-and-a-half weeks before discovering something of possible medical value. Another 32 days usually pass before they do so again.

Merck is in good company when it comes to throwing most of its darts straight into the floor. According to Dr. John T. Kelly of PhRMA, the drug-industry association, "Only five in 5,000 compounds that enter pre-clinical testing make it to human testing. And only one of these five tested in people is approved for sale."

Citing Tufts University data, Kelly adds: "On average, it costs a company $802 million to get one new medicine from the laboratory to U.S. patients." This process normally takes 10 to 15 years."
Drug researchers are not just patient. They are amazingly tidy, too. And if cleanliness is next to godliness, this place could be the Vatican.

"It's not like at home where you have a spot on your glass, and that's OK," says Joye Bramble, a biochemical engineer and 14-year Merck veteran. "Here, that's not OK." Building 17, Merck's two-year-old, $180 million Biologics Pilot Plant located on West Point's Discovery Way, has glowing floors, gleaming steel fixtures, and smudgeless glass — as if the place were scrubbed hourly by hyperactive Swiss maids.

Giant pipes and tubes located in the building's attic, nicknamed The Penthouse, pump steam, chilled water, and purified air through laboratories below. In some rooms, the atmosphere is refreshed 35 times each hour. In others — for example, where ampules are filled with vaccines for clinical trials — the air is replaced 100 times hourly, or once every 36 seconds. Small ceiling nozzles force air down, rather than across the room, so that random particles will be driven to the floor, not allowed to drift into any medication. Standing in the hallway, one can feel a steady breeze blow through cracks in the doors and across one's skin. "That's there to protect the product from you," Bramble says.

"We can grow cell cultures, bacterial cultures, mammalian cells, live viruses," Bramble adds. "There are only three or four buildings in the world like this." She points through the pristine double-pane glass of one particular bioreactor suite. "This room alone is on the order of $10 million" in value. "Universities don't have this. The National Institutes of Health doesn't have this."

A sign in one room reads, "Caution: Consider all systems and equipment energized." Nearby, big steel tanks with scores of shiny pipes flowing in and out of them ferment a confidential concoction.

"We're doing work on a new, important product that women will love," Bramble teases. Nearby simmers a batch of a vaccine in development since 1986, now in Phase II clinical trials.

Dr. Eliav Barr, Merck's senior director for clinical research, is a cardiologist by training. He saw patients until fairly recently, but now works on that same vaccine. It is designed to prevent the Human Papillomavirus. HPV occurs with disturbing frequency. It afflicts 50 to 75 percent of sexually active adults at some point in their lives. HPV causes genital warts, as well as cancers of the cervix, vulva, and anus. So far, tests have found the vaccine 100 percent effective against HPV-16, one of the virus' particularly menacing strains. Thanks to similar findings, the November 2002 New England Journal of Medicine predicted "the beginning of the end of cervical cancer," a disease that afflicts 10,000 American women annually and kills 4,000 of them. Worldwide, cervical cancer causes 250,000 deaths each year.

None of this comes cheap, either. "Several hundred people are working on this exclusively around the world for Merck," Barr says. Consequently, the company has built clinics in Iceland, Peru, and Thailand. "Merck put equipment in, and we'll leave it in," Barr says. This will provide a steady stream of research data for obstetricians and gynaecologists.

Merck also is responsible for building a $100 million structure specifically to manufacture the HPV vaccine. Indeed, the samples the Food and Drug Administration tests for safety and effectiveness must roll off the same production line that would generate actual doses for patients. "All the performance qualifications have to be done on specific equipment," Barr explains. If the drug is approved, its price will reflect, in part, this huge up-front investment. But if the HPV vaccine fails to secure FDA approval, Merck will be the proud owner of a gleaming, $100 million white elephant. This sunk cost will have to be spread across the rest of Merck's product line. Alternatively, this money could be subtracted from shareholder dividends, employee salaries, or new R&D. These are lame long-term strategies.

Merck already pays huge bills, even before facing a potentially calamitous post-Vioxx situation at the hands of brokers who are unloading its stock, federal prosecutors who may levy huge fines, and tort lawyers who are salivating at payouts that could rival the huge asbestos and breast-implant jackpots. Site Facilities Director Greg Landis still calls this enormous establishment "a self-contained city, in all respects." He estimates its annual electricity expenses alone at $50 million.

That, and more, adds up. This is why new drugs cost what they do, and why price-controlled Canadian drugs, industry-led product discounts, and Rep. Henry Waxman's (D., Calif.) comment that "frankly, it doesn't make sense to me" that innovation and high prices are connected, all will make it harder for this lab and its counterparts to cover their costs. These factors boost the odds that the lights in these miracle factories will flicker, then fade to black.

The vaccine against this ailment is for pharmaceutical companies to teach Americans — starting with Washington's bipartisan political class — a simple but vital truth: Those little pills do not invent themselves.

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LOSING CASE

7 June 2005

Uncle Sam has a breathtaking ability to be all things to all people at everyone's expense. Look no further than U.S. District Judge Gladys Kessler's Washington, D.C. courtroom. That's where Uncle Sam is busy suing the cigarette industry despite the hot tub full of tobacco-related hypocrisy in which he soaks.

Leading the Justice Department's civil RICO lawsuit is Attorney General Alberto Gonzalez, reputedly a sneaky right-winger who serves the even further-right G. W. Bush administration. Gonzalez and Bush, when not plotting to torture innocent Muslims, conspire to help their overfed buddies in corporate America, or so administration critics claim. That's what makes this lawsuit so puzzling.
This litigation commenced under Attorney General Janet Reno, a crafty liberal lawyer with little love for big business. So why are Gonzalez and Bush, putative pawns of the Fortune 500, continuing Reno's inquisition against Brown & Williamson, Liggett, Lorrillard, Philip Morris, and R. J. Reynolds? This chameleonism is one of Washington's charms.

Reno herself changed colors regarding Big Tobacco. On April 30, 1997, she told the Senate Judiciary Committee: "The federal government does not have an independent cause of action" against this industry. Sunshine yellow that day, Reno added: "We needed to work with the states," 46 of which squeezed the smokes sector for $206 billion in the 1998 Master Settlement Agreement (MSA).

But Reno then turned beet red and told reporters on September 22, 1999: "This morning, the United States filed a lawsuit in federal court in Washington, D.C. against the major cigarette companies. In the complaint, the United States alleges that for the past 45 years, the companies that manufacture and sell tobacco have waged an intentional, coordinated campaign of fraud and deceit."

Prosecuting these tobacco kingpins has cost taxpayers at least $135 million so far. While that money trickles from the Treasury, over $10 billion pours through Uncle Sam's fingers in an industry-funded, government-managed, 10-year buy-out of farmers' tobacco quotas. This bonanza to those who cultivate the crop that inspires Surgeon Generals' warnings comes with few conditions. Farmers may keep planting tobacco. Thus, Uncle Sam simultaneously handles tobacco with litigation, regulation, and subsidies. Ringling Brothers should have such a juggler.

Adding to this circus, Uncle Sam castigates Big Tobacco while thriving on its product. In fiscal 2004, the 39 cents-per-pack cigarette tax yielded $7,778,569,117 in federal revenues, according to Orzechowski and Walker, an Arlington, Virginia-based tobacco consultancy. Moreover, federally owned stores from Capitol Hill to Camp Pendleton sell cigarettes, often at discounted prices. In its most recent study on this topic, "Economic Impact of the Use of Tobacco in DoD," the Pentagon's Office of the Inspector General reported on December 31, 1996 that "in FY 1995, DoD retail system tobacco product sales of $747 million generated gross profits and surcharge revenues of about $103 million." Thus, Uncle Sam hooks up nicotine addicts while tasting the action that Big Tobacco relishes on a grander scale.

This lawsuit originally sought to "disgorge" $280 billion of Big Tobacco's "ill-gotten gains" earned between 1971 and 2000. This included $75 billion in cigarette "proceeds" from the "youth-addicted population," those who smoked as few as five cigarettes daily before age 21. Never mind that 18-year-olds legally could purchase cigarettes in most states and, as a February 22 tobacco-company brief observes, "selling tobacco products is not illegal under RICO." The "additional gain" of $205 billion in hypothetical interest payments reflects a 273 percent return on investment, or a 9.4 percent annual average across 29 years. Let's free Americans to open personal retirement accounts managed by Big Tobacco's stock brokers!

The D.C. Appellate Court chopped disgorgement from the lawsuit. Now Justice fishes for other penalties including money for smoking prevention and cessation programs, which the MSA already funds. Justice also is weighing the highly socialistic "remedy" of telling tobacco companies which senior managers to fire. Bureaucrats in Beijing would love such public control of private assets.

The MSA also dissolved the industry-funded Tobacco Institute and Council on Tobacco Research. Nonetheless, Justice is suing them even though government drove them out of existence. Uncle Sam is frisking a pair of dead bodies for their wallets.

As an asthmatic who hates coming home from pub crawls reeking like an ashtray, I would be thrilled to see America's tobacco farms devoured by something like Dutch Elm Disease. Still, the tobacco sector is a legal industry, not a vacuum for collecting tax dollars through courtrooms rather than through the Internal Revenue Service.

Washington's self-entangling, tobacco-related hyperactivity is beyond tiresome. The feds should drop this foolish lawsuit and their perennial payments to the very industry they sue and regulate. And the 40 federal prosecutors assigned to this case should be given worthier duties, such as smoking out terrorists.

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H.O.T. TAX

17 June 2005

If liberals want to pay higher taxes, here's a way they can.

President George W. Bush's bipartisan Advisory Panel on Federal Tax Reform should propose a measure to assist a neglected segment of society: the avowedly under-taxed. The H.O.T. Tax, or Higher-rate Optional Tax, would give those who think their levies are too low the ability to pay the steeper tax bills they say they deserve. This is the truly compassionate thing to do.

The H.O.T. Tax would offer relief to powerful Democrats and wealthy liberals who cannot stand it when Republicans cut their taxes. Look how lowering taxes has raised the blood pressure of these Americans:

- "I don't need a tax cut," Sen. Frank Lautenberg (D., N. J.) announced last October 8 on the Senate floor. "It will not do me any more good. I can't buy more. I can't eat any more. I can't do more, and I want it distributed among the ordinary people who work every day."
- "If you think it's good policy to pay for my tax cut with the Social Security checks of working men and women, and borrowed money from China, vote for them [the GOP]," Pres. Bill Clinton told the Democratic Convention last July 26. "If not, John Kerry's your man."
- "I am a traitor to my class," actor Paul Newman said last July 8. "I think that tax cuts for wealthy thugs like me are borderline criminal. I live very high off the hog."

● "Because of Bush's tax cuts, I saved a million and a half in taxes last year. Does anyone think that's fair?" Ben Affleck asked at a July 2004 John Kerry fundraiser.
● "Why should wealthy people such as myself receive a tax cut?" Barbra Streisand wondered on her website. "I will be the first to admit that I don't need it. What we all need is a healthy government that can provide the services (such as education, health care, national and homeland security) that we all depend on."
● "I don't need a tax cut or tax relief," billionaire music impresario David Geffen explained in the March 15, 2001 Washington Post. "It is a privilege to be an American citizen. It is appropriate to pay a greater share of taxes."
● "I want no tax cuts, and want to pay MY FULL SHARE of taxes to support the public good," Oregonian Harry Demarest stated on the website of United for a Fair Economy, an anti-tax-cut group co-founded by Chuck Collins, heir to the Oscar Meyer wiener fortune.

The H.O.T. Tax would ease these statists' pain. The IRS simply would add a small box to the 1040 tax form beside these words: "If you believe you should be taxed at a rate above that assigned to your income bracket, please indicate here the higher rate you prefer. Kindly calculate your tax liability, and send it in."

With that easy step, congressional liberals and residents of Malibu and Martha's Vineyard no longer would have to keep the tax cuts conservatives keep throwing their way. Instead, they could send 50, 75, or even 99 percent of their incomes to Washington, so the GOP, Congress, and President Bush can spend it even better than they can.

While this reform would increase taxpayer choice, it might generate little revenue. Arkansas, Massachusetts, and Virginia taxpayers already may pay above and beyond their usual top rates, though few do this. When Massachusetts cut its top tax rate to 5.3 percent in 2001, it let guilty liberals pay the old 5.85 percent rate if they wished. According to the Massachusetts Department of Revenue, as of June 15, only 930 taxpayers opted to do so on their 2004 returns, generating an extra $246,505. In 2002, 2,215 taxpayers paid the higher rate, yielding $341,829. Among 3,218,572 returns filed in 2003, only 1,488 (or 0.046 percent) paid the voluntary higher rate, adding $209,216 to state coffers.

Citizens for Limited Taxation in Marblehead, Mass., persuaded friendly state legislators to introduce this law in 2000. Pro-tax U.S. Rep. Barney Frank (D., Mass.) also has spurned the higher rate. "No, I won't" pay some $800 extra, Frank told Boston radio host Howie Carr in April 2003. "I don't trust the legislative leadership and Gov. [Mitt] Romney to make the right decisions, so I'll donate the money myself, probably to some health clinics in New Bedford that are going to get hit hard in the new budget." How inspiring to see a confirmed progressive like Barney Frank choose private charity over public assistance. "Americans recognize, as Congressman Frank also figured out, that government doesn't spend its money wisely as is and already takes too much of what we earn," National Taxpayers Union president John Berthoud observes.

Sen. John Kerry (D. Mass.) sailed into hot water last year when tax returns revealed that he also paid the Bay State's lower tax rate. Kerry thus enjoyed state tax cuts akin to the federal tax reductions he excoriated on the campaign trail. Then again, perhaps he intended to pay Massachusetts' higher rate, but his calculator slid off his yacht.

This idea certainly has national political value. "It gives a real, live vote," says Grover Norquist, president of Americans for Tax Reform. "Without releasing any personal information, the government could report each year that only 1 percent of Americans paid the extra amount, which gives us a hard count on who thinks he is undertaxed."

Beneficent supply-siders should introduce the H.O.T. Tax in Congress even before the tax-reform commission's September 30 reporting deadline. American liberals should be given the earliest opportunity to stop resisting tax relief and send the Treasury as much of their own money as their bleeding hearts desire.

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Mary Anastasia O'Grady

The Wall Street Journal

Economic Musings Hatched in a Latin 'Paradise' – 11 March 2005

Why Brazil's Underground Economy Grows and Grows – 10 September 2004

World Bank Researchers Find Truth, But to What End? – 17 September 2004

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ECONOMIC MUSINGS HATCHED IN A LATIN 'PARADISE'

11 March 2005

Lake Atitlan, Guatemala – Late on a lazy Sunday afternoon a couple of local men help us push off in our small boat. As we power away, they stand on the dock, smiling and waving goodbye. The two silhouettes in the fading late day sun outline a national portrait.
The older one wears the traditional calf-length skirt, a colorful woven blouse and sandals, a costume completed by a wide-brimmed hat. He is the archetypical Guatemalan of centuries past.

His hatless, 20-something son wears a button-down shirt, jeans and running shoes. He would look at home in my New York City neighborhood.

What first appears to be a mere difference in fashion tastes symbolizes a profound demographic shift hitting the Western Hemisphere. The old man is unlikely to ever leave the volcanic shores of this legendary lake. The young man, I learn, is scouting opportunities up north, not in the Guatemalan capital but in the U.S.
If he makes it, he will join millions more like him who are fueling a robust U.S. economy while their own Latin homelands are stripped of precious human capital.

U.S. policy makers are racking their brains trying to figure out how to get ambitious young Latins to resist the mighty magnetic pull of U.S. economic growth. But if you spend even a little time in this country the futility of that cause becomes apparent. Opportunity is to be found elsewhere, not here, and even the humblest Guatemalan peasant, washing clothes on a rock by the water's edge, knows it.

There is a certain irony in what, to borrow a term from Alan Greenspan, is a conundrum for the U.S. It has an immigrant "problem" because the U.S. economy is roaring while developing Latin America is stubbornly stuck in a kind of feudal time warp.

Economic modernization here is creeping along at too slow a pace to satisfy the aspirations of the best and brightest. Their motivation is strong and they find ways to slip through even today's beefed up border protections. A national poll last year by the International Organization for Migration projected that remittances to Guatemala from abroad would be equivalent to 10% of gross domestic product in 2004, an increase of two percentage points over 2003.

Railing at this formidable demographic impulse is a little like protesting gravity. A far more productive path would be to start looking more closely at the difference between the economic policy advice the U.S takes for itself and what it gives its southern neighbors.

Not surprisingly, what one finds is that while the booming Bush economy is ingesting large doses of Reaganomics, minions of the State Department, the Agency for International Development (USAID) and the International Monetary Fund have Latin America on a steady diet of Rubinomics and regulation. Is it any wonder that the U.S. is vigorous while its Latin stepchildren are frail and sickly?

There is wide agreement that development requires sound institutions that will defend the rule of law. But that's a political problem: It is hardly in the interests of the ruling classes to allow or facilitate the creation of institutions that will alter the status quo. Progress, then, relies heavily on the ability of parties other than the country's traditional powerbrokers to gain access to incomes and wealth. For this, countries need fast economic growth.

Yet rather than focus on this goal, the U.S. policy agenda in the region obsesses about deficits and condescendingly lectures the neighbors on corruption, illegal immigration, so-called social justice and drug trafficking. More egregiously, when crisis strikes a corrupt oligarchy like Peronist Argentina and presents an opportunity for profound change, the U.S. sends the IMF in to rescue the status quo. No wonder reformers can't get any traction.

What brought the U.S. economy out of a sluggish, recessionary environment inherited from the Clinton administration was Reaganomics: Cuts in marginal income tax rates, dividend taxes and capital gains taxes, have acted like smelling salts for the investor class and this week the effects have been dramatically apparent. The U.S. economy created 262,000 jobs in February and economists are raising their estimates of 2005 U.S. economic growth.

Contrast the Reaganesque optimism that set this recovery in motion with conventional Rubinomics, theologically grounded in class warfare and so popular with Washington's armies of economic "experts" fanned out around Latin America.

These Cassandras of dreary defeatism issue dire gloom and doom warnings daily, predicting twin deficit catastrophe in the U.S., and a widening gap between rich and poor. To hold back the apocalypse, the theory goes, taxes ought to be at whatever level satisfies politicians' appetite to spend. Balanced budgets and that great left-wing will-o'-the-wisp, income equality, are set as the highest goals.

This doesn't play well in America these days but retains its power in populist Latin America where the evils of "capitalism" have been preached for decades by politicians even as their own policy prescriptions generate poverty.

These "men of the people" actually are quite popular with the caudillos who sit on top of Latin economies because their policies guarantee that nothing will change and that free market capitalism will not intrude on existing domains to inflict creative destruction. It's no surprise that when career bureaucrats in U.S. embassies around the region preach Rubinomics, well-heeled defenders of the status quo shout hurrah.

What ought to further scandalize those who pay lip service to the poor and jobless in these miserable economies is the arm-twisting by the U.S. to insist that local governments impose regulations that raise the cost of labor. This has very little to do with serving the interests of Latin workers and a lot to do with American labor unions trying to reduce competition from lower cost producers abroad.

The sad truth for Latin America is that the American left has made the region its playground. There it takes its bad ideas that Americans have rejected but Latin caudillos eagerly embrace. If you want to understand the immigrant flow to the U.S. forget about why walls and guns don't hold back migrants. Look instead at where you would rather live your life.

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WHY BRAZIL'S UNDERGROUND ECONOMY GROWS AND GROWS

10 September 2004

It's not going too far out on a limb to predict that when the International Monetary Fund and the World Bank convene their semiannual meetings in Washington in three weeks, global poverty will be much discussed.

And why not? Without that issue, the two organizations would find it hard to come up with a raison d'etre. In Washington, sweet dear poverty offers boundless opportunities for bureaucratic self-preservation. What ought to be a disgrace – the persistence of Third World poverty under years of IMF tutelage and World Bank aid – will be trotted out with fanfare to make the case for support of more of the same.

Cynicism sometimes seems the only way to respond to this semiannual celebration of costly failure. The cynicism rises even more when one notes that an expanding body of solid empirical research aid proves the shortcomings of multilateral aid for development.

Take, for example, the thorough findings of "The Power of Productivity," University of Chicago Press, 2004. The author, William Lewis, is a former McKinsey & Company partner and the founding director of the McKinsey Global Institute. His conclusions, which powerfully refute much multilateral orthodoxy, come from studies conducted by the institute over the past 12 years.

Of great interest is the Lewis survey of Brazil, "one of the world's richest low-income countries" and, it ought to be noted, an important recipient of IMF and World Bank "aid." Sound money advocates may quibble with some of Mr. Lewis's monetary views but he makes an indisputable contribution to understanding Brazilian underachievement.

Why, Mr. Lewis asks, does Brazil have such an impressively high level of productivity in its formal sector and yet seem condemned to suffer the consequences of a huge informal sector mired in misery.

Fans of the late, great development economist Peter Bauer will not be surprised by what Mr. Lewis finds. Like Lord Bauer before him, Mr. Lewis has done lots of on-the-ground research to understand how economies actually work. Notable among his conclusions is his thorough rejection of the Washington establishment's view that the cause of underdevelopment in Brazil is a lack of education and infrastructure development.

"Lack of education of the Brazilian workforce is just an excuse today for poor economic performance," Mr. Lewis writes. "There are just too many examples from banking to food processing and automotive where firms have been able to match productivity levels at the economic frontier with the Brazilian workforce. These findings just reinforce what we found in every other country we studied. The primary means through which workers attain the skills to perform at the economic frontier is through on-the-job training." As to the infrastructure argument, Mr. Lewis says that only in the steel industry might it have some relevance because of high port costs. But even there, "it is not clear how much of the high port costs came from physical infrastructure constraints and how much from inefficient port operations."

Brazilian liberal economists have for years been complaining about what they call the "Brazil cost," that is the heavy burden that the monstrous Brazilian government imposes on the economy. Sure enough, this is where the trail leads Mr. Lewis. "Most people don't recognize the destructive power of big government on economic development. Big governments demand big taxation. When part of the economy is informal, and untaxed, the burden falls heavily on legitimate businesses," he explains in the book's prologue.

Brazil is a case in point. "The two big characteristics of Brazil's economy that stand out now are the large amount of informality and the large size of its government," Mr. Lewis notes. Lo and behold, the two are connected.

Half of all Brazil's workers are outside the formal economy and their low productivity fuels poverty. Mr. Lewis notes that in a developing country, the problem "should take care of itself as more productive formal business, with lower prices and better service overtake the informal enterprises." This raises productivity and growth and leads to development. But it hasn't happened in Brazil. In fact, the informal sector is growing bigger.

The culprit is the voracious appetite of big government. Despite higher productivity, formal-sector businesses don't have a pricing advantage against informal, less-productive businesses because they are saddled with so many taxes – payroll taxes, value-added taxes, sales taxes and income taxes. Moreover, Brazil's corporate tax rates are scandalously high. "Brazilian corporations pay 85% of all taxes collected, compare with 41% for U.S. corporations." This not only hampers legal-sector businesses but it also deters small, informal businesses from growing and moving into the legal sector.

As Mr. Lewis points out, "The corporate tax burden in the U.S. when it was at Brazil's state of economic development was so low that informality did not hold back the growth of the formal sector. Unfortunately, that's not true for Brazil."

Happily, Mr. Lewis avoids the IMF prescription to this problem, which is all about using the force of the state to impose its will against evaders. That, he points out, is neither politically nor technically feasible. A better course, he recommends, would be to shrink the size of government and shrink tax rates on the formal sector. Formal enterprises will become more competitive and expand, while the informal sector will shrink and overall productivity levels will rise.

"The Brazilian government spends an amount equal to 39% of GDP compared to 37% in the U.S. today and 8% in the U.S. in 1913, when it was at the level of development that Brazil is at today," Mr. Lewis writes. The 8% level is not the goal but 20%, Japan's level in the 1950s, would make sense, he maintains, adding that this, of course, is ultimately a political matter.

Such conclusions underscore the futility of multilateral "development" methods. More money and intervention might be a jobs generator in Washington but it is counterproductive if the goal is moving Brazilians out of the favelas. Development in Brazil will depend on the choices Brazilians make about their own political economy. More worrying is the fact that multilateral lenders too frequently distort those decisions.

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WORLD BANK RESEARCHERS FIND TRUTH, BUT TO WHAT END?

17 September 2004

The recent World Bank research department paper titled "Doing Business in 2005" details the critical nexus between growth and smaller government. But over in the Bank's lending operations, the addiction to shovelling money out the door to poor-country governments shows no signs of abating.

What happens when Bank researchers conclude that Bank lending operations not only are an improbable source of development but perhaps even an impediment? Probably nothing, given the consultants, bureaucrats and politicians with a vested interest in keeping the Bank's money flowing. Nevertheless, the report is noteworthy.

Since 1945, the World Bank's International Bank for Reconstruction and Development has lent some $383 billion with the aim of "reduc[ing] poverty in middle-income and creditworthy poorer countries by promoting sustainable development." Since 1960, the Bank has lent another $142 billion through the International Development Association. The Bank says that "Contributions to IDA enable the World Bank to provide $7 billion to $8 billion a year in highly concessional [zero interest rate] financing to the world's 81 poorest countries."

Even in government fantasyland, where seven-figure handouts are dismissed as pocket change, $500 billion in poverty assistance can't be sneezed at. Yet, what rankles here is not so much the volume of aid as its failure to make people better off, a fact that explains why the World Bank refuses to allow independent, outside auditing of its projects.

Poverty's resistance to so much international largess raises logical questions. As development economist Lord Peter Bauer observed long ago, "Lack of money is not the cause of poverty, it is poverty." The cause is something else entirely.

As "Doing Business in 2005" notes, a key cause of underdevelopment is the burden that government regulation imposes on the poor who are trying to climb out of poverty. Successful economies, the researchers note, have less regulatory drag and unsuccessful countries could do better simply by reducing regulation.

Latin America is a case in point. In 2003 the Bank made new IBRD commitments amounting to $5.7 billion in that region and disbursements of $6.5 billion. It also made new IDA commitments of $153 million and disbursements of $322 million. The annual report notes that for Latin America and the Caribbean, the "portfolio of projects under implementation as of June 30, 2003, was $19.8 billion." Yet, the region's informal sectors are growing, a massive brain drain is underway and politics are turning chaotic in some countries.

"Doing Business in 2005" notes that "A vibrant private sector – with firms investing, creating jobs, and improving productivity – promotes growth and

expands opportunities for poor people." Sound macroeconomics can be part of this but as the Latin experience of the 1990s illustrates and the report reiterates, without reform at the micro level "entrepreneurial activity remains limited, poverty high, and growth stagnant." In fact, the Bank researchers say, "Although macro policies are unquestionably important, there is a growing consensus that the quality of government regulation of business and the institutions that enforce this regulation are a major determinant of prosperity."

Ten categories are analyzed: starting a business, hiring and firing workers, registering property, getting credit, protecting investors, enforcing a contract and closing a business. A regional summary of Latin America is comprised of bar charts that compare Latin nations to the world leader in each category. The findings are dismal.

For example, in Australia it takes two business days to complete the regulatory requirements for starting a business. Brazil stands in sharp contrast to this, in next to last place in Latin America, draining 152 days for a business start-up. Haiti is last, where it takes 203 days. Denmark is the least expensive place in the world to start a business and happily, Brazil ranks third in Latin America, just behind Chile. Haiti brings up the rear again in this measurement, costing 176% of national per-capita income, or the income from almost two years of work effort. In labor rigidity, Hong Kong and Singapore rank as the best worldwide and show up Mexico and Brazil, which tie regionally at the bottom of the pile.

It can take a long time, over 500 days, to enforce a contract in Brazil, but Guatemala comes in last in this category at 1,459 days. Closing a business, which is to say going through insolvency and settling with creditors, is also a regulatory nightmare in the region. In Ireland, the world's fastest place to go through insolvency, it takes three months. Brazil is the slowest in Latin America, taking 10 years, almost twice as long as Haiti. Creditors are likely to recover the most after a bankruptcy in Japan; in the region, they recover the least in Brazil, even less than in Haiti.

The World Bank report is an indictment of Latin America's leadership, which spouts heavy concern for the poor but, in action, demonstrates a preference for keeping the bureaucracy fat and happy. The Bank exacerbates the problem by removing the discipline of the market. Why should governments eschew the high they get from anti-market populism and patronage when the Bank is there to ensure that the dollars still flow?

The Bank's Multilateral Investment Guarantee Agency throws fuel on the fire. MIGA issues guarantees to investors against such bad governance risks as expropriation and breach of contract. This raises moral hazards, reduces the incentives for government to build authentic credibility with respect to contracts, and therefore leaves locals who don't qualify for MIGA worse off.

Finally, it's worth mentioning the indefensible International Finance Corporation. The IFC says in lending to the private sector it "seek[s] to reach businesses in regions and countries that otherwise have limited access to capital." This is a joke. If there is limited access to capital the market is sending a signal that ought not be distorted. Moreover, why should the IFC's portfolio include such large and successful businesses as the airline company Lanchile, Mexico's Banorte and Brazil's Banco Itau?

It's clear that the Bank's need to lend has superseded the rationale for lending. Could it be that Bank lending is more about filling rice bowls in Washington than in the developing world?

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Dinakar Sethuraman

Forbes Global

Fuel for Consumption – 1 November 2004

Yes We Have No Bananas – 25 April 2005

Take Two Pills and Call the Trade Envoy – 9 May 2005

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FUEL FOR CONSUMPTION

1 November 2004

India is opening gasoline retailing to multinationals. The next step is the hypermarket.

A truck rolls into Reliance Industries' new gas station on India's national highway 4–a dry and dusty road in the south where workers are languidly setting tar to earth building a sliver of India's downsize version of the U.S. interstate system. The trucker mumbles about the poor quality and quantity of diesel at higher prices from other, older pumps down the road run by state oil companies, as a uniformed attendant fills the tank from imported Italian dispensers. The 10-acre site is a joint product of Flying J, a large diesel distributor in the U.S., and Minale Tattersfield, a U.K. design firm. A central server in Mumbai, India's commercial capital, keeps tabs on pumps at 200 (of a proposed 5,000) Reliance service stations.

Such is the change coming to Indian petrol marketing, a first step to broader retail liberalization. Although Reliance is India's biggest homegrown private-sector player, this incipient retail revolution extends to foreign multinationals, which will get to sell directly to Indians for the first time. Farther down NH4 lies Bangalore, India's Silicon Valley, where Royal Dutch/Shell is busy scouting for a site. Vikram Singh Mehta, chairman of Shell India, is finalizing plans to situate the first few of Shell's proposed 2,000 stations. Shell and Reliance combined are to invest more than $2 billion nationwide in the next five years.

The wheel has turned full circle since India nationalized subsidiaries of Shell (now Bharat Petroleum) and US Esso (now Hindustan Petroleum) in 1974, turning petroleum into a state affair. Shell now wants to take back its share of India's $30 billion petroleum products market. It, Reliance and another private domestic concern, Essar Oil, are concentrating on highways where 330,000 truckers guzzle $10 billion worth of diesel every year. "The new entrants have no options. State oil companies crowd the cities," says Devinder Chawla, executive director, PricewaterhouseCoopers, Mumbai.

The new entrants are offering choices to Indian motorists. Most pumps have been isolated entities, selling a cocktail of kerosene, a highly subsidized product, and gasoline. Today there are pumps every few kilometers. Tired truckers, who earlier curled up in their vehicles for a nap and urinated by the roadside, now use motels, restrooms and telephones offered by Reliance's new pumps. And urban Indians, who until recently drove outdated cars and relied on word of mouth to find a clean pump, now drive large Fords and Hondas and demand better fuel and service.

Competition is forcing Indian Oil, Bharat Petroleum and Hindustan Petroleum, which together run more than 20,000 outlets nationwide, to clean up their acts. "Adulteration is widespread. But we are changing," says N.G. Kannan, director of marketing at $28 billion (revenues) Indian Oil, which has a 55% market share, making it the biggest state-owned player. Kannan is going one up on competition by housing ambulances, hospitals and AIDS awareness centers – working with the Bill and Melinda Gates Foundation – at 113 highway outlets. Also, India's biggest oil company is spending up to $250 million to refurbish 2,800 of its busiest outlets.

The newcomers are bringing more than service stations. "We are investing well over $650 million in a gas import terminal in Hazira, our first such investment in the world. We have faith in the market," says Shell's Mehta. The highway-building program should induce big increases in Indian oil consumption, currently only a tenth that of the U.S. Only 7 in every 1,000 Indians owns a car, as compared with 12 in

neighboring Pakistan. Surely $50-a-barrel oil will slow things in a largely poor country like India, but under normal circumstances the gap with the West will close.

Still, Shell rivals ExxonMobil, BP and ChevronTexaco are not exactly rushing in, fearing regulatory potholes. India requires an investment of at least $450 million in the petroleum sector to gain retail rights. And it is tough to make your board understand why a bureaucrat or a minister sitting in New Delhi should fix the price of your gasoline and diesel when you have put that kind of money into the country.

India deregulated the oil sector in 2002, but, as with many things in this country, the gesture was purely symbolic. "The government controls pricing through state players," says a senior official of Indian Oil, which itself lost $210 million in April to September 2004 because of price curbs on diesel and gasoline. Shell will source gasoline and diesel from a rival. Unlike Reliance, it does not own a refinery in India.

"It is uncomfortable to depend on your competition for supplies. But we are in for the long haul. If you want your money in three years, [this market] is a no," says Mehta. The industry is banking on ultimately getting out of the squeeze between controlled prices and rising crude costs by relief on both ends.

India's foray into freer petroleum retail is a teaser to throwing open an estimated $200 billion broader retail market (just under Wal-Mart's total sales) to foreign direct investment. Supermarkets and department stores make up only 2% of this market, with the rest coming from 12 million mom-and-pop stores, according to a Jardine Matheson report. India badly lags its modern benchmark, China, in this aspect of consumerism – although it is just ahead of China in opening gasoline retailing.

China had to give retail access commitments in order to enter the World Trade Organization, whereas India, a longer-standing WTO member, did not. Nonetheless, a report being prepared for the new Congress Party government – so far sympathetic to economic liberalization – has optimists expecting major steps within five years, maybe much sooner if the West horse-trades.

Hong Kong's Dairy Farm International is currently the only foreign entity with a big stake in retail through a 49% ownership in India's Foodworld, which was acquired during a two-year liberalization window that ended in 1997.

At $75 million in revenues Foodworld – which is teaming with Indian Oil to offer pumps at supermarkets in the Chennai (Madras) metropolitan area – the traditional role of grocery buying by women is giving way to men pushing shopping carts down air-conditioned aisles. Ved Prakash Arya, chief operating officer at Pantaloon, a $140 million retailer whose stores are modeled on Western hypermarkets, recalls seeing "a man wearing a single cloth and no footwear" enter its new Big Bazaar hypermarket in Bhubaneswar, a small city in eastern India.

The convenience store is even further behind the supermarket in coming to India, thanks to the loyalty shown to traditional small merchants, but Bharat Petroleum has opened 235 In & Out stores. Still, overall nonfuel revenues in India are close to 1% of pump revenues compared with the U.S., where the figure could be as high as 35%.

The barriers to full-scale multinational retailing in India go beyond the country's first-order protectionism: Huge chains like Gap, Wal-Mart and Carrefour would need to build domestic sourcing (which they are busy doing for export) as well as systems as a prelude to rolling out storefronts. Even laws dictating the working hours of women are a factor. But now that Indians are getting a taste of competition and convenience at the roadside pump, the momentum for shopper sovereignty is only likely to increase.

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YES WE HAVE NO BANANAS

25 April 2005

There are no mangoes or limes, either, in the produce section at Metro's store in Bangalore. But there are a lot of Indian politics on display.

It started when the German cash-and-carry outlet opened its doors in late 2003 on the outskirts of India's Silicon Valley (pop. 6.5 million), which is replete with the old ways of the country as well as the new. Metro is situated at the junction of a well-tarred main road in Yeshwantpur, a sleepy suburb northwest of Bangalore where the main commercial activity until a few years ago was the *mandi* – a government-demarcated market where wholesale traders sell spices, grains, fruits and vegetables. Now it is the testing ground for multinationals. Just behind the Metro outlet lies Royal Dutch/Shell's first gas station in India.

Fruit and vegetable traders, in league with small-village satraps, created a ruckus when Metro-the first foreign retailer to test the Indian market-opened its initial store here. Bangalore retailers took out half-page ads in local newspapers comparing the German retailer to the infamous East India Company, the foreign merchants who paved the way for Britain's colonization of the subcontinent.

A lawsuit-declaring that the cash-and-carry concept was retailing disguised as wholesaling-made it all the way to the high court in New Delhi before it was tossed out. Metro's first customers had to cross lines of angry picketers to enter the store.

The protests ceased only when vested interests discovered a centuries-old act prohibiting produce sales outside of the mandi, like the one down the road from Metro. The protectionists had their legal roadblock for the moment.

At the mandi, fruits and vegetables are strewn on footpaths used occasionally for urinating. Long lines of trucks, vans and pushcarts jam the narrow roads where bare-bodied men, sweating under a hot sun, load large brown sacks. Flies hover.

Back at Metro, the store is clean, the air-conditioning is powerful, and room-size freezers keep meats fresh. There are shopping carts and broad, clear aisles-and no flies. The checkout clerks wear the Indian version of Metro's corporate uniform-blue-and-yellow saris-and pass out receipts with every purchase.

"We never get proper bills at Chikpet [a crowded, dusty wholesale market stocked with fabrics, plastic goods and electronics]," says Nicholas Roy, an air force officer and Metro customer. "How do we explain to audit committees about

prices scribbled on plain paper?" Roy is wheeling out 14 Metro trolleys filled with pencil boxes, plastic bottles, chocolates, chips and lunch boxes for the Air Force Wives Welfare Association, a nonprofit.

Metro buys directly from willing farmers and fishermen and threatens a decades-old agricultural-marketing structure thick with middlemen, moneylenders and politicians. With so many actors, more than a quarter of India's fruits and vegetables spoil before they even make it to market, says Metro Chief Hans-Joachim Körber. "If India could manage this better, it could be an exporter of produce."

The protracted battle is hurting Metro in India. The caterers, hoteliers and shopkeepers who shop at Metro can still find fish and meat there, but it is produce that would give Metro the volumes necessary to keep prices low. In other countries perishables make up 60% of sales.

Metro plans to invest $400 million over five years to open outlets in Kolkata, Chennai, Punjab, Hyderabad and New Delhi, but not until its shelves are well stocked with local produce. Agriculture rules are different in every state, and interpretation of the rules often depends on who is in office. In 2003 the federal government began circulating a new act that would scrap the ancient trading rules. But two years later there are still no bananas for sale at Metro's Bangalore outlets.

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TAKE TWO PILLS AND CALL THE TRADE ENVOY

9 May 2005

SHASUN CHEMICALS & DRUGS IS a name not known far from its location in a crowded shopping district in Chennai, the former Madras.But Shasun is not a retail pharmacy. Most notably, it is the world's largest producer of the generic painkiller ibuprofen, used in Advil and other overthe-counter pills.

What makes Shasun newsworthy, however, is not its exports from India but what it will be importing and why. It's planning to build a plant to make isobutylbenzene, a key ibuprofen ingredient, in Thailand. Thailand! "The Indo-Thai free-trade agreement (FTA) was one reason," says Chief Executive N.Govindarajan of the 28-year old company's first-ever foray into foreign manufacturing.

That eight-month-old FTA is India's second of what could be a series of regional hookups. It's part of the fitful opening of once-insular India to a trade oriented, comparative-advantage economy.

The key advantage here, Shasun says, are the propylene pipelines that factories in Thailand, with its more modern industrial infrastructure, can use to make the drug's critical petroleum derivative. A kilogram of isobutylbenzene goes into making every kilo of ibuprofen. Thailand also goes easy on red tape and offers key tax breaks.

Shaving even 20 cents a kilo off what the substance would cost at a new plant at home would net a million dollars, nearly one-sixth of last year's post-tax profits, the company figures. Add to that more reliability. "Supply security is key," says Govindarajan. The 36-year-old engineer thus hopes to double Shasun's share of the U.S. ibuprofen market to close to 30%. The firm, listed on the Mumbai exchange, also makes antiulcerants ranitidine (goes into Zantac) and nizatidine, but ibuprofen makes up almost half of the company's $60 million in total sales.

The drug emerges from a clean, gray-walled plant – U.S. FDA approved – at Pondicherry, southeast along the coast. "Shasun's strength lies in its ability to supply to America and Europe," says K. Ravichandran, an analyst with ICRA, an associate of Moody's Investors Service.

That ability looked under siege last year when cheaper Chinese competitors started creeping in and rising raw-material prices crimped productivity gains. Shasun hiked capacity – edging out Albemarle Corp. of the U.S. as tops in ibuprofen production. But it could not rely on suppliers in India and China for a steady dose of nearly 5,000 tons of isobutylbenzene annually, says Vimal Kumar, one of Shasun's founders. "We decided to go international."

Free trade across the Indian Ocean is not just good news for Shasun and others like Exide Industries, a Kolkata-based $270-million turnover battery maker also seizing the outsourcing opportunity. India's growing middle class is enjoying freer and cheaper access to items such as refrigerators and air conditioners. Moreover, the FTA, which involves a gradual reduction in import duties to nil by next year, allows farmers and fishermen in India to sell mangoes, wheat and fish to consumers 1,500 miles away in Bangkok. (Isobutylbenzeneand battery components aren't yet on the duty free schedule, but additions are expected in a year or two).

Indo-Thai trade accounted for $1.4 billion last year, a sliver of both nations' exports and imports. But it is the next step in a campaign that even India's Communist backed government envisions extending to zero-duty trading corridors with China, South Korea and Japan.To the extent that India opens the door as well to nations like Singapore that also have freetrade pacts with the U.S. and some European countries, this could lead effectively to huge new possibilities.

Before Thailand came calling, India tested the FTA waters with nearby Sri Lanka in 2000. "Indo-Lankan trade has risen 250% in four years," says Nagesh Kumar, director general of Research & Information System for Developing Countries, a New Delhi think tank. Sri Lankan exports to Indian industries, mostly commodities, quadrupled.

For $310 million-in-sales Ceat, a Mumbai tiremaker, the benefits went beyond raw materials. It uses a Sri Lankan acquisition to export to Pakistan, something still impossible from its Indian operations. Shasun may not make such an easy gain from its planned Thai operation, but overall exports from Thailand to India rose nearly 75% to $480 million between last October and February (compared with the year-earlier period).

Indian automakers have more than doubled imports of aluminium alloy molded into auto parts- from Thailand since the FTA halved Indian import duties. Of course, trade engenders domestic opposition from industries threatened with cheaper imports. And some in India make the legitimate request that pacts with developed countries extract concessions on temporary movement of professionals to service IT contracts and

provide health care, teaching, accounting and legal services.

And even some early outside investors in India fear being left out of the party now. "The FTA was pushed in unholy haste. It would have killed India's auto sector," says B.V.R. Subbu, pugnacious president of Hyundai Motor India.

The Korean automaker has invested $900 million to make 250,000 cars in Chennai. But Japanese rivals are using the new trade pact to source elsewhere. "The FTA[was] a disincentive to invest in India. It was 25% cheaper to shift the press line [which molds steel into auto body parts] to Thailand," says Subbu, concerned that Honda and Toyota could squeeze margins on his midsize cars in India.

But open borders have a way of hastening reforms. For instance, Subbu's main grouse was that Thailand had a 5% duty on steel compared with 30% in India.New Delhi reduced duties on steel to 5% to mollify Indian automakers. Hyundai responded by announcing additional investment of $500 million to build 150,000 cars in Chennai. Call it trade's great pain reliever.

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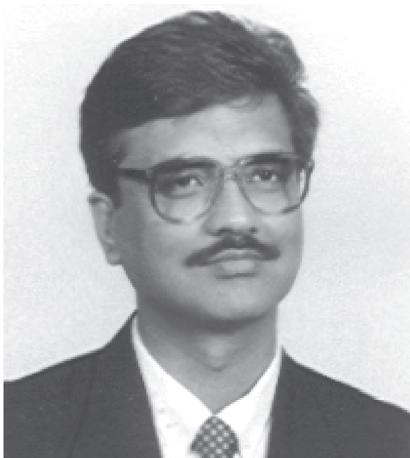
Rakesh Wadhwa

The Himalayan Times

An Obstacle on Maha Shivratri – 11 April 2005

Coffee, the Grand and Government – 30 August 2004

Nepal and Occam's Razor – 2 August 2004



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AN OBSTACLE ON MAHA SHIVRATRI

11 April 2005

It was Maha Shivratri. My wife, Shalini and I were in a car and passing through Nag Pokhari in Kathmandu. Suddenly, the chauffeur brought the car to a screeching halt. Some 12-14 children stood with a rope blocking our way. Without thinking, more as a reflex, I took out Rs.50 from my wallet and handed it to the leader of kids and we were on our way again.

No big deal, you might think, everyone driving a car has experienced this rather harmless collection effort of boys and girls in Nepal. I started discussing with Shalini, "What do kids do in the US when they want extra pocket money?" "They might run a lemonade stand, mow the neighbour's lawn, wash cars, or deliver newspapers", said Shalini.

Whatever the kids might do in America, not once have we seen them holding up the traffic and demanding payment. They make money by selling a good or providing a service. This involves a voluntary exchange between the buyer and seller.

Warren Buffett, the world's second richest man, delivered newspapers as a kid. He now owns a significant portion of that particular paper – 'The Washington Post'. But, that is another story.

The point here is that Buffett, as a child growing up in America, imbibed the lesson, 'you make money if you can induce someone to buy what you are selling – be it your labour, service or a good'.

The lesson which I had taught the kids in Nepal was, 'block, obstruct, create problems, stop us from going where we want to and we will pay you to lift the restrictions you put in our path'.

I asked myself what would happen if one day one of the kids who had stopped us becomes a government officer? He would remember that the way to riches is by blocking and stopping people from doing things.

What if that kid grew up and went on to take charge of the customs department of HMG? Would he stop the release of goods until he was paid off? Would he stop the issuance of import licences until he got what he wanted?

If another of those kids became a Minister of Industry, would he expect a big pay-off from a foreigner wanting to establish an industry in Nepal? The way to riches for him would be to use his power to block the progress of other people.

Indeed, it may mean prosperity and riches for the government official and Minister, if they can block the grant of licences, restrict businesses, and have the power to tax them out of existence. What about us?

For you and I, it means poverty and destitution. What enriches bureaucrats and politicians, impoverishes the rest of us.

"Power corrupts and absolute power corrupts absolutely". This is a cliché, but it's true. We can afford to pay the officers of the government to sit at home and do nothing. But we can't afford them if it means halting the progress of productive men and women.

The vested interests of those in government to maintain the status quo are so strong that minor tinkering with the system just won't do. Changing government regulations won't be enough. If we, for example, change the licencing policy into a mere registration requirement, but leave the bureaucrats in place, soon they will come up with a registration procedure which equals licencing in its complexity.

What is required is wholesale surgery. We have to excise major chunks of

government, throw it away and not look back. Do away with licencing. End most taxes and whatever minimum you have to levy, simplify them so that interpretation by bureaucrats is dispensed with. Abolish exchange controls and allow foreign investment without an approval process.

Go one step further. Consider whether we really need all the ministries that we have at present. Government's job is to keep us secure, enforce a rule of law, administer justice, and leave the rest to the people.

And, yes, it is time to take a stand against those kids. Next time around, I intend to refuse to pay them off.

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COFFEE, THE GRAND AND GOVERNMENT

30 August 2004

Unbelievable as it may sound, Starbucks, specializing in serving a variety of coffees to its customers, has become a US $19 billion chain. Its shares are listed on the Nasdaq stock exchange in the US. Starbuck's founder Howard Schultz made a fortune serving coffee. How is it possible? Doesn't every restaurant, hotel, supermarket chain, store, home, and office in the US serve coffee? Yes, anyone who has ever been to the US knows that coffee is the national drink of the Americans. Coffee is available in every establishment. The coffee maker is ubiquitous and more a symbol of America than its flag.

The answer just lay under the eyes of everyone in the US, but only one man, Schultz, had the vision to see the possibilities offered by this simple stimulant. He recognized that though everyone drank and served coffee, no one specialized in doing it. He said let me serve the finest and largest variety of coffees to my customers and they will pay me three times more than what they pay other coffee vendors. Starbucks did just that and the rest as they say is history.

That is the power of specialization. A legendary Japanese industrialist once said, 'it doesn't matter if I just make and sell noodles in a village, I will merely make sure that I sell the very best'. This example may resonate well with us in Nepal where noodle-makers have done such a tremendous job that Nepal with barely 2.5 percent of India's population consumes as much as 50 percent of the noodles consumed in India.

Recently, while in Delhi, I had idlis and dosas, both at The Grand hotel and at the lowly Madras Cafe, a small, largely unknown South Indian restaurant which specializes in these southern dishes. The idlis and dosas at The Grand were just what they are in a 5-star establishment: dosas rather tasteless and idlis just a little too hard; Madras Cafe, served them near perfect.

Was there anything wrong with The Grand management? Why can't they serve idlis and dosas like Madras Cafe, and coffee like Starbucks? They cannot and in their defense I might add that no other 5-star establishment can either. Why not? Because dosas, coffees and idlis is not the core product which these hotels sell. Their competence lies in providing accommodation, ambience, and style to their customers and that they do.

Starbucks would not survive with bad coffee - that is its core product. Madras Cafe would not survive if it sold the kind of dosas and idlis which are routinely offered at 5-star hotels.

This shows that irrespective of money and resources, one can't be best in other than a very few services or products. Therefore, the need for specialization is obvious. And this has a profound lesson for how governments ought to be run.

It is impossible for governments too to be all things to all people. Governments must understand that trying to run airlines, airports, hospitals, sugar companies, cement companies, banks, finance companies, newspapers, TV stations, hotels ... and simultaneously trying to manage its core task of providing law and order, a justice system, and a national defense is a sure recipe for disaster.

Accept that it is impossible to do so many things, accept that people and businessmen can handle airlines and the like better, accept that governments responsibility is to fulfil its core functions, and we will see the birth of a new Nepal which will prosper in no time at all. Some people will dispute what I say. To them I say: let's do a poll and find out if people are satisfied with the functioning of the law courts and the police force. If and when 75 percent of the people say, "we are satisfied", then and only then should the government venture out to do more. Until such time let our government concentrate on what it is supposed to do and leave the rest to us.

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NEPAL AND OCCAM'S RAZOR

2 August 2004

Gurcharan Das, former CEO of Proctor and Gamble, columnist of 'The Times of India', and author of 'India Unbound' was recently in Kathmandu. On June 23, 2004, he gave a talk on the opportunity presented to Nepal in having a vibrant, growing India as its neighbour. Nepal has not one but two giant neighbours. This is not a mere plus for Nepal - it is a Himalayan sized opportunity.

The task before the government is easy. It is so easy, in fact, that bureaucrats and politicians refuse to accept it and seek complications where there are none. Government seeks to do everything: the current budget, grown to over Rs.124 billions, is an indication of the direction in which the country is headed. It is going in precisely the direction which takes us away from prosperity.

Does the government need to tax, spend, and regulate more? That is the way to poverty and misery. How is it going to help this country if the government preempts a vast percentage of the country's investable surplus, blows up a substantial part on sustaining itself and, then, if the people are lucky they get a tiny percentage of it back for themselves.

We don't need more government programmes, higher bureaucratic expenditures, more taxes on employment generating businesses, we need less of all this. Nothing can be simpler.

If we want to prosper from our proximity to the giants, we need simple but clear thinking. We need to understand what people of India and China want and we need to give it to them. We do this and they will, in return, give us what we want. People in Nepal know what the Indians

want. Ask any shopkeeper and he will tell you about not only what the Indians want but what shoppers from anywhere want. Shoppers are price sensitive, they want cheaper goods and they want a vast variety. Make Nepal a duty-free nation and an overnight boom in shopping-tourism will result.

Ask the traders, what would boost their business. They will tell you the same thing. We can supply to the markets of China and India, if government removes taxes and gets out of the way. As long as Nepal is a free trading state, people will find a way to take goods from here to other countries, irrespective of the laws in those countries.

Traders in Dubai and Singapore do not break any laws in their country when goods move to India. Why can't Nepal be that trading duty free hub instead of Dubai? Nepal's costs of trading would be much lower as a consequence of lower real estate prices and insignificant labour costs.

No one has ever given me any convincing reason as to why this would not be possible.

Open the skies and permit free flow of foreign investment for opening of shopping arcades and we can visualize a transformed Nepal with huge employment generated by these trading and retailing establishments.

If this sounds simple, too simple, let us go back to 14th century England. Then a monk from Surrey called 'William of Occam' laid down a philosophy which still guides modern sciences and has come to be known as 'Occam's Razor'. He said, 'what can be done with fewer assumptions is done in vain with more', and, 'entities are not to be multiplied without necessity'. That was old English. In today's language, it means, 'keep it simple, sweetheart.'

Occam's Razor shows that most often the simplest theory is the best. Rejecting the idea of a duty free Nepal because of its simplicity is perhaps the worst reason for doing so.

In making Nepal duty free, we would be doing not only what Singapore, Dubai, and Hong Kong have done, but, what made West Germany great in the aftermath of World War II. Ludwig Erhard, its Finance Minister, rejecting all advise from his occupation masters, simply removed all controls and taxes on goods, wages, and currency. Within days the shops in Germany were full of goods and its economy was humming away.

The German miracle had begun. Isn't it time for the Nepalese miracle to happen?

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