FOREIGN AFFAIRS

JANUARY/FEBRUARY 2014 • VOLUME 93 • NUMBER 1 • WHERE TO BET NOW

AMERICA'S SOCIAL DEMOCRATIC FUTURE

JANUARY/FEBRUARY 2014

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Six Markets to Watch

How China Is Ruled

Running the Pentagon Right

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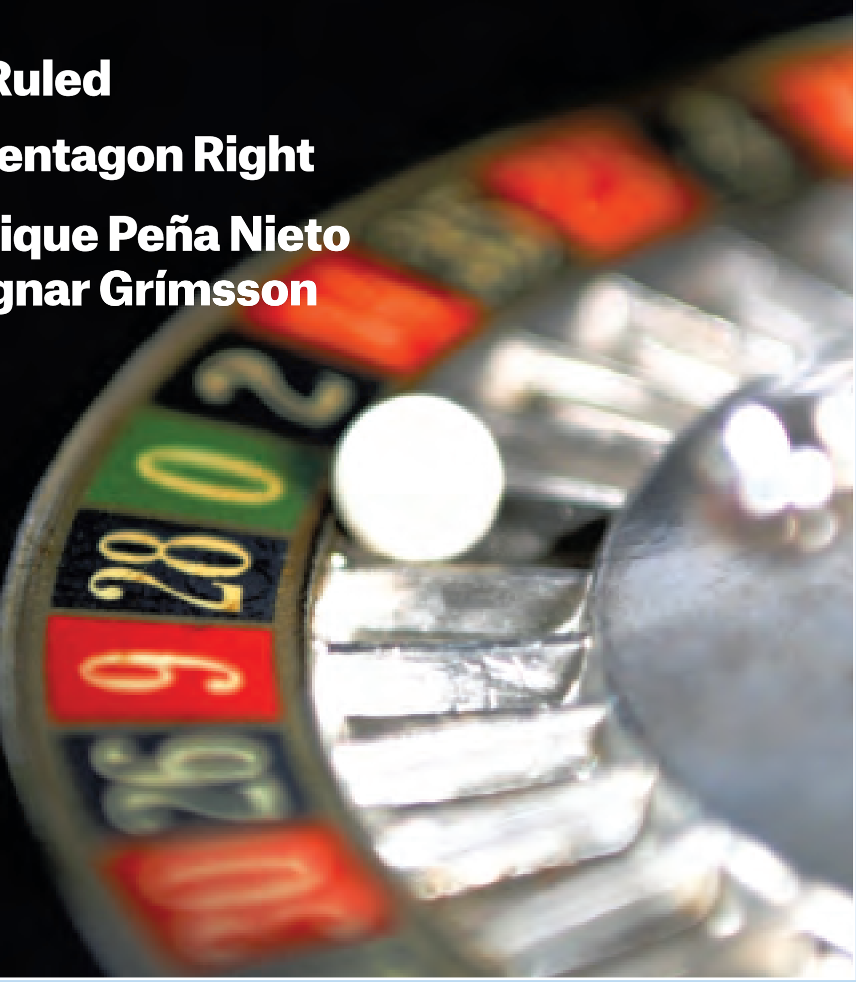

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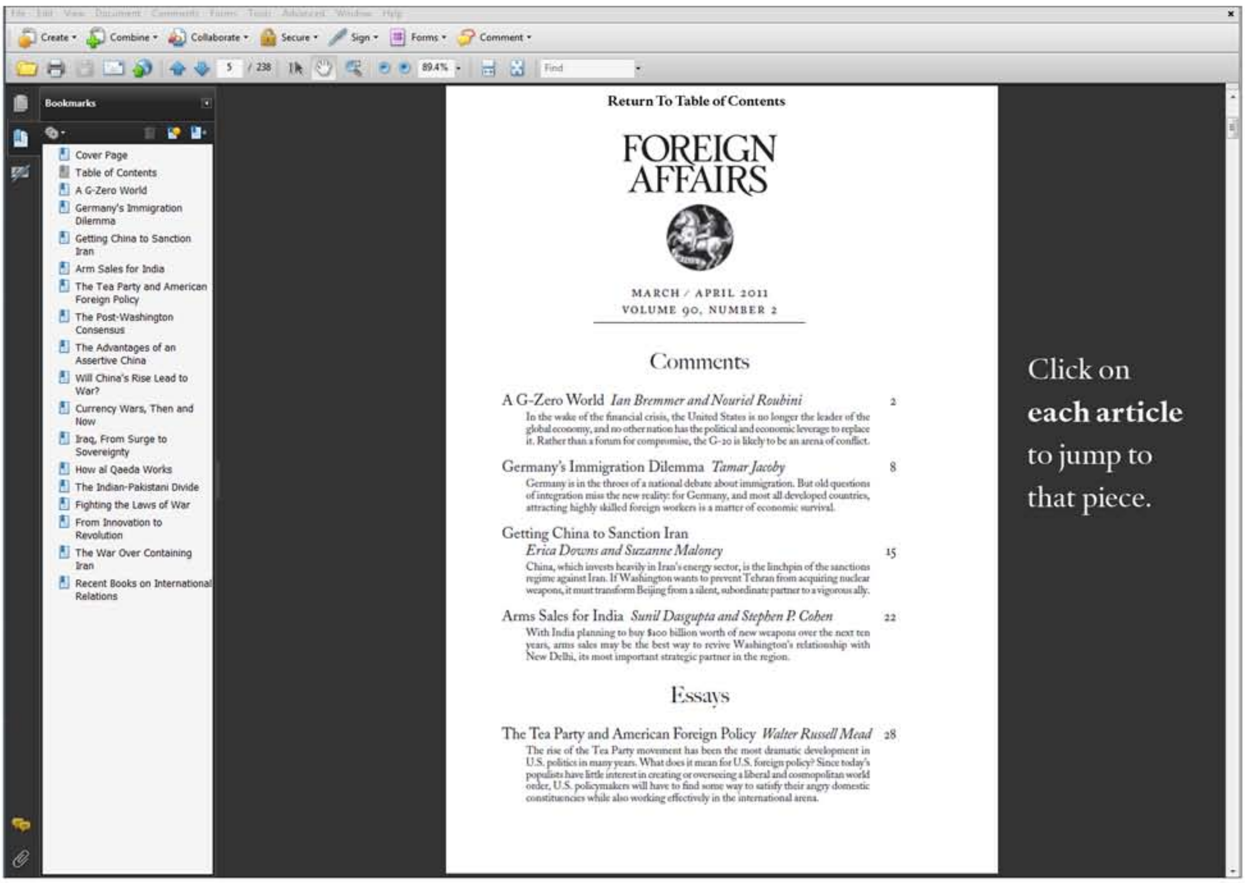

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January/February 2014

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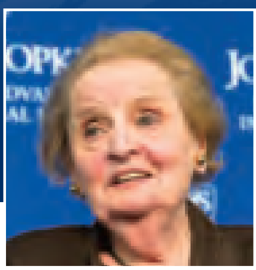



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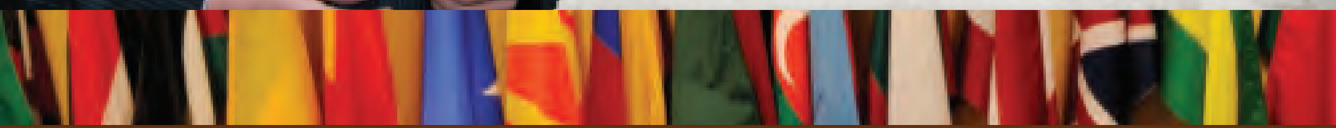

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Archibald Cary Coolidge, Founding Editor
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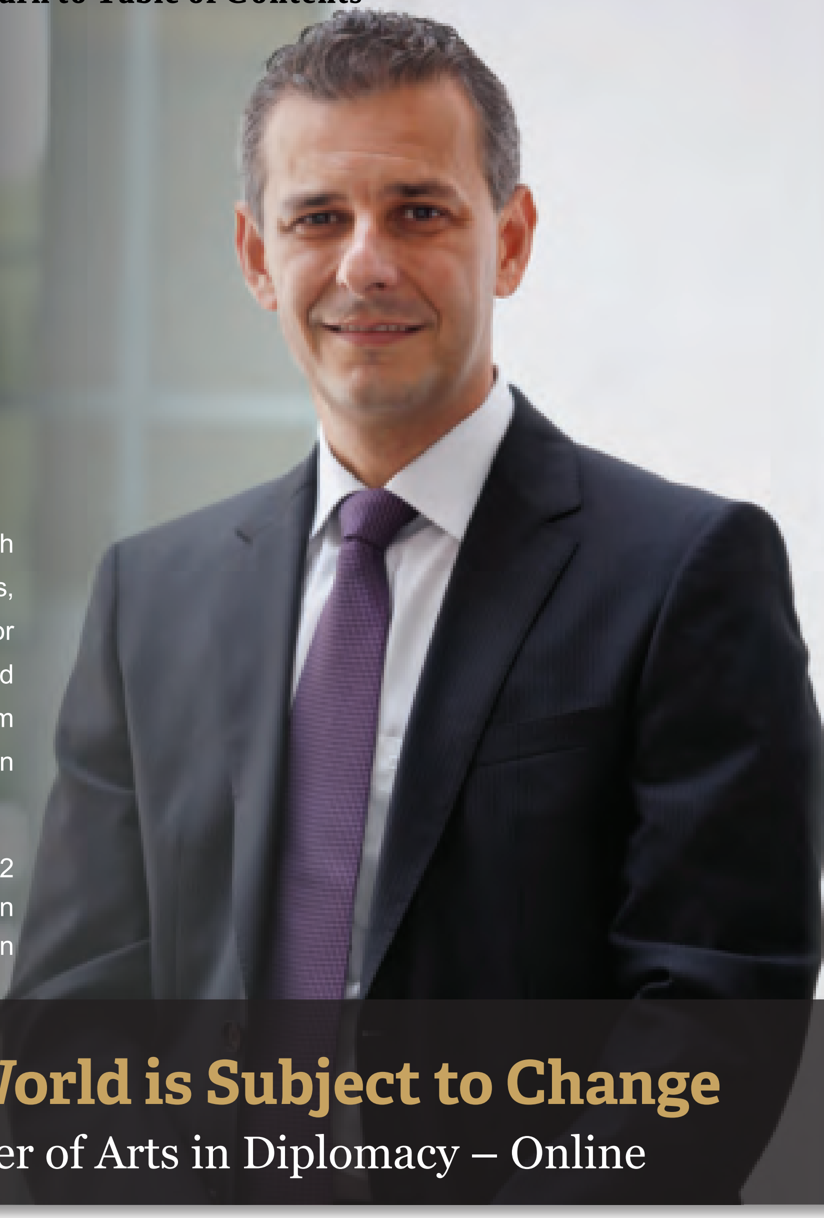

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Until December, **ASHTON CARTER** was the number two official at the Pentagon. A Rhodes scholar with a doctorate in theoretical physics, Carter has long been a faculty member at the John F. Kennedy School of Government at Harvard University and has served on the Defense Science Board, the Defense Policy Board Advisory Committee, the secretary of state's International Security Advisory Board, and innumerable other official panels and commissions. In "Running the Pentagon Right" (page 101), he lays out the lessons he has learned about how to get U.S. forces the support and equipment they need, when they need it.

CARLA HILLS, an attorney by training, became the third woman to serve in a U.S. cabinet post when she was sworn in as secretary of housing and urban development by President Gerald Ford in 1975. From 1989 to 1993, she served as the U.S. trade representative, negotiating the North American Free Trade Agreement on behalf of the United States. In "NAFTA's Economic Upsides" (page 122), Hills looks at the fruits of NAFTA 20 years on and suggests how to build on the treaty in future decades.

A veteran journalist and editor, **LAURA SECOR** has worked at *The New Yorker*, *The New York Times*, *The Boston Globe*, and *The American Prospect*, among other publications. Her reporting on Iran has covered everything from the fall of the Green Movement to the rise of the price of chicken. She is currently writing an intellectual history of reformist thinking in Iran—a subject she explores in "From Shah to Supreme Leader" (page 160), a review of two new books on Iranian politics since the Islamic Revolution.

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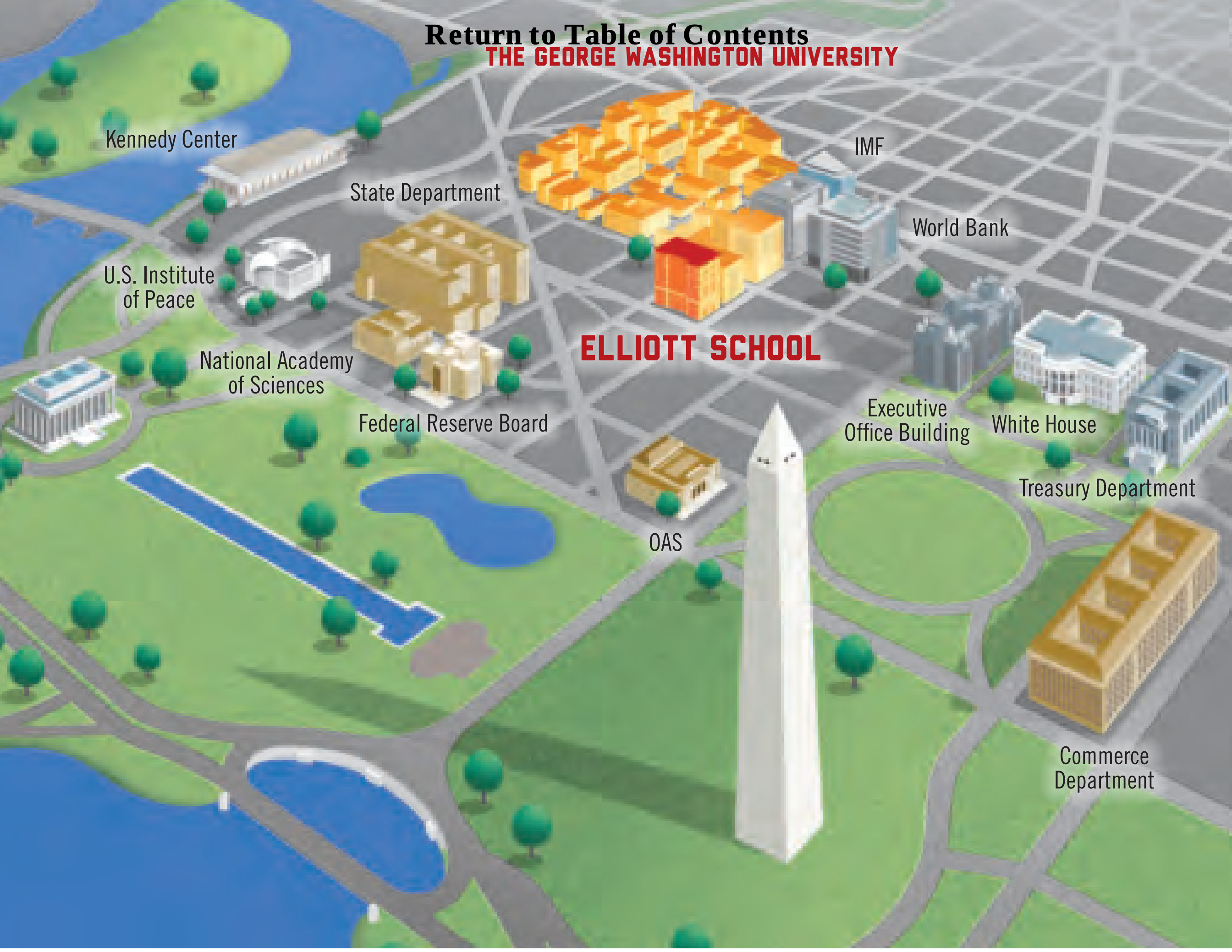

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WHERE TO BET NOW

A whole new group of economies is heating up, and all are well positioned to thrive as China slows and the commodity boom cools.

— Gideon Rose and Jonathan Tepperman

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The Shape of Things to Come

Hot Markets to Watch

Gideon Rose and Jonathan Tepperman

The idea that we live in an increasingly interconnected and turbulent world is something of a cliché—yet true and important nevertheless. Decisions made by the U.S. Federal Reserve affect the purchasing power of villagers in southern Thailand; consumer demand in Europe and North America affects the output of factory workers in eastern China, which affects the jobs of oil workers in Brazil, Russia, and elsewhere. Elite investors now routinely send their capital abroad in a ceaseless quest for new opportunities and high returns; whether they realize it or not, hundreds of millions of less highflying people do the same indirectly, through their mutual or pension funds. So global economic forecasting—trying to look past current events to glimpse what's coming over the horizon—has become an exercise of general, not specialized, concern.

A decade ago, the big story in the international economy was the so-called rise of the rest: the impressive growth of dozens of emerging markets around the globe. Poverty rates plummeted, the middle class exploded, and forecasters began talking of a great convergence, in which broad swaths of the developing world would catch up to the developed one. Then, the global financial crisis hit like a tidal wave, dousing almost everyone and redrawing the landscape. In its wake, many of the once-hot emerging markets have cooled. The BRICs are crumbling. China's three-decade run of phenomenal growth seems to be ending, with the big question now being whether its landing will be hard or soft. And half a decade after the crisis began, Europe is still floundering. But not all the news is bad. The United States has surprised skeptics by making a slow but steady recovery, led by energy and manufacturing. And a whole new crop of green shoots is springing up.

Given the tumult, we decided that now would be a good time to survey these up-and-comers: countries and regions whose combination of size, recent performance, and economic potential will make them particularly interesting to watch and attractive to investors over the next half decade. All our choices—Mexico, South Korea, Poland, Turkey, Indonesia and the Philippines, and the Mekong region—are well positioned to thrive as China slows and the commodity boom cools. All have crucial strengths to draw on and will play increasingly important roles in the future of the global economy. And yet, as our expert authors show, each faces a distinctive set of challenges.

After years of stagnation, violence, and political drift, Mexico is now enjoying energetic new management, and recent reforms, plus the country's vast oil wealth and proximity to the world's largest market, should spur it forward

GIDEON ROSE is Editor of *Foreign Affairs*.

JONATHAN TEPPERMAN is Managing Editor of *Foreign Affairs*.

in the years to come. (In an exclusive accompanying interview, Mexican President Enrique Peña Nieto explains how he did it and what he plans next.)

South Korea and Poland have also profited from smart leadership and proximity to bigger players; indeed, both have grown so rapidly in recent decades that they no longer fully qualify as "emerging." But both remain more volatile than established, fully developed states, making their manufacturing-driven economies especially appealing for investors.

Turkey's story is somewhat similar, although its economy remains less advanced and its leadership less enlightened. With an impressive decade behind it and an important election ahead, Turkey faces its biggest challenge today in the realm of domestic politics. As Prime Minister Recep Tayyip Erdogan flirts with authoritarian populism, the country teeters between continued growth and a reversion to the Middle Eastern mean.

Giant Indonesia also confronts political challenges, and a crucial election in 2014 will determine whether it delivers on its promise or returns to the more familiar path of stagnation. Meanwhile, the nearby Philippines, now an outsourcing powerhouse, has been racing ahead under the clean and committed stewardship of President Benigno Aquino III.

Finally, mainland Southeast Asia—the region around the Mekong River and its tributaries—is rediscovering the benefits of interconnectedness, as its diverse economies take advantage of their ancient cultural ties and new transportation links to grow together.

We round out the package with a look at the pitfalls and promise of economic forecasting in general by Ruchir Sharma, the head of emerging markets and global macro at Morgan Stanley Investment Management.

Even the best crystal ball gets cloudy at times, of course, and there are many factors such a package cannot cover, from unexpected technological developments to currency fluctuations to natural disasters (such as Typhoon Haiyan, which struck the Philippines just before the package went to press). We have not tried to make short-term predictions, nor have we focused on the extent to which global markets may have already priced in the various issues our authors discuss. What we have tried to do is offer a compelling look at the fundamental issues likely to drive success or failure in some of the global economy's newest and brightest stars in the years to come.

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Pact for Progress

A Conversation With Enrique Peña Nieto

When Enrique Peña Nieto, 47, became Mexico's president, on December 1, 2012, expectations were hardly sky-high. A one-term state governor, Peña Nieto was relatively untested. His election also represented a return to power for Mexico's Institutional Revolutionary Party (PRI), which had run the country for 70 years before being ousted in 2000 in the country's first freely contested elections. Many feared that Peña Nieto's ascendance would mean a resumption of the bad old days of crony capitalism, economic stagnation, and tacit cooperation with the country's brutal drug cartels. Instead, the new president immediately set about enacting far-reaching economic reforms, taking on fiscal policy, unions, oligarchs, and a cosseted energy sector in rapid succession. He even got a fat tax on junk food passed last October. But as Peña Nieto's first year in office has drawn to a close, results from the new approach have yet to materialize. Mexico's economy has slumped, crime remains a serious threat, and polls show voter confidence in the president sagging. In mid-November, Peña Nieto met with *Foreign Affairs* managing editor Jonathan Tepperman at Los Pinos, Mexico's presidential residence, to discuss his term to date and his plans for the future.

Your administration has gotten off to one of the best starts of any in recent history, but recently, the picture has started to look a lot gloomier. What concrete improvements can you point to from your first year in office?

This government has come not to manage but to transform. Part of what has allowed this is the Pact for Mexico [a deal to push through reform signed by all three of Mexico's major parties at the start of Peña Nieto's term]. The pact gave us space to debate and agree on the changes Mexico needs, and that is exactly what has been happening throughout this year. We've made adjustments in labor, in education, in finance, on fiscal issues, and I hope also in energy. All these adjustments have—and this is natural—faced resistance from the people who are being affected. But we've been building the foundations for a country that will be more promising in the near future.

But for ordinary Mexicans, these changes must seem abstract. Can you reassure them that growth will improve soon or give them other targets to look for?

Undoubtedly, the changes that have already taken place will allow our economy to perform better next year, for many reasons. First, the international environment will improve. We see signs right now that other economies seem to have hit bottom and are starting to recover. This will be good for the economic dynamics of Mexico, which is an open country.

Second, it was natural that with the change of administration, there was a change in the pace of government, and this will be felt next year. There will also be a higher budget, which is the consequence of the fiscal reform. Obviously, this new budget will test the capacity of the government to spend

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The president in Mexico City, September 2012

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with transparency and efficiency, but I think this first year has set the basis for us to be able to [do that]. This has been a year of planning, of undertaking indispensable projects. Some of the results are already materializing. But next year, we will have a budget that will be the highest in the history of Mexico.

So are you promising specific new kinds of spending for next year?
We have to expand higher education and health care. We're going to be spending more. We also have a very ambitious plan for infrastructure. It has to do with roads, highways, modernizing ports, and also with expanding and modernizing part of our railroad network.

I also hope that in this [current] legislative period, the financial reform package (which is different from the fiscal reform) will be passed. It seeks to find a lever of growth and to make growth more accessible to the population. Mexico has very solid financial institutions, with good levels of capitalization, but they're not lending much, perhaps because the current legal framework doesn't really favor higher credit. The financial reform seeks to facilitate the offering of more loans by financial institutions and to make loans cheaper for Mexicans.

You've taken some initial steps on energy reform, but oil output is falling, and many people argue that more needs to be done. You've promised to allow foreign investment and joint ventures in the Mexican oil sector as a way of boosting production. But what exactly are the next steps? And if you offer foreign companies only profit sharing, not production sharing, can you get the kind of participation Mexico needs?
I think the model we have presented to Congress is very similar to models that have proved successful in other parts of the world. It promotes greater participation by the private sector in oil, gas, and all our energy resources. This issue is very sensitive in Mexican culture. It's practically a religious issue. But we've seen other countries implement reforms inviting in the foreign private sector, and they were able to boost production in Colombia, and in Brazil . . .

But Brazil just held its first big foreign auction for the development of its pre-salt offshore oil field, and they got only one bidder. Doesn't that make you nervous?
No. Mexico is a country that has a lot of energy potential. We not only have oil; we also have shale gas. But we cannot expect that a Mexican state company is the only one that can exploit the resources. Resources will continue belonging to Mexicans. They are the patrimony of the nation. But the Mexican state must find more efficient ways to exploit those resources. If we don't make sure that Mexico can offer potential investors more input, they'll stop coming to Mexico. They'll go to the United States or other places where it is more economically viable to carry out their projects. I think that the debate taking place in Congress will lead to majority support for the necessary reforms before this legislative period concludes in December.

And when can we hope to see output actually start to grow?
If the energy reform succeeds, its implementation should be gradual but

also immediate, because the major challenge Mexico faces is economic growth rates that, unfortunately, have been lower than expected. Our growth has been well below what we originally thought it would be. But this happened to most other economies, and we believe that next year will be better. I think Mexico can grow, should be growing, by over four percent, five percent.

In your campaign, you promised a fundamental change in security strategy. But in some ways, you have followed the same strategy as your predecessor—by continuing to target cartel kingpins, for example. Meanwhile, some sorts of crime, such as kidnapping and extortion, are on the rise. How is your strategy different from the last president's?
The constant element is the role of the Mexican state in fighting criminal gangs. This is a task that the Mexican state cannot renounce.

But reducing the level of violence is what I [emphasized in the campaign], because the way [crime fighting] was being done in the past resulted in an increase in homicides. Our strategy emphasizes prevention, coordination, and the reconstruction of the social fabric. And we have seen a reduction in violence, in homicides. Unfortunately, the reaction of different groups has been to resort to other types of illegal acts, like kidnapping and extortion, and this is something we're fighting.

Here, I would highlight a major difference compared with the strategy of the past. Today, we have effective coordination between the federal and state governments. There is a permanent review of the different actions that each level of government is committed to implementing. I think that the issues to improve were there in the past: making professional policemen more reliable and making more investments in instruments such as intelligence systems. We're going to create five regional centers that will allow us to reinforce the capacity of local authorities.

As for extortion and kidnapping, a lot of it comes from the jails themselves. We now have a project to put better equipment in jails to inhibit telephone calls, so that the people in prison cannot be making phone calls [to plan and commit crimes].

It seems like the underlying problem, though, is really about the lack of the rule of law. Mexico suffers from terrible corruption: the World Bank estimates that it eats up as much as ten percent of your annual GDP, and recent high-profile cases have involved everyone from the top to the bottom in Mexican society. What does your government plan to do about that?
Corruption is an endemic evil—a cultural problem, not only for Mexico but for [all] Latin America. Fighting it has to do with [improving] the environment for individual development. And this involves improving the economy, which we're doing. And wherever there's corruption, people have to denounce it so that there's no impunity and we can penalize or sanction corrupt practices.

I [also] think the state should make additional efforts. I have proposed a bill in Congress, which is about to be passed, to create an anticorruption commission that will be given autonomy to look into claims filed by citizens. This, along with the effort to give more autonomy to the Federal Institute for

Access to Public Information [which administers Mexico's freedom-of-information law], will reinforce the capacity of the state to fight corruption in a more efficient manner.

But this cannot be the only thing we do. The effort should also be linked to education and, of course, the conditions of development in Mexico. Whenever there are some who have more opportunities than others, this feeds corruption. When you have more [equitable] development, it helps to curb corruption. So it's a dual effort: on the one hand, you have to improve the environment and, on the other, to grant the state the necessary instruments to allow it to fight corruption more efficiently.

This year is the 20th anniversary of NAFTA. You've said that you'd like to widen relations with the United States. Would you like to see more integration and, if so, in what areas?

As we've told the U.S. government, first of all, we need to recognize the harmonious and historic relationship between the two countries, breaking from the exclusive emphasis in recent years on fighting insecurity and collaboration for that purpose. The space of the relationship should be broadened.

What do we want? We have to recognize that the U.S. is the first destination of our exports. Mexico is also a top destination for the U.S. and Canada: there are no other countries the U.S. sells more to than Mexico and Canada. And we are geographically united. We governments have to recognize the gaps that still exist, and we have to improve the relationship for the benefit of all the populations.

What have we proposed? Let's create conditions to help North America be more competitive vis-à-vis the world. I think that if we are able to attract the attention of the United States, all of North America might be a more competitive and productive region. We have to design an infrastructure to [unlock] the potential of our nations.

So better infrastructure across the borders. What else?

I would emphasize financing infrastructure projects and the development of integrated value chains between Mexico and the U.S.

Would that require regulatory or legislative changes?

No. We need political will, so that we can build together. The relationship is there, with the governments and without the governments. We're very integrated. If we look at trade between Mexico and the U.S., for instance, before NAFTA and after NAFTA, the volume has grown. But Mexico and the U.S. were natural destinations for each other even before NAFTA. We're neighbors.

We can develop more efficient borders that will allow the trade of goods and the crossing of people to become more agile, secure, and safe. Not many people know this, but the Mexico-U.S. border is the busiest in the world. Every day, legally, we have a million people crossing. We have good cooperation with the U.S. administration, but I do think we have a lot more to do.

Is the rising power of Latino voters in the United States changing ties? And has the stalling of immigration reform or the Snowden revelations about U.S.

wiretapping of your communications hurt relations with Washington?
U.S. politicians are increasingly recognizing the relevance of the Hispanic vote in U.S. politics. This motivated the immigration reform bill presented by President Obama. Mexico views that issue with enormous sympathy, although it is of course a domestic issue for the United States. Immigration reform would be a fair recognition of those [Mexicans] who live in the United States and are part of the dynamic U.S. economy.

In terms of the espionage, this is something I have talked to President Obama about. We don't want it to mar the relationship between Mexico and the United States. But it is unacceptable for a country to practice such espionage, especially if there is a good relationship with the other country. This revelation is [an issue] not only for Mexico but for many other world leaders. The espionage is illegal, and I think that it breaks from the climate of harmony and cordiality we should have among our nations and peoples. Given everything that is now known, and the position of other heads of state on this issue, we hope that the United States, with humbleness, will recognize [the error of] what it did and avoid such actions from now on. And if there have been violations of international law, penalties should take place. We have pointed this out, and we are expecting to get a categorical and convincing explanation. But I insist that this will not be an obstacle in our relationship.

What are you planning to do to increase Mexico's global profile? The Pacific Alliance—an Asia-oriented trade pact including Mexico, Colombia, Peru,

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and Chile—seems promising. Will Mexico join the alliance's integrated stock market, making it the largest exchange in Latin America? And what other international initiatives do you have planned?
I think there are two initiatives that will help demonstrate Mexico's openness to the world. One is the Pacific Alliance. We're practically ready to reach the accord. And the other one is the Trans-Pacific Partnership. There are 12 countries participating in the TPP: Mexico, the United States, Canada, and countries in Asia. Asia is a region with great potential, and the TPP would create a new relationship with great potential for trade among the countries signing the agreement. These two instruments, if they materialize, will create great opportunities for Mexico. Mexico hasn't been the obstacle to finalizing the TPP. On the contrary, Mexico has always been in favor of the TPP.

I hope such efforts will project [the image of] another Mexico, a different Mexico, a Mexico [not associated] with a climate of insecurity or narco-violence, as in the past. Internal success will allow Mexico to project a different face to, and have a better position in, the world.

In the past, the PRI was hardly known as the party of reform; in fact, it often blocked such changes. How and why did the PRI change so quickly and become so enthusiastic about reform?
I can tell you immediately. The answer is that Mexico changed, and the PRI has simply adapted itself to the new democratic conditions of our country. [In 2000,] the PRI stopped being the hegemonic party, and it got to be in the opposition. So it had to learn to compete, to gain the support of society. I think the PRI has really taken in these new lessons.

And the challenge and the opportunity for the PRI now is to show that we—not just me but also governors and congressmen—have learned these lessons, have learned to compete, and are here to produce results for society.

I know there are great expectations. But I would conclude by saying, first, that this government understands where we want to go and how we're going to accomplish it, and we haven't deviated from our path. And second, things are happening in Mexico. We have a political climate in which there are differences, controversy, polemics, and everything else. And we have our challenges. But unlike in other countries, where politics is a lid that doesn't allow them to develop, here in Mexico, things are happening—we're reaching agreements. As we move from passing to implementing the energy and political reforms, that will be a good closing for this first year of my administration and will have created a sound foundation for more development in the coming years.

I'm very optimistic. The three main parties are at the table. Every time I speak to someone else from another country—from Denmark, Italy, Spain, the United States, wherever—they tell me, "What we need is a pact like in Mexico." The most important changes are about to come, but they will come.

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Mexico

Viva las Reformas

Shannon K. O'Neil

Just over a year ago, as President Enrique Peña Nieto started his administration, the domestic and international press were touting "Mexico's moment" and the rise of "the Aztec tiger." Now, the naysayers have returned. Their pessimism stems in part from disappointing economic results: Mexico's GDP growth has fallen, from nearly four percent in 2012 to around an estimated one percent in 2013. The negativity also reflects the impatience of pundits and markets, as the economic dividends from Peña Nieto's ambitious economic reform agenda have yet to appear.

Today's vocal disappointment discounts the positive changes Mexico has undergone and continues to make. Over the last three decades, Mexico has made the transition from a commodity- and agricultural-based economy to one dominated by manufacturing and services. It is also finally moving forward on a host of overdue domestic reforms. Internationally, the country is firmly situated within North American supply chains, augmenting its global competitiveness. And these advantages should only grow with Mexico's involvement in both the Trans-Pacific Partnership (TPP) and the Pacific Alliance, two of the most dynamic free-trade negotiations of this century. If Mexico is able to make its legislative changes stick and harness its geostrategic potential, the country will excel over the next five years, benefiting its people and making it a good bet for investors.

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ONCE UPON A TIME IN MEXICO

As the North American Free Trade Agreement (NAFTA) celebrates its 20th anniversary, many forget just how much Mexico has changed in the last two decades. Once hidden behind high tariffs, quotas, subsidies, and hundreds of state-owned enterprises, Mexico's economy is now one of the most open in the world. Mexico boasts free-trade agreements with over 40 countries and a trade-to-GDP ratio—a common measure of economic openness—above 60 percent, surpassing the United States, Brazil, and even China. And whereas oil once represented over 75 percent of Mexico's exports, today it is manufactured goods that produce three out of every four export dollars.

This transition has not been easy. In fact, Mexico's openness was for many years seen as a weakness. Relentless international competition threatened new companies and otherwise promising industries, giving them little time to climb the learning curve. Particularly after China's 2001 entrance into the World Trade Organization, the search by CEOs and their boards for lower-cost and more flexible producers led many east, decimating several of Mexico's manufacturing sectors, including textiles and apparel.

This trend is now reversing. The low-skilled, low-paid jobs are likely gone from Mexico for good. But rising wages in China, combined with higher Mexican productivity; increasing energy costs, which make shipping more expensive; the proximity of Mexican factories to the United States, reducing delivery times; and worries about intellectual property rights, have led a number of manufacturers to choose Mexico over China. Others have brought back production once sent across the Pacific. In advanced manufacturing industries such as aerospace and automotive, Bombardier, Embraer, Honda, Nissan, and Volkswagen have invested billions of dollars in Mexico and made the country a vital leg of their global supply chains.

As Mexico's economy has changed, so, too, has its society. Alongside a few of the world's wealthiest individuals and tens of millions who are still poor, a growing middle class has arisen. Depending on how one measures this group, it now comprises anywhere from 40 million to over 60 million Mexicans—either way, a large percentage of a population of 116 million. These individuals and their families own cars, houses, and every modern appliance, as well as new cell phones. A growing number use their newfound disposable incomes to send their children to private schools.

Such increased consumption shows up in aggregate GDP numbers and on companies' balance sheets. Providers of electronics (Elektra), air travel (Interjet, Volaris), basic goods (OfficeMax, Walmart), cars (Ford, GM), credit cards (American Express), and high-end coffee (Starbucks) are just some of the firms that have seen their sales and profits rise.

THE PRESIDENT'S PLAN

The current government under Peña Nieto has kicked off its six-year term with an ambitious reform agenda. Working with Congress even before he donned the presidential sash, Peña Nieto helped pass a labor reform to reduce the size of the informal sector by making it easier for businesses to hire and fire employees (among many other changes). Once in office, his administration, working with all three major political parties, passed an educational reform to make the system more transparent and merit-based, introducing evaluations and performance tests. Next came telecommunications and the media, with new legislation creating a more powerful regulator and opening up the broadcast spectrum in an attempt to break up the current monopolies. Recent fiscal reforms should increase government revenue while also redistributing the tax burden, raising rates on the wealthiest, taxing capital gains and dividends, and creating universal pensions and unemployment insurance for those in the formal sector.

Peña Nieto's administration has focused on major political and energy reforms, which are intended to take on two of Mexico's most sacred political cows: the reelection of politicians and foreign investment in energy, both of which have long been banned. The government has also pursued financial reforms that would encourage lenders to extend credit beyond just a fortunate few. Although all the reforms entail compromises, many represent real changes. If fully implemented, they have the potential to chip away at Mexico's many barriers to broader, more inclusive growth.

Homemade: a "Made in Mexico" marking, July 2007

FLICKR / RUBEN BALDERAS

With a stronger domestic economic base and a richer society, Mexico can take advantage of its greatest potential, which lies in its deepened ties to two developing economic blocs: North America and the Pacific Alliance. The most important region for Mexico is and will be North America. The continent is a global economic powerhouse, with Canada, the United States, and Mexico together boasting around 470 million citizens and an economy totaling some $19 trillion—nearly equaling the EU in population and outpacing it in production.

A large part of North America's economic dynamism stems from its interdependence. Since NAFTA entered into force, intraregional trade has multiplied, from around $290 billion in 1993 to over $1.1 trillion in 2012. Roughly half of this trade crosses the U.S.-Mexican border each year. The nature of this back-and-forth has also changed, as new supply chains have taken root throughout the region. A study by the National Bureau of Economic Research found that on average, 40 percent of the content of the products imported by the United States from Mexico actually comes from the United States, reflecting the degree to which Mexico and the United States now make things together.

The recent boom in North American energy could further deepen regional ties. Ten years ago, North American analysts worried about a growing energy deficit as demand rose and supply diminished. Today, with the rise of shale oil and gas production in the United States, oil sands in Canada, and the potential opening of Mexico's energy sector, many experts are talking about the possibility of the continent's becoming self-sufficient. For Mexico, greater access to stable and affordable gas from the United States also stands to boost the country's competitive edge in manufacturing.

Still, challenges remain. Limited infrastructure investments, higher security hurdles, and duplicate regulations and bureaucratic procedures have increased border delays, raising costs for many

North American operations. Studies show that the added time costs billions of dollars—eating away at profit margins and hurting companies and workers on both sides of the U.S.-Mexican border.

After a decade of stagnation, the United States is finally taking steps to improve and facilitate economic ties between itself and Mexico. In September 2013, the two governments began the U.S.-Mexico High Level Economic Dialogue, led by U.S. Vice President Joseph Biden and Mexican Finance Secretary Luis Videgaray and Mexican Foreign Secretary José Antonio Meade. From customs forms to border crossings, product testing to standardized regulations, teams in both countries are beginning to work to reduce the current obstacles to freer trade, to the benefit of regional manufacturing and production.

NOT JUST NAFTA

Mexico also now forms part of the United States' most ambitious international trade effort, the TPP. Bringing the NAFTA partners together with Chile and Peru in the Western Hemisphere and Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam across the Pacific, the bloc would represent one-third of the world's trade and 40 percent of global GDP. The TPP is intended to transcend traditional free-trade agreements and address such issues as regulatory coherence, e-commerce, and how to encourage small and medium-size businesses to trade internationally, all of which would increase competition and deepen production chains.

But even as Mexico is reaching out to the north, it is also actively looking south. In 2012, it became a founding member of the Pacific Alliance, alongside Chile, Colombia, and Peru (Costa Rica and Panama are expected to join soon, too). These like-minded globalizing countries are working to eliminate tariffs, allow the free movement of people, share diplomatic embassies overseas, and combine their stock markets into a joint trading platform. Although trade and investment flows among the members of the Pacific Alliance remain modest, the bloc offers a space for rapid growth.

By laying the groundwork for deeper regional supply chains, these blocs could represent a boon to manufacturers, distribution and logistics companies, construction businesses, and service providers. Taken together, they could help Mexico compete with, and benefit from, a rising Asia.

NO COUNTRY FOR OLD WAYS

For all of Mexico's strong positioning, the country still faces many daunting hurdles, which, if unaddressed, will hold it back. The biggest one is security. Crime remains stubbornly high—not only homicides but also extortion, kidnapping, and petty crime. Corruption and impunity only compound the problem. Mexico's police have often proved unwilling or unable to stem the bloodshed of the country's violent drug wars. The judicial system has also failed, with just two percent of all crimes leading to convictions. Without the basic rule of law, citizens and investors cannot hope to thrive over time.

The most immediate bellwether for investors is whether Peña Nieto's government will use the political will and influence so ably wielded in the economic realm during its first year to reform security policies in its second. Perhaps the first important step will

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be fully implementing Mexico's justice reforms. Passed in 2008 under President Felipe Calderón, they aim to fundamentally transform Mexico's judicial system, moving it from one of written evidence to one of oral trials; redefining the roles of judges, prosecutors, and defense attorneys; and even altering the de facto assumption of guilt. Although the changes are not a panacea for all of Mexico's criminal ills, they would move the country toward a more transparent and accountable system of justice.

Mexico's political reforms are just as important for its future. If the country actually allowed reelections, elected officials would have incentives to keep their promises to voters rather than their promises to their party bosses, whom they currently rely on for their next posts. This shift would not only empower citizens but also encourage politicians to invest in public goods that take more than one term to be fully realized, such as professionalized police forces and reformed court systems.

Economically, weak infrastructure holds the nation back. According to the World Bank, less than 40 percent of Mexico's roads are paved, and much of its railways were laid over a century ago. Investments in ports, airports, and highways have not kept pace with the growing economy or its increasing northward orientation. In the energy sector, underinvestment in pipelines has left half the country unconnected and caused gas shortages that reduce its competitive advantage as part of North America.

Finally, Mexico still struggles with uneven playing fields in business and in its citizen's daily lives more generally. For companies and entrepreneurs, the monopolies and oligopolies across various

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sectors both box out healthy competition and new ideas and raise the basic costs of doing business. As a result, according to estimates from the Organization for Economic Cooperation and Development, the average Mexican pays 40 percent more than necessary for everyday basics. Mexicans also have unequal access to health care and basic household services and face huge disparities in educational opportunities. These obstacles make it difficult for poorer Mexicans to climb up the economic ladder and, in the process, keep the country stuck in the "middle-income trap," with not enough highly skilled, educated workers or innovative jobs to boost productivity and grow its burgeoning middle class.

MADE IN MEXICO

Despite these barriers, many companies have found a way to thrive. The automotive, aerospace, electronics, and appliance industries have all seen both investment and returns grow quickly over the last decade. In other sectors, Mexico's obstacles could turn into economic opportunities. The unevenness of public education opens up space for for-profit schools and universities. The infrastructure deficits, combined with the current government's ambitious five-year investment plan and advantageous public-private partnership laws, create possibilities for profitable private investment in ports, railroads, airports, roads, and border crossings. Recent reforms have also opened up at least the possibility of competition in long-closed sectors and markets; for instance, Virgin Mobile has already announced new investments in telecommunications.

Consumer sectors more broadly remain promising, especially if the proposed financial reforms are adopted, expanding credit in the country, which currently lags behind that in not just the United States but also Mexico's emerging-market peers, such as Brazil, China, and India. Hotels, retail outlets, clothing lines, restaurants, cinemas, pharmacies, and thousands of other businesses stand to gain.

Although Peña Nieto recently made a show of going to China and promoting bilateral economic ties, Mexico competes with, rather than complements, China's rise. It provides few natural resources to the Asian behemoth, and its own factories have faced the threat of low-cost Chinese production. But with its growing trade links to the United States, Mexico now looks increasingly attractive; investing in Mexico remains, in essence, an anti-China play.

For the moment, the idea that the next iPhone or iPad will be built in the Western Hemisphere from beginning to end seems far-fetched. Few believe that the continent has the capacity, the skill, the supply chains, or the competitive pricing to compete with China or the rest of Asia. But the TPP and the Pacific Alliance represent the best and most promising paths to making this a reality—and Mexico stands at the heart of both.

What Mexico already has is a stable economy, a strong banking system, a democratic government, favorable demographics, globally competitive manufacturing sectors, and preferential access not just to the world's largest market (the United States) but also to many others through its growing trade alliances. If Mexico is able to get beyond its current limitations and capitalize on these benefits, investors and Mexican citizens alike will come out far ahead.

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South Korea

The Backwater That Boomed

Marcus Noland

South Korea's development over the last half century has been nothing short of spectacular. Fifty years ago, the country was poorer than Bolivia and Mozambique; today, it is richer than New Zealand and Spain, with a per capita income of almost $23,000. For 50 years, South Korea's economy has grown by an average of seven percent annually, contracting in only two of those years. In 1996, South Korea joined the Organization for Economic Cooperation and Development, the club of rich industrialized countries, and in 2010, it became the first Asian country and the first non-G-7 member to host a G-20 summit.

To call South Korea an emerging market, therefore, is a bit of an anachronism. The country is a rich, technologically advanced, mature democracy with an impressive record of innovation, economic reform, and sound leadership. Yet South Korea is not exactly a developed market, either. The value of its exports plus imports (at $1.25 trillion a year) exceeds its national income (at $1.1 trillion). That openness, along with the lack of protection provided by a bloc such as the EU, subjects South Korea to greater market volatility than other major industrialized countries and presents some serious challenges. So, too, does its highly concentrated corporate sector, aging population, and politically dangerous neighborhood. South Korea may well be more dynamic than some developed economies, making it attractive to investors, but it is also much riskier.

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SO LONG, KOREA DISCOUNT

Given South Korea's extraordinary accomplishments, it is tempting to try to distill the secrets of its success, so that they can be bottled and used elsewhere. But South Korea's remarkable leap from poverty to riches owes to a unique set of historical circumstances.

Soon after the division of the Korean Peninsula, in 1945, South Korea already had in place the building blocks for growth: an educated population, property rights, land reform that boosted productivity, and the institutions of modern capitalism. But then came the Korean War, which devastated the country. Investment did not take off until the country began to rebuild in the 1960s, when the authoritarian president Park Chung-hee (father of the current president, Park Geun-hye) embarked on a set of policy reforms that encouraged domestic saving and opened the economy up to international trade.

South Korea's initial rapid growth was characterized by both political authoritarianism and extensive state intervention in the economy. In the 1970s and 1980s, Seoul channeled massive amounts of capital through subsidies and low-interest-rate loans into trusted family-led chaebol, or conglomerates. These favored firms also enjoyed trade preferences and monopoly rights, among other indulgences extended by the government. Such preferential treatment enabled the chaebol, which today include Hyundai and Samsung, to grow into massive business empires whose brands are now recognized and envied around the world. But the story has a dark side: today, the chaebol's ongoing dominance poses challenges to regulators seeking to make South Korea's markets more competitive. And the conglomerates' historical ties to the country's early dictators feed resentment among many South Koreans, who regard the businesses as having achieved their dominance unfairly.

In recent decades, South Korea's politics have gone through an evolution just as stunning as that of its economy. After 40 years of rule by a succession of strongmen, in 1987, South Koreans freely elected Roh Tae-woo as president. Roh, a former general who had been handpicked by his military predecessors, was still linked to the old regime. But his next two successors—Kim Young-sam (a centrist civilian politician) and Kim Dae-jung (a former dissident)—most certainly were not. Their elections were a testament to South Korea's rapid liberalization. As Park's recent election shows, however, the echoes of the country's authoritarian past linger, and divisions over that past form one of the main fault lines in modern South Korea.

Despite all this progress, the country's recent years have not been uniformly easy. Still, one of the things that has distinguished South Korea is its ability to adapt to and learn from setbacks. The country was badly burned during the 1997–98 Asian financial crisis, for example, which exposed a weak, badly regulated financial system; wildly overleveraged firms; and occasionally corrupt corporate governance practices. But the government under Kim Dae-jung responded by undertaking significant reforms: it shut down bad banks, forced the resolution of bankrupt companies, and, most of all, strengthened previously inept financial regulation.

Such changes have paid off handsomely. According to several international barometers, including the World Bank's Ease of Doing Business Index and the World Economic Forum's Global Competitiveness Index, South Korea's financial institutions and business practices, which once dragged down income levels, have steadily converged on global norms. The so-called Korea discount, under which South Korean equities were undervalued due to international concerns about opaque corporate governance, has disappeared.

The reforms of the late 1990s also helped South Korea weather the global financial crisis. Despite a sudden stop in capital inflows and a precipitous fall in its currency in 2008, South Korea was able to avoid a larger crisis or a dramatic decline in output. And its recovery was swift: the International Monetary Fund forecasts that the country's economy will grow by 3.7 percent in 2014 and by 3.0–3.5 percent a year over the long term.

Maintaining this economic performance will not be easy, however. South Korea faces a range of challenges, from its aging population and the stresses that the swelling ranks of retirees will put on the government budget to its lagging productivity in the service sector, domestic inequality, and geopolitically unstable region. South Korean business may have gone global, but the country is still wedged between two political and economic giants,

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Won love: a poster depicting South Korean currency, Seoul, November 2004

REUTERS / KIM KYUNG-HOON

China and Japan, which will remain formidable for years to come—even if the former slows, as expected, and the recovery of the latter proves short-lived.

A downturn in China might give some South Korean midtech manufacturers, such as steel-makers and shipbuilders, a little more breathing room. But it could also threaten South Korea's trade surplus with its neighbor. Factories in China rely on South Korean machinery for their operation, so a Chinese slowdown would also have an adverse impact on South Korean makers of capital equipment and intermediary industrial products. South Koreans complain bitterly about Japan's policy of quantitative easing—buying bonds in large amounts to push down long-term interest rates—which they regard as a form of beggar-thy-neighbor currency depreciation. But any "tapering" of those purchases, in either Japan or the United States, could hit indebted South Korean households and firms hard.

And then, of course, there's South Korea's stunted twin. Even if North Korea manages to avoid starting a war or collapsing, the threat of instability or the sudden need for South Korea to absorb the North's 25 million citizens will remain a real risk, both for South Koreans and for foreigners looking to do business in South Korea.

TECHNOLOGY VS. DEMOGRAPHICS

Economists normally ascribe growth to the availability of basic inputs—labor and capital—as well as to increases in productivity. From 1963 to 1997, when South Korea was growing at its fastest, it benefited not only from the general openness of the world economy but also from a rapid expansion of its labor force and a relatively low number of dependents per worker, combined with a major increase in the education level of its work force. But those favorable demographics are now reversing. In 2010, South Korea's "core productive population"—citizens aged 25–49—fell for the first time. If current trends continue, its dependency ratio will begin to rise within the next decade, and by 2030, its population will start to decline, falling below current levels by 2050.

If those forecasts prove broadly correct, they will put significant new burdens on South Korea's health-care and pension systems, forcing the government to consider such measures as raising the retirement age, improving the efficiency of the delivery of health-care and retirement services, and making better use of female labor, especially educated women. South Korea may also have to reconsider its immigration policies, which are currently among the most restrictive in the developed world.

South Korea also needs to squeeze the most productivity it can out of its labor and capital, especially given the competition it faces from its neighbors low-wage China and high-technology Japan. South Korea may be tempted to try to accomplish this feat by emphasizing technology above all else. After all, as competitors from Apple to Toyota will attest, the country's progress in this field, particularly in information technology and manufacturing, has been phenomenal.

But increasing productivity requires more than just technological innovation; it also takes encouraging innovation in emerging sectors while terminating inefficient practices throughout the economy. In South Korea's case, the area that needs the most help is the heavily regulated service sector. If the government were willing to lower barriers to entry, the ongoing development of the country's financial sector could help restructure the service sector by making more capital available to underwrite innovation and boost investment.

South Korea also needs more financial integration between its corporations and their foreign counterparts. Seoul has largely lifted long-term barriers to both foreign direct investment in and equity ownership of South Korean firms. But balancing that integration with South Korea's desire to preserve its corporations' autonomy will be difficult, especially given that South Korean public opinion is still sometimes xenophobic and chauvinistic—an expression of the country's long-held resentment of being a proverbial "shrimp among whales."

However, given South Korea's track record as the quintessential open economy and its major trade relations with China, the EU, Japan, and the United States, Seoul is likely to surmount these difficulties. South Korea is an enthusiastic negotiator of free-trade agreements, including with the EU and the United States, and it is considering agreements with China and Japan. In 1997, South Korea signed the World Trade Organization's Agreement on Government Procurement, bringing greater transparency to public procurement and creating new opportunities for foreign firms. Trade in manufacturing and the service sector in the country is largely open; only agriculture is still protected. The automobile sector remains a source of contention. Many of the policies that in the past deterred foreign entry into the market have been removed, but foreign car companies still struggle to get a foothold against Hyundai and Kia and their well-established sales and distribution networks.

South Korea still needs to fix a labor market in which some workers have extensive benefits and job protection and others do not. It will also have to phase out its highly restrictive regulations on hiring and firing. At the same time, it should pass legislation that protects the interests of nonregular workers and encourages the smooth deployment of labor to its most productive uses by making wages less dependent on job tenure or seniority and making pensions and benefits more portable.

Seoul should also implement smaller reforms to encourage innovation. If South Korea can reduce the risk that its firms will imitate and reverse-engineer technology invented abroad, foreign firms will become less hesitant to transfer technology to South Korean partners. Meanwhile, universities and other public institutions should integrate their research and development with the private sector, and South Korean researchers should look harder for new partnerships abroad.

A final challenge faced by South Korea—although it is hardly alone in this area—is the growing inequality of income and wealth. Encouraged by the historically symbiotic relationship between business and the state, the government has concentrated economic, political, and cultural life in Seoul, one of the world's most expensive cities. As with London in the United Kingdom, the pull of the capital city has stoked inequality elsewhere in South Korea. To fight this, the government has tried to stimulate regional development by establishing "special economic zones" and relocating many government offices to provincial areas. But the movement of government ministries will only complicate the lives of many South Koreans and foreigners currently used to working with the government in Seoul.

Still, addressing the widening wealth gap is critical if South Korea hopes to avoid the kind of political backlash that could damage its economic growth. Park, a conservative, won the presidency in 2012 thanks in part to strong support from older voters who have relatively fond memories of her repressive, though effective, father. But few younger South Koreans share such sentiments. South Korea has a history of alternating between center-left and center-right leaders every decade or so (presidents serve single five-year terms). Given that history, as well as the country's shifting demographic trends and growing wealth gap, the center-left—with its greater emphasis on redistribution, or what South Koreans term "economic democracy"—could return to power in 2017. Such a shift could impede South Korea's progress if the center-left turns populist, breaking the budget with politically popular measures such as free university education, higher property taxes on the wealthiest, and punitive but dubious legal cases against prominent firms.

THE HARDEST PART OF BREAKING UP

Of course, many countries share such political risks. What makes South Korea unique is the threat that lies just beyond the 38th parallel: North Korea. Most South Koreans agree that economic engagement with North Korea would make Pyongyang less repressive domestically and less belligerent in its foreign relations. Even though North Korea's new head of state, Kim Jong Un, is a third-generation hereditary leader with a penchant for nuclear provocation, hope springs eternal that he will turn out to be a reformer.

In the meantime, South Korea is hesitantly planning for reunification. Inter-Korean projects, such as the Kaesong Industrial Complex (closed earlier this year by North Korea but recently reopened) and the opening of railroad lines along the east and west coasts, linking South Korea to Russia and China, are broadly popular in the South. Gas pipelines from Russia through North Korea to South Korea (and even onto Japan) could follow.

Despite such efforts, there is no guarantee that a North Korean transition would go smoothly; sudden collapse remains a distinct possibility. Such a scenario would have one of two consequences, both dire: the massive movement of southern money north or of northern people south. Plausible estimates of the money that would be needed to raise North Korean incomes to some significant share of those in the South, and thereby forestall mass emigration, exceed $1 trillion—equal to South Korea's annual national income.

Mass emigration from North Korea could also provoke a number of political cleavages within South Korea, especially between capital and labor. Industrialists view Northerners as a potential new source of cheap labor, while labor regards the North as a potential source of competition. The liberation of North Korea could also exacerbate divisions between high-skilled and low-skilled workers in the South and, if foreign capital flows in and drives up the value of the won, between the export sectors, which would suffer, and the local construction sector, which would boom.

In the nearer term, however, the real risks posed by the North have less to do with an abrupt, German-style reunification than with a reversal of South Korea's own gradual success at regularizing its business-government relations, which are still far too cozy, opaque, and corrupt. In the North, of course, there is no real difference between the state and the economy. Any large-scale economic integration between the two countries would by its very nature be highly politicized, and the expansion of the government's role in the South Korean economy could seriously undermine recent reforms.

From an investor's perspective, North Korea represents both a threat and an opportunity. The dangers are obvious. As for the potential benefits, the successful opening of the North would provide South Korean firms with a new source of low-cost labor. And North Korea has underground minerals, including rare-earth metals, possibly worth trillions of dollars.

For investors, South Korea has the deep, well-regulated debt and equity markets of a developed economy such as Japan, but in an economy with higher growth and greater dynamism. It is far more transparent than its giant neighbor, China, with greater protections for investors, including the rule of law. The country's manufacturers are competitive globally; the service sector represents an emerging opportunity.

Sixty years ago, the U.S. government considered making its destitute ally South Korea a regular line item in its foreign aid budget; many Americans expected Seoul to remain a ward of Washington in perpetuity. South Korea, of course, has proudly proved that expectation wrong—and seems likely to keep defying skeptics for years to come.

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Poland

From Tragedy to Triumph

Mitchell A. Orenstein

Anyone who knows Polish history cannot help but marvel at the country's emergence from the ashes of its traumatic past. Over the last 25 years, Poland, after centuries of war and subjugation, has enjoyed peace, a stable and booming economy, and integration with the rest of Europe.

An independent kingdom for the previous 800 years, in 1795, Poland was wiped off the map of Europe and absorbed into three great neighboring powers—the Prussian, Russian, and Austro-Hungarian empires—a state of affairs that lasted until 1918. Reborn following World War I, Poland spent a few short years as a democracy before proving ungovernable, succumbing to dictatorship, and then once again being conquered and divided, this time by Nazi Germany and the Soviet Union, in 1939. Over the next six years, Poland found itself at the center of what the historian Timothy Snyder has called the "bloodlands" of Europe; an estimated five million Poles died between 1939 and 1945, more than half of them Polish Jews. The Nazis and the Soviets also wiped out the cream of the crop of Poland's intelligentsia and clergy. Warsaw was reduced to rubble, and mass graves were sown across the landscape. Then came four gray and sooty decades of communist domination. Only the Catholic Church offered Poles any hope.

Since communism collapsed in 1989, however, Poland has experienced a remarkable reversal of fortune. After leading the protest movement that toppled the old regime, the trade union Solidarity won democratic elections and initiated aggressive, market-oriented economic reforms. The communist Polish United Workers' Party turned into the capitalist Democratic Left Alliance, which won elections in 1993 and 1995 and led the country into NATO in 1999. And in 2004, Poland joined the European Union as a full member, cementing its close alliance with Germany, its erstwhile antagonist.

The Polish economy, meanwhile, has grown rapidly for two decades—at more than four percent per year, the fastest speed in Europe—and garnered massive investment in its companies and infrastructure. Poland's is now the sixth-largest economy in the EU. Living standards more than doubled between 1989 and 2012, reaching 62 percent of the level of the prosperous countries at the core of Europe. All of this led the World Bank economist Marcin Piatkowski to conclude in a recent report that Poland "has just had probably the best 20 years in more than one thousand years of its history."

How did Poland manage so decisively to move beyond the repeated tragedies of its past? The question is rarely asked by market analysts, whose sense of Poland seems to go no further back than the economic reforms of the 1990s. Those

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reforms are indeed part of the story—but only part it, and focusing exclusively on them obscures the deeper causes of the country's resurgence. Explaining Poland's economic boom—and why it is likely to last—requires a deeper look into its troubled history.

WESTWARD HO!

For centuries, Poland's tragedy was one of geography. Situated on the flat, open plains of northern Europe, with no natural boundaries separating it from Germany to the west and Russia to the east, Poland was often torn between the two. From 1569 to 1795, Poland had an eastward-looking empire of its own: the Polish-Lithuanian Commonwealth, which included large parts of present-day Belarus, Estonia, Latvia, Lithuania, and Ukraine. Today, however, Poland has decidedly joined the West—so much so that Poles hate when their country is considered a part of eastern Europe, insisting that they live in central Europe. Although some attribute this shift to the warm embrace of the EU, the real author of Poland's Western transformation was none other than Joseph Stalin.

Stalin's unwitting contribution stemmed from the way the Soviet leader forcibly reshaped the country's borders after World War II. His top priority was to expand the Soviet Union, and so he kept all the parts of eastern Poland that he had annexed in 1939 and compensated the country with a large chunk of the eastern German territories of Silesia, Pomerania, and East Prussia. Apart from increasing the size of his own empire, Stalin was focused on punishing the Germans, and indeed, millions of them were expelled from their homes in the new Polish territories. Millions of Poles were then driven from the annexed east into the newly emptied west.

Today, Moscow's decision to push Poland to the west must seem a massive strategic error. That's because its long-term effect was to move Poland solidly into the orbit of Germany. Indeed, today's Poland, to a large extent, is Germany, inhabited by Poles. Since Germany accepted this situation by signing a peace treaty with Poland in 1990, it has sought to draw Poland closer. And Warsaw has proved a willing partner.

Part of what makes Poland such a good place to invest today is the depth of the bond it has forged with Europe's leading economy. The relationship benefits both countries. A large part of the German export machine is now based in Poland. Poland gets German investment and markets for its goods, and Germany profits from the opportunity to use Poland as a low-cost, high-quality production platform to compete with East Asia. Indeed, some German industries are able to produce goods in Poland for less than what they would cost to make in China. And Poland offers Germany a friendly business climate, plenty of skilled labor, and, above all, proximity.

Germany owes much of the success of its automobile industry to its eastern neighbor. At its factory in Poznan, Volkswagen employs 6,900 workers who produce intake-pipe modules, cylinder heads, and steering-gear housings, as well as 155,000 commercial vehicles each year. The MAN Group employs 4,000 workers in Poland who build heavy trucks, city buses, and bus chassis at three different factories. Cars and automotive components are now Poland's leading export, despite the fact that the country has no internationally known brand; a large

Kiss and sell: Polish Prime Minister Donald Tusk and Merkel in Berlin, November 2012

REUTERS / THOMAS PETER

share end up as German marques. The same holds true for industries as diverse as household appliances and clothing; the German fashion house Hugo Boss, for example, produces its shoes at a factory in the Polish city of Radom.

Because Poland is now a key part of the German supply chain, it has become a great exporting economy—exports now make up 46 percent of its GDP. A recent Morgan Stanley report estimated that 30 to 40 percent of Poland's exports to Germany now end up as German exports to the rest of the world. This interdependence explains why Germany is by far Poland's largest trade partner, buying or selling 25 percent of Poland's exports and imports, which total about 12 percent of the overall Polish economy.

None of this could have happened if the German-Polish relationship were not embedded in the broader EU. Since Poland joined in 2004, the EU has done wonders for it and the rest of eastern Europe, ensuring democratic freedoms and administrative reforms and helping the region liberalize its markets. In the last decade, the EU has invested nearly 40 billion euros in Polish infrastructure, building the autobahns that Poland never had; replacing its outmoded, overcrowded, and often deadly two-lane highways; renovating its decrepit train stations and train lines; cleaning up its rivers; and setting up broadband infrastructure. In the process, Poland has become Europe's biggest construction site. Between 2000 and 2013, the aggregate length of Polish highway and express roads grew fivefold, dramatically reducing the cost and the time it takes to transport goods to the west. And the benefits should keep coming: between 2014 and 2020, the EU is expected to pump 106 billion more euros into the country. That infusion of cash will equal nearly two percent of Poland's annual GDP, a level of funding similar to what Washington provided to Europe under the Marshall Plan.

MANAGING POLAND'S RISE

Because of the centrality of foreign investment to Poland's economy (most of its major banks and enterprises are foreign-owned), its reliance on foreign trade, and the fact that so many Poles work outside the country, political economists often characterize Poland as a "dependent market economy." This dependence creates a fundamental dilemma: to attract foreign business and maintain its competitiveness, Poland must keep down its wages, which today stand at about one-third of those in the more developed countries of the EU. But Polish workers live adjacent to the rest of Europe, traveling and working there in great numbers, and thus aspire to a higher standard of living. This fact will make it difficult for Poland to maintain the advantages that come with cheap labor.

Poland should be especially worried about this dilemma given the presence of other low-wage countries in its neighborhood that could serve as manufacturing bases. In 2009, when the computer manufacturer Dell moved its main European factory from Limerick, Ireland, to Lodz, Poland, the mayor of Limerick predicted, with deep schadenfreude, that "Dell will probably head for Ukraine in six to eight years' time." One could say the same about the many call centers that have become mainstays of Polish employment.

To overcome this challenge, Poland must rise up the value-added ladder and begin producing more high-tech and knowledge-intensive exports. At the moment, Poland does not invest much in research and development relative to its more developed neighbors—only 0.7 percent of GDP, compared with about 2.0 percent in the EU as a whole. But there is reason to believe that Poland can change course. The country's greatest asset is its mass education system. One of the very few benefits of communist rule was that it left Poland with one of the highest literacy rates in the world. And since 1989, Poles have continued to invest heavily in their education, learning English, building new private universities, and participating in the Erasmus student-exchange program among European universities. Poland now has the second-highest rate of college enrollment in the Organization for Economic Cooperation and Development. Meanwhile, as small, innovative Polish technology companies boom, the path to a high-tech future is presenting itself.

Yet the greatest long-term risk to Poland is that its consumption and wages will rise too fast, crowding out domestic investment and deterring foreign business. In managing their country's rise, Polish politicians must walk a fine line between satisfying voters' concerns and maintaining the country's cheap labor costs.

This dilemma of dependence also explains why Poland is unlikely to join the eurozone, at least not anytime soon. Although the Polish government and Polish elites initially clamored to adopt the common currency, the financial and sovereign debt crises changed their minds. Part of the reason Poland weathered the 2008 global financial crisis well was that it was able to devalue the zloty, which helped Warsaw maintain its exports and keep jobs in the country. And when the sovereign debt crisis hit in 2009, Poland relied on devaluation and government stimulus to avoid a recession, making it the only European country to do so. Warsaw knows that keeping its own currency means that investors will pay transaction costs, but it will also help the country keep wages down. So don't expect to see euro notes on the streets of Krakow or Gdansk until Poland's and the eurozone's living standards get much closer to each other.

WHY POLAND?

A final challenge facing Poland, and one potential investors should take note of, is the extent to which it, like other countries in its neighborhood, has struggled to build an effective bureaucracy. Poland still ranks only 41st and 55th, respectively, on Transparency International's Corruption Perception Index and the World Bank's Ease of Doing Business Index—below all western European countries with the exception of Italy. Although there is little political risk to doing business in Poland—especially compared with doing business in Russia—it takes months to establish a company there, with as many as 33 separate stamps needed from different agencies. Some businesses complain that Warsaw favors partially-state-owned enterprises, using regulation as a tool to pick winners, or that the government has not worked aggressively enough to remove administrative barriers to growth. Even though opportunities for investment abound, the government is unlikely to help.

Although some other central and eastern European countries offer similar opportunities, Poland is still an attractive choice relative to its neighbors. Its population of 38 million—approximately four times the population of the Czech Republic or Hungary—means that it has a large domestic market. Whereas the Czech Republic and Hungary have richer and more open economies, Poland has much lower labor costs and has grown more rapidly. At the same time, its governance structures are more rule-bound than those of its low-wage competitors, such as Bulgaria, Romania, or others outside the EU. All these countries need to continue to move into more technologically sophisticated industries over time, in order to enable their citizens to increase their living standards.

In some ways, Poland is the template for the Europe that German Chancellor Angela Merkel hopes to create. It has carved out a profitable niche in the German production machine, and it can thrive with an export-oriented economy based on a strong currency and dampened domestic demand. This German model has provoked the ire of southern Europe, but for Poland, it works.

Warsaw is sometimes called "the phoenix city" because of the way it rose, like the mythical bird, from the ashes of World War II. Today, many ordinary Poles and investors are wondering just how high the phoenix can fly. Economic projections suggest that Poland's economy will grow by about 2.5 percent per year through 2030, becoming one of the top 20 economies in the world before eventually succumbing to demographic decline. If the country can create a more hospitable business environment, build a knowledge-based economy, and encourage immigration and higher birthrates, it may keep growing even faster. After all, the Poles have a knack for beating expectations.

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Turkey

How Erdogan Did It—and Could Blow It

Daniel Dombey

For much of last year, Turkey's economy seemed almost on top of the world. In May, as huge construction projects moved ahead, Ankara paid off its remaining debt to the International Monetary Fund, ending what seemed to many Turks a long history of humiliation. The country received an encouraging investment-grade rating, and foreign funds poured in like never before.

In a flurry of appearances that month, Prime Minister Recep Tayyip Erdogan feted record-low interest rates, a slide in the unemployment rate from 15 percent to nine percent since 2009, and, above all, the growth that Turkey has enjoyed "due to reforms carried out over the past ten years." He underlined his point—and his driving ambition—on an exuberant visit to Washington. Addressing the U.S. Chamber of Commerce, he noted that when his Islamist-rooted Justice and Development Party (AKP) came to power in 2002, at least 20 other economies were bigger than Turkey's in terms of dollar output. "Now, we are 17th," he exulted, "and in due course, we are going to be among the ten largest economies."

The Turkish economy has indeed come a long way during Erdogan's decade in office, propelling Ankara's ascent to greater global prominence. In the late 1990s, Turkey was running 90 percent inflation and attracting almost no foreign investment. As recently as 2002, Turkey was using up almost 90 percent of its tax revenues to pay the interest on its debt. Today, these problems have all but disappeared.

But the optimism of May has since faded. Turkey, like many other developing countries, has found itself facing skittish markets, volatile exchange rates, political unrest, and an uncertain outlook. The picture of Turkey today is less flattering but more revealing than before, displaying both the promise and the perils of being an $800 billion emerging economy.

Turkey is still on track to grow faster than much of the industrialized world in the coming years. In October, Jim Yong Kim, the president of the World Bank, hailed the country as "an inspiration to many developing countries." But the fact remains that Turkey's success could yet unravel. To live up to its economic potential, Turkey will have to overcome two main challenges: its reliance on fickle foreign funds and the intrusion of heavy-handed politics into its economic life.

SEEDS OF SUCCESS

The seeds of Turkey's success this century lie in the failure of the period that immediately preceded it. After the liberalizing reforms of Turgut Ozal, the visionary prime minister of the 1980s, who opened up what had been a perennially closed economy, the 1990s were a wretched decade, punctuated by economic crisis, brutal episodes in the country's Kurdish conflict, a de facto coup, and a devastating earthquake.

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This was a time when the lack of foreign funds, often the result of spikes in U.S. Treasury yields, could cause economies to seize up, and Turkey was hardly alone in its misery. During these years, macroeconomic shocks also hit Mexico, Russia, and Southeast Asia.

For Turkey, this sorry period came to an end just after a 2001 banking crisis, when Finance Minister Kemal Dervis, with the cooperation of the International Monetary Fund, laid the groundwork for success. Ankara pruned back its spending, brought inflation under control, introduced a floating exchange rate, restructured the country's banks, and granted more independence to the central bank and regulators. When the AKP took over in 2002, it stuck to this template, which paid off as Turkey's discussions with the European Union progressed. The prospect of EU membership—negotiations started in 2005—opened the floodgates for foreign direct investment.

A boom in infrastructure development and construction added to the good times. Since the outset of Erdogan's tenure, the country's highway network has been expanded by more than 10,000 miles. The number of airports has doubled, to 50, and Turkish Airlines now flies to more than 100 countries, more than any other carrier in the world. New, upscale housing complexes and shopping malls seem to flank every major city.

Turkey's once-fragile banking sector was strong enough to get through the 2008 financial crisis with only a brief, albeit deep, recession. Then, as the United States unleashed an unprecedented monetary stimulus, Turkey floated on a sea of money. Growth roared ahead: the economy expanded by 9.2 percent in 2010 and 8.8 percent in 2011, although higher interest rates slowed the overheating economy to 2.2 percent growth in 2012.

HOOKED ON FOREIGN FUNDS

Yet for all its strengths, Turkey remains vulnerable. Its first major problem is its dependence on foreign funds. The country suffers from structural weaknesses that have been obscured by the waves of money that have been crashing in because of loose monetary policies elsewhere. It shares this problem with other developing countries, including Brazil and Indonesia, whose governments have grown lazy about reforms and let the quantitative-easing-induced good times roll. This dependence has become particularly worrying since May, when the U.S. Federal Reserve floated the possibility of reining in its monetary stimulus, a step that would likely reduce the funds that have been pouring into emerging economies. For Turkey, the talk of a tighter U.S. monetary policy left a particular mark: amid other troubles, yields on the country's benchmark two-year bonds doubled.

Turkish markets were sensitive for one reason above all: a lack of balance in the country's economy. Even though Turkey was expected to have grown by only 3.5 to 4.0 percent in 2013—below the level needed to create enough jobs for new entrants into the work force—the country's current account deficit stands at about seven percent of GDP. Despite Turkey's enormous appeal for tourists (36 million arrived in 2012), a manufacturing base well positioned for exports, a $62 billion agricultural sector, a tradition of trading, and ambitions to become an energy hub, the country still relies on domestic consumption to power its economy, and consumption has risen

Ottoman of the people: an Erdogan election poster, Istanbul, June 2011

REUTERS / OSMAN ORSAL

rapidly as savings have fallen. At present, Turkey sucks in foreign goods and relies on foreign cash to finance even lackluster economic expansion.

Making matters worse, the foreign funds that are financing Turkey's expansion are overwhelmingly short-term investments and could be swiftly pulled out of the country. Net foreign direct investment underwrote just $7.3 billion of the country's $56.7 billion current account deficit between August 2012 and August 2013. By contrast, five years ago, such investment—which is intrinsically more stable than short-term portfolio funds—financed half the deficit.

Turkish officials argue that concerns about the country's prospects are exaggerated and emphasize that a return to a more traditional U.S. monetary policy should not be compared with traumas on the scale of the collapse of Lehman Brothers. And in fact, with the U.S. economy still troubled, the Federal Reserve has so far held off tapering back its $85 billion of monthly asset purchases: money has returned to Turkey, and the spike in Turkish bond yields has partially subsided. Most analysts predict that Turkey will continue to grow moderately, as the country's living standards continue to converge toward those of the developed world, albeit at a slower pace than before.

But Washington's loose monetary policy can't last forever, and behind the Turkish economy's ups and downs, deeper problems lurk. The rebound from the 1990s is over, the low-hanging fruit of the last decade's reforms has been picked, and the foreign money on which the economy depends will eventually be in shorter supply. If Turkey cannot reduce its dependence on short-term foreign capital, it will not be able to grow enough, or at least not sustainably.

To a certain extent, the Turkish story so far has been less than meets the eye. The government trumpets that during its time in office, income per capita has tripled, partly a result of disparities between inflation and the exchange rate. But that growth happened early on, mostly due to the lira's strengthening in real terms, and for the past half decade, that figure has largely been stuck around $10,500.

Then there are a whole host of structural issues that Turkey must address. Participation in the labor force remains low: only about 50 percent of working-age adults were employed in 2012, compared with an average of 68 percent across the mostly developed countries of the Organization for Economic Cooperation and Development. Part of the reason for this is the fact that Turkey has overlooked the potential of half its population: according to a recent World Economic Forum report, Turkey ranks 120th out of 136 countries in terms of gender equality, and women constitute only 23 percent of the nonagricultural work force. Moreover, Turkey still lags behind the developed world in terms of educational levels. In 2011, two-thirds of Turkey's working-age population had received only primary education or less, and according to the EU, fully 30 percent of Turkey's young people are neither receiving education or training nor securing jobs.

The government acknowledges all these concerns. Ankara is seeking to reduce its dependence on foreign fuel, which accounts for almost all its current account deficit, by encouraging alternative sources of energy and attempting to develop Turkey as an energy hub between its oil- and gas-rich neighbors. The government has recently imposed measures to limit credit card and consumer lending to contain private consumption, and it has offered new incentives for pension schemes to encourage saving. The World Bank recently commended the "remarkable improvement" in Turkey's education system since 2003. And the government's finances are in admirable shape.

But the existing problems translate into economic facts of life: much of the increase in employment in recent years has come from agriculture, services, and relatively low-technology manufacturing in Anatolia. Outside the greater Istanbul area and beyond the Aegean coastline, two areas that export products such as refrigerators, washing machines, televisions, and vehicles, much of the country produces low-value-added goods, which generate less income and can be more vulnerable to competition.

THE STRONGMAN

Turkey's other main challenge is political. The concentration of power under Erdogan was once an essential precondition for economic success. Today, however, it could make things worse, not better.

Erdogan's chief accomplishment has been to establish the supremacy of Turkey's elected leaders and hence the stability of government on which economic progress often rests. After 40 years in which the military ousted four governments, Turkish democracy no longer operates at gunpoint. Erdogan has pushed aside a host of opponents, some of them antidemocratic, including the military, big business, the country's old media barons, and the judges who bent laws in a bid to weaken the AKP government. But the consequence is that the prime minister is now master of almost all he surveys, which, combined with his often erratic behavior of late, has raised important questions about the Turkish government's transparency, rationality, and stability.

The institutions that played a role in Turkey's success over the past decade now struggle to appear independent of the prime minister's will. Despite the prospect of an end to the U.S. stimulus—and inflation of about eight percent—the central bank has kept the benchmark interest rate at 4.5 percent. Instead of increasing that rate—what would seem the appropriate response—the central bank has tightened the money supply with unorthodox and often confusing measures. Underlining the constraints under which the bank operates, Erdogan has long made clear his aversion to high interest rates, not least because of their role in holding back growth, and blamed an "interest-rate lobby" for stoking the Gezi Park protests last summer.

Other examples of the centralization of economic power abound. The Capital Markets Board of Turkey has named three AKP officials, including two former ministers, as directors of Turkcell, the country's biggest cell-phone company. Last summer, Turkey's broadcasting watchdog fined television stations that screened footage of the Gezi protests. Most conspicuous, after Erdogan denounced the Turkish conglomerate Koc Holding for sheltering protesters in one of its hotels, in July, tax inspectors accompanied by police raided the offices of several Koc subsidiaries. The case is ongoing and could fizzle out in the long run, but Turkish executives now privately complain that such an atmosphere could scare away the foreign direct investment that Turkey so desperately needs.

Indeed, the risks that Erdogan's erratic policymaking could wreak economic damage is especially great in a country with few natural resources and little capital of its own. If the government continues to punish the media for broadcasting bad news, if big decisions come to depend on the mood of one man, and if companies fear predatory fines, Turkish growth seems unlikely to continue at the rates to which the country has become accustomed.

Little of this seems to have dawned on Erdogan himself, however: the prime minister has rarely sounded more optimistic. His government projects that Turkey will reach a per capita income of $25,000 by 2023—the centenary of the founding of the republic—and realize its aim of becoming one of the world's ten biggest economies. The latter target would require barely credible rates of growth—15 percent a year, according to Rahmi Koc, the patriarch of Koc Holding—but it is in keeping with the prime minister's monumental approach. Erdogan has also backed and begun such giant projects as a vast new airport for Istanbul, a new bridge across the Bosporus, and a new canal to run parallel to the strait. In Turkey's current political climate, any suggestion that such projects could face financing difficulties leads to howls of outrage by the pro-government press.

As all of this implies, Turkey's economic potential is decidedly mixed. The country remains alluring to consumer goods companies that want to sell to the country's youthful population; it has been tried and tested as a manufacturer, and it retains a strong tradition of exporting apparel. But for other foreign investors, it presents more uncertain prospects; government officials acknowledge that foreign direct investment is considerably below where they would like it to be.

Nevertheless, Turkey still stands out amid the troubled economies of southern Europe, not to mention a Middle East in turmoil. In a November survey, the European Bank for Reconstruction and Development forecast that in 2014, Turkey would grow by 3.6 percent—less than it had previously expected, but still a higher rate than those projected for many of its neighbors. The country's enviable geographic location and its customs union with the EU remain important competitive advantages.

ANKARA'S AMBITION

The current state of affairs may not necessarily endure. Optimists argue that the country will return to trend, in politics as well as economics. They note that Turkey is incomparably richer and freer than it was 15 years ago. On the economic front, if education improves and Turks save more, the country can continue to grow at an accelerated pace. And on the political front, Erdogan may change course if the drawbacks of his current approach sink in.

In fact, Erdogan might not even be at the helm of government for much longer. Erdogan has sworn not to serve another term as premier (AKP term limits prohibit it), and he has shown great interest in running for the country's presidency—currently a largely symbolic post—in the first direct elections for the position, which will be held later this year. Should he do so, the current president, Abdullah Gul, may well become prime minister. And a country led by Gul could be an entirely different place. Although Gul and Erdogan are old allies who built the AKP together, in recent years, Gul has taken pains to establish himself as a more moderate alternative to his old comrade. During his address at the opening of parliament in October, Gul called for a "new growth policy" and argued that Turkey should address its low savings rate, its educational failings, and the lack of women's participation in political and economic life, as well as find ways to make "foreign investors and our own entrepreneurs feel safe and secure."

Whoever leads Turkey next will face strong headwinds. Few analysts predict that Turkey will face the sort of crashes that have done it so much damage in the past. But in a harsh report in September, the International Monetary Fund warned that it would be difficult for Turkey to grow by four or five percent annually—let alone by the extraordinary levels of recent memory—"while continuing to accumulate large external liabilities." It predicted that without structural reform, higher interest rates, and tighter spending policies, the country would be left with an unenviable choice between sluggish growth and bouts of instability.

This is the dilemma that Erdogan faces as he seeks to continue the political and economic advances his country has made since 2002. He has often proved his critics wrong. But Erdogan can achieve his outsized ambitions only if the country and the government do everything right. And the way things currently look, that might simply be too much to expect.

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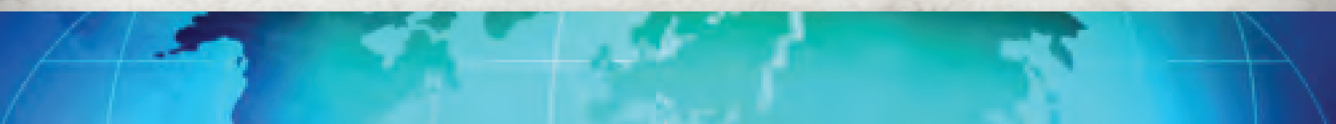

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Indonesia and the Philippines

A Tale of Two Archipelagoes

Karen Brooks

As recently as 2008, the economies of Southeast Asia received roughly less than half as much foreign direct investment as China did. Four years later, in 2012, they pulled to within spitting distance ($111 billion versus $121 billion). This surge in international interest reflects the region's attractive demographics and, even more so, its impressive recent economic performance.

The ten countries of the Association of Southeast Asian Nations (ASEAN) represent a collective market of 620 million people, significantly larger than that of North America, Latin America and the Caribbean, the eurozone, or the Middle East and North Africa. They are home to a young, large, and growing labor pool, as well as a growing and increasingly consumption-oriented middle class. The ASEAN countries posted a combined GDP of over $2.2 trillion in 2012—larger than Russia's GDP and almost the same size as Brazil's—and many economists expect that number to double by 2020. ASEAN's five core countries—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—have been growing as fast as any other regional grouping in the world over the past five years.

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Impressive as this pack has been, two of its members have stood out as particularly promising. Giant Indonesia soared during the last half decade, boasting high growth, low inflation, an extremely low debt-to-GDP ratio, strong foreign exchange reserves, and a top-performing stock market. But it is the Philippines, the region's other archipelago, that is now providing the biggest upside surprise. The Philippine economy expanded by 6.6 percent in 2012, exceeding most economists' predictions, and was among the fastest-growing economies in the world in the first half of 2013, expanding by 7.6 percent. (Despite the destruction of Typhoon Haiyan, which had just ravaged the country as of this writing, the Philippines' growth rate for all of 2013 is expected to remain above 6.5 percent.) The Philippine Stock Exchange Index has posted record highs since President Benigno Aquino III came into office in 2010, and approvals for foreign investment have more than doubled in that period. The country's inflation is low, its foreign exchange reserves are high, and its public debt is steadily declining. As a result, all three of the major credit-rating agencies upgraded Philippine sovereign debt to investment grade in 2013: the first such rating in the country's history.

Past performance, however, is not necessarily indicative of future prospects. So what is to be expected of these two island nations in the years ahead?

JAKARTA'S STRAITJACKET

Indonesia, with more than 250 million citizens, isn't just the largest country in ASEAN; it is the fourth largest in the world. Thanks to abundant natural resources, a massive domestic market, and solid macroeconomic policymaking, it has grown by more than five percent a year on average for more than a decade. In the five years leading up to 2011, it more than doubled its exports (from $84 billion to $204 billion), and many experts started calling for it to be added to the BRICS group of major emerging markets.

Today, however, the picture looks far less rosy. Indonesia's current account went into deficit in the fourth quarter of 2011, its trade balance followed suit the following spring, and the rupiah was one of Asia's worst-performing currencies in 2012, with its value dropping by almost six percent. Those trends accelerated in 2013, as the country's trade and current account deficits ballooned and as the rupiah slumped still further. Indonesia quickly went from being hailed as a new economic superstar to being dubbed by Morgan Stanley as one of the world's "fragile five" countries, owing to the vulnerability of its currency to foreign capital outflows. The weak rupiah is raising the cost of imported goods, exacerbating inflationary pressures, and eroding Indonesian purchasing power—significant factors for an economy whose growth is overwhelmingly consumption-driven.

Some of these problems can be attributed to the retreat of capital from emerging markets in anticipation of changes to the U.S. Federal Reserve's policy of quantitative easing. But Indonesia's currency and stock market were hit far harder than those of its peers in mid-2013, and Indonesia did not recover as quickly when the Federal Reserve ended up keeping its foot on the stimulus pedal last fall. Investors correctly saw Indonesia's deficits as symptomatic of broader structural imbalances in the country's economy, and they remain concerned that Jakarta has no strategy for responding to its numerous challenges.

Among these are the fact that Indonesia's export sector is overly dependent on commodities, a handful of which, including coal, rubber, palm oil, and mineral ores, account for over 50 percent of the country's exports. Indonesia was a major beneficiary of the commodities boom between 2009 and 2011, when revenues for key resources rose exponentially. But those same commodities experienced precipitous price drops throughout 2012 and 2013, and prices are expected to remain low for some time. The decline in prices has largely been a function of decreased demand from China, yet increases in supply have also played a role, due to the proliferation of small miners in Indonesia who get licenses at the local level.

The biggest source of Indonesia's recent problems, however, has been its shrinking exports of oil and gas, thanks to declining production and rising consumption at home. Indonesia has been a net importer of refined oil since 2004, but for most of the years thereafter, it has remained a net exporter of crude oil and natural gas. In 2013, however, Indonesia experienced huge crude oil deficits, and the revenue it took in from exporting surplus domestic gas also dropped dramatically. The declines in crude oil production and natural gas exports highlight the problems that plague Indonesia's energy sector, including regulatory uncertainty, corruption, and a trend toward criminalizing

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Up, up, and away: the Philippines' stock market, Manila, May 2013

REUTERS / ERIK DE CASTRO

commercial disputes. Rising resource nationalism has also paralyzed a number of major oil and gas projects, as the government and powerful domestic business interests have tried to squeeze foreign contract holders. With a young and growing middle class, Indonesia will have to either improve its investment climate in order to increase production at home or else be condemned to an ever-greater reliance on imported energy.

Manufacturing, meanwhile, has also fallen behind: exports of electrical appliances, iron and steel, chemicals, cars, auto parts, and computers all declined in the first nine months of 2013 compared with the same period in 2012. At the same time, Indonesia has started importing significantly more of just about everything, especially oil and gas. Indonesia's fuel subsidies are among the highest in the world, which encourages profligate consumption. And as the rupiah weakens, the import bill is going up.

The absence of sufficient domestic processing capability to make refined fuels and petrochemicals represents another structural problem. Indonesia needs 1.3 million barrels of refined crude oil per day, but its existing refineries produce only 770,000 barrels a day. Meanwhile, Indonesia's failure to attract the investment necessary to expand value-added manufacturing and processing industries at home has left the country increasingly dependent on a growing range of imports. From 2007 to 2012, for example, imports of textiles, electrical appliances, iron and steel, chemicals, cars, auto parts, computers, fertilizers, processed food, and feed increased significantly. Indonesia is going to have to learn how to make much more of what it needs at home if it is to turn its rapidly growing consumer class into an economic opportunity rather than a burden.

Indonesia needs domestic investment not just to correct its growing imbalances but also to create more and better-quality jobs. With over half the population now under the age of 30, the proportion that is of working age will rise significantly over the next decade. Attracting job-creating investments in manufacturing will require a more flexible labor regime, improved infrastructure, lower transportation costs, education reform, and more legal and policy certainty.

Jakarta is starting to make headway on some elements of this agenda, specifically allocating more of its budget to infrastructure spending, passing needed eminent domain laws to accelerate infrastructure projects, and bringing a growing number of corruption cases against powerful politicians and officials. The government has also made progress on reducing the overall level of poverty. But after years of complacency on economic reform, fed by the commodities boom and easy credit, the government now faces a long to-do list. With legislative and presidential elections looming in 2014, however, leadership is in short supply, nationalism and populism are on the rise, and the appetite among the major political parties for reform appears limited. This suggests a period of stagnation and further backsliding is ahead, at least until a new administration takes office in October 2014.

THE THRILLA IN MANILA

The Philippines enjoys some of the same strengths as Indonesia. With the second-largest population in ASEAN, at 106 million, the Philippines has also enjoyed consumption-led growth and similarly benefits from high domestic demand. Thanks to reforms put in place after the 1997–98 Asian financial crisis, the Philippines, like Indonesia, has a strong banking system, with large amounts of capital on hand and a low incidence of loans in default. Respected technocrats run key economic portfolios in both countries and produce sound macroeconomic management.

The two economies also share many of the same challenges. They are both vulnerable to severe natural disasters. They have low tax-to-GDP ratios, limiting government revenue. They both suffer from inadequate infrastructure, high logistical costs, and rigid labor regimes, which have restricted the expansion of their manufacturing sectors. The Philippines' exports are nearly as dominated by electronics as Indonesia's are by commodities, and shipments of electronic components and semiconductors, which account for over 50 percent of Philippine exports, have slumped due to a drop in global demand. As a result, the Philippines has run a substantial trade deficit in recent years.

Unlike Indonesia, however, the Philippines' current account has been in surplus since 2003, ending an era of perennial balance-of-payments crises. Indeed, the Philippines' current account surplus exceeded that of the rest of Asia in 2012 and is projected to keep growing. This success is the result of two key factors: the substantial flow of remittances

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from the more than ten million Filipinos working abroad and a dramatic expansion in the Philippines' service sector, thanks to huge growth in business-process outsourcing.

A high birthrate and a lack of jobs at home has for years sent millions of Filipinos to look for work abroad. Almost ten percent of the population now lives overseas, and remittances from this group, which represent nine percent of GDP, have grown by double-digit rates since 2002. With the working-age population forecast to expand for the next 50 years, the outflow of people will continue, as will the money they send home. These remittances help keep consumption up, especially among the poor and the unbanked, and they are among the sources of foreign exchange least sensitive to economic shocks. During the Asian financial crisis, for example, remittances helped stabilize capital flows and shield the peso from depreciation. Similarly, the peso fell by only five percent in 2013, while the rupiah dropped by 18 percent.

Another distinctive feature of the Philippine economy is the large role of the service sector, accounting for 57 percent of GDP in 2012. The Philippines is now the second-largest center of business-process outsourcing in the developing world, after India. The industry is estimated to have created about 800,000 jobs, originally mostly in lower-end call centers but increasingly also in fields such as engineering, medicine, and accounting. The government deserves credit for facilitating this growth through investments and fiscal incentives.

Still, the Philippines continues to struggle on a number of key fronts. High economic growth has yet to translate into more jobs and less poverty. Unemployment has stubbornly remained above seven percent—higher than in any other core ASEAN state—for the past six years, and underemployment has stood at roughly 20 percent during the same period. With over one million Filipinos entering the labor force each year, the service sector alone cannot absorb them all, especially since the manufacturing and agricultural sectors have been shedding jobs. No surprise, then, that poverty has barely declined in recent years or that the country's per capita GDP is the lowest among ASEAN's core five.

To reverse these trends, the country has to create jobs for semi- and unskilled workers in manufacturing and agriculture. But doing that, in turn, will require attracting more foreign investment, which for the Philippines is currently among the lowest in Asia, reaching only $2 billion in 2012 (compared with the $20 billion that went to Indonesia).

Investment in the Philippines has stayed so low because the country's economy remains one of the most restrictive in the world, with constitutional provisions limiting foreign ownership of Philippine companies to 40 percent in a broad range of sectors. Manila must address this problem, as well as regulatory bottlenecks, infrastructure shortcomings, and confusion about the overall direction of its economic policies. The land reforms that were passed during the administration of the current president's mother, Corazon Aquino, for example, have not had their intended effect, as uncertainty over property rights has limited investment in the agricultural sector. The Philippines is one of the most mineral-rich nations on earth. However, policy flip-flops have ground mining investment to a halt, and infrastructure projects have suffered a similar fate.

Manila's to-do list, then, is nearly as long as Jakarta's. But whereas Indonesia has not passed any meaningful reforms in nearly a decade, the Philippines, under Benigno Aquino III's bold leadership, has taken real steps to address some of its challenges. In the first three years of his six-year term, Aquino has been relentless in fighting corruption and has implemented reforms to improve transparency and efficiency in government spending and tax administration. Despite fierce opposition from the Catholic Church, he won passage of a landmark reproductive health bill to help the country's poor gain access to birth control. He liberalized the aviation industry by adopting an "open skies" policy, enabling the entry of long-prohibited foreign carriers and giving the Philippines' underperforming tourism industry a boost. He has challenged vested business interests by passing a sin tax on tobacco and alcohol to reduce the overall consumption of these products and to improve government finances, implemented a conditional cash-transfer program to provide a social safety net for the poor, and expanded access to education and health care. On the political side, he reached a framework agreement for a new peace deal with the country's largest insurgent group. For these and other reasons, Aquino enjoys unprecedented popular support for a president halfway through his presidency, as shown by his coalition's decisive victory in the May 2013 midterm elections.

The president is also well received abroad: his record has earned the Philippines significantly improved scores on a number of global surveys. During his tenure in office, the Philippines has moved up 26 spots on the World Economic Forum's Global Competitiveness Index. The Philippines beat Indonesia on Transparency International's 2012 Corruption Perceptions Index, moving up 24 spots (to 105); Indonesia fell 18 spots (to 118). And the Philippines jumped 30 notches on the World Bank's 2014 Ease of Doing Business Index, reversing years of decline and again surpassing Indonesia.

As a result of these improvements, the Philippines is well placed to withstand the expected return to volatility in global capital and equity markets when the U.S. Federal Reserve ends its quantitative easing in 2014 (as it is expected to do). The Philippine central bank will have significantly more leeway than its Indonesian counterpart, for example, to maintain a flexible monetary policy and to take measures to spur growth. Although the Philippines is unlikely to continue booming at the pace it managed in early 2013, which was driven in part by election-induced stimulus measures, growth is expected to remain above six percent in the coming years. (Typhoon Haiyan may impact this forecast.) By contrast, the World Bank and the International Monetary Fund have significantly downgraded Indonesia's 2013 and 2014 growth forecasts, to just over five percent.

THE REFORM IMPERATIVE

Indonesia's many strengths, including its size, natural resource wealth, strategic location, consumer-driven economy, and resilient financial system will continue to attract investment and bolster the country's economic prospects in the years ahead. But the next president will need to return to a path of reform if Indonesia is to retain its competitive edge.

The Philippines, on the other hand, has momentum behind its reform efforts and a popular president with three years left in his term. This provides a compelling platform for growth moving forward. But to make the most of the country's opportunities, Aquino will first need to manage the humanitarian disaster wreaked by Typhoon Haiyan as quickly, efficiently, and compassionately as possible. Then, he will need to push forward with structural reforms, especially constitutional changes necessary to promote foreign investment. The president has shown little enthusiasm for this project thus far, but a range of forces, especially the evolution of public opinion, may well push him toward change.

All major business groups now support the relevant constitutional amendments, reflecting a change in the country's political economy, as Filipino oligarchs now feel that they have more to gain than lose from the introduction of new foreign capital and competition. The shift in opinion on liberalizing the economy also reflects public support for the Aquino administration's decision to draw closer to Washington, a result of Manila's strained relations with Beijing over maritime boundary disputes. Support is growing among Filipino elites for joining the U.S.-led Trans-Pacific Partnership, a regional free-trade agreement that would also help open up the Philippine economy. This stands in stark contrast to Indonesia, where no constituency speaks in favor of joining the TPP and where the polity as a whole is turning more nationalist and increasingly favoring protectionism.

In the end, it may be this evolving public consensus in favor of openness and transparency that provides the most promise in the Philippines. Revelations in late 2013 that legislators had siphoned off huge sums of pork-barrel funds for personal use and that the office of the president had also misused discretionary funds sparked a public outcry so strong that Aquino may have to go even further than intended in fighting corruption in order to maintain his moral authority. If he does, the president could leave his country with an impressive and lasting legacy—unlike the outgoing Indonesian president, Susilo Bambang Yudhoyono, who will leave behind nearly a decade of missed opportunities to advance economic and political reform when he steps down in 2014.

The Mekong Region

A River Runs Through It

Thitinan Pongsudhirak

Mainland Southeast Asia—long fought over and controlled by outside powers, from the colonial era through the Cold War—is finally fending for itself, and then some. Cambodia, Laos, and Vietnam, which were once French Indochina, have grown at an impressive clip in recent years, with the last two taking their cues from China to blend communism and capitalism. Myanmar (also called Burma), once part of British India, is rapidly opening up to trade and foreign investment after decades of insular military dictatorship. And Thailand, the only Southeast Asian country never to have been taken over by a European colonial power, has proved resilient despite its prolonged political discord, humming along as the region's manufacturing, tourism, and service-sector hub.

Even as mainland Southeast Asia moves forward, it is beginning to resemble, in a curious way, parts of its precolonial past, when its mainly Buddhist peoples freely crisscrossed the region in search of better lives, mixing across ethnic and linguistic lines. As trade barriers fall and borders open up, people and commerce are moving more freely throughout the region, which also includes China's southern Yunnan Province. Yunnan's economy and culture have become inextricably linked to these five countries, as they were in centuries past.

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Understanding the region's promise requires a grasp of not just its growing interconnectedness but also its demographics. Together, the mainland Southeast Asian economies now constitute a consumer and labor market of over 300 million people, with rising incomes and a combined GDP that could exceed $1 trillion by 2020. Add in maritime Southeast Asia—Brunei, Indonesia, Malaysia, the Philippines, and Singapore—and you get the Association of Southeast Asian Nations, a 46-year-old bloc that is home to a combined GDP of over $2.2 trillion and 620 million people. ASEAN's members have young, working-age populations and an abundance of natural resources, from land suitable for agriculture and timber to vast mineral deposits and considerable oil and gas reserves. With greater economic integration planned for 2015, the countries of mainland Southeast Asia will enter a new era of promise and prosperity.

Foreign powers still have a role in the region, but now that involvement could benefit locals and foreigners alike. In a parallel to the Great Game of the nineteenth century, when the British and Russian empires fought over Central Asia, today, China and the United States are vying for influence in mainland Southeast Asia, while Japan remains heavily invested and India exerts significant cultural influence. The involvement of these major powers bodes well for the region, as long as the involvement can minimize any geopolitical tension and maximize the economic benefits. With so much of the rest of the global economy looking volatile and uncertain, mainland Southeast Asia, with its relative stability, diversity, and strategic location, is luring investors from near and far.

FOLLOW THE RIVER

Cambodia, Laos, Myanmar, and Vietnam should be able to maintain their recent annual growth of five to eight percent in the coming decade. Thailand's growth is expected to hover in the four to six percent range. And Yunnan Province has an economy that would make many independent countries jealous: it has a population of 50 million people, GDP of $150 billion, and economic activity well above the Chinese national average. In all these economies, inflation has been brought into the single digits, although it remains highest in Vietnam. They all have healthy international currency reserves, sustainable external accounts, and manageable debt profiles. With the exception of Thailand, with its minor GDP contraction in 2009, all the mainland Southeast Asian countries managed to keep growing through the 2008 financial crisis. Yet the region's potential extends beyond headline numbers. A good way to grasp it is by looking at geography—in particular, the Mekong River.

The Mekong is the 12th-longest river in the world. It charts a course south from Yunnan to Vietnam, covering one million square miles, more than a quarter of the size of the United States. Since 1992, the Greater Mekong Subregion, an initiative administered by the Asian Development Bank, has sought to harness the economic potential of the six countries along the river through a series of road and rail development projects. These efforts have focused on extending mainland Southeast Asia's links to southern China; the GMS also includes China's Guangxi Zhuang Autonomous Region, which lies east of Yunnan and north of Vietnam and is home to 50 million people and a $200 billion economy.

Integration requires transportation, and the GMS now counts over 540,000 miles of roads and 11,700 miles of railways. The length of the road network has grown by more than 37 percent since 2005, and rail has grown by ten percent since 2001. Those networks will only expand across the region and within individual countries as their economies grow. Thailand, for example, plans to spend more than $66 billion over seven years to more than double its rail capacity. According to the Asian Development Bank, ongoing and new construction of highways in the region will further shorten travel times already cut in half over the past two decades, reducing transaction costs and expanding markets, and thereby spurring growth in the GMS countries by between 1.1 and 8.3 percent by 2015. That could lift millions of people out of extreme poverty, mainly in Cambodia and Vietnam.

Better road and rail networks will also link labor markets across mainland Southeast Asia and move investment from one country to the next. More than 2.5 million migrant workers, most of them from Myanmar but 250,000 of them from Cambodia, are already in Thailand; 70 percent are undocumented

Trade flows: borders converging on the Mekong River

REUTERS / SUKREE SUKPLANG

and work in low-wage service and manufacturing industries. Without them, the Thai economy would sink. Better transportation infrastructure could also encourage more investment from Thailand, already a leading investor in Cambodia, Laos, and Myanmar. As the aviation and tourism hub of the region, Bangkok is benefiting handsomely from the continued growth of its neighbors, as the foreign (mostly Western) tourists and diplomats and the various development specialists and businesspeople enticed by new opportunities in those rapidly changing countries visit the Thai capital.

COMPARATIVE ADVANTAGES

For its part, Laos sends Thailand more than just expatriate vacationers. Known as "the battery of Southeast Asia," Laos is a major hydroelectric exporter and sells almost all its excess power to Thailand (nearly $1 billion worth in 2013). Without electricity from Laos, Thailand could return to the rolling blackouts so common in the 1960s and 1970s. And Laos plans to expand its output: a massive new dam is already under construction along the lower Mekong, and the communist regime has approved the construction of another—with plans for nine more.

Cambodia, one of Laos' downstream neighbors, is using light manufacturing and tourism to wean itself off the Chinese aid to which it is beholden; China is Cambodia's largest investor and a major aid donor. Cambodia's garment industry is the country's biggest foreign exchange earner, representing 75 percent of its total exports.

Two million tourists now visit the country every year. Sandwiched between Vietnam and Thailand, Cambodia has had its prospects buoyed by a young work force, most of whom were born after the peace process of the early 1990s, which finally ended the years of bloody rule under the Khmer Rouge and the subsequent war with Vietnam.

Just over the border, Vietnam looks likely to see its GDP expand by six to eight percent in the next few years, despite credit troubles, inflation of 11.8 percent, and three currency devaluations in 2010 and 2011. Notwithstanding its struggling economic reforms, Vietnam is resilient, with an internal market of more than 90 million people, which has made it an attractive target for growth and one of the largest regional recipients of foreign direct investment this decade.

Thailand, meanwhile, is far from this region's upstart: its export-driven economy expanded by an average of over seven percent annually over three and a half decades until 1997, when the Asian financial crisis forced Bangkok to devalue the baht and bring in the International Monetary Fund. But when the Thai economy recovered, it still could not shed its trouble with competitiveness, a result of being stuck between such lower-wage competitors as China and Vietnam and such higher-skilled peers as Malaysia and South Korea. The lack of a highly skilled, well-educated work force has kept Thailand stuck in the "middle-income trap," around the $5,000 per capita income level. The country could get out of it with better education and worker training and by making its labor market more competitive, especially in the service sector.

Myanmar, which is now slowly opening, stands in stark contrast to Thailand. With such a low economic base, Myanmar resembles Cambodia in the early 1990s, when it relied on foreign aid, brought about a semblance of political stability through constitutional reform and elections, and wooed foreign investment in labor-intensive light-manufacturing industries, such as textiles and garments. Myanmar has the advantage of possessing a bounty of timber, minerals, and oil and gas. But resources also carry risks. An overdependence on natural resources and foreign aid can make for quick and easy GDP growth that discourages long-term investments in infrastructure, education, and technology. Fortunately, Myanmar's leaders have the benefit of seeing how other countries with similar profiles have pursued overdue economic development.

One advantage all these economies share is young, working-age populations—so unlike the developed world—which also bodes well for their future growth. And as income levels rise, greater purchasing power from Myanmar to Vietnam will keep these economies attractive for foreign multinationals and industries interested in cheap, available labor and nearby markets. Rising incomes will also allow mainland Southeast Asia to rely more on its internal markets for consumption, which will keep the region insulated from the uncertainties and fluctuations of global markets. Apart from Thailand, the other Mekong countries will climb the middle-income ladder more slowly but will be able to avoid the usual pitfalls of lagging productivity along the way. Yet even if these countries enjoy another decade of growth, they will still need to shore up their economic and social foundations if they hope to see sustainable expansion in the longer run.

ROUGH WATERS

Indeed, mainland Southeast Asia still has plenty of work to do. Most consumers in the region have little disposable income, so governments must focus on raising those incomes as part of their countries' broader social development. Education also remains poor. Thailand has the region's best universities and other higher-learning institutions, but its recent global rankings have been abysmal, which speaks to the urgency of better education not only there but also in the other countries in the region. According to the World Bank, enrollment among high school students in Cambodia, Laos, and Myanmar is at or under 50 percent, even though adult literacy rates are above 70 percent in Cambodia and Laos and above 90 percent in the rest of the GMS countries. Woeful health care is another problem in all these countries, although less so in Thailand. Well-heeled citizens of Cambodia, Laos, and Myanmar head for Thai hospitals when they need treatment, since their own countries' options are so inadequate. Governments must also try to narrow conspicuously rising income disparities and eliminate extreme poverty altogether. In Cambodia, for example, an estimated four million people live on less than $1.25 per day; 37 percent of Cambodian children under five years old suffer from malnutrition.

As for the political systems of the Mekong countries, these are already being tested. As Thailand has shown, when incomes rise, the emerging middle class demands a say. This means pressure to democratize will soon intensify on governments long used to ignoring it. The generals of Myanmar and the Communist ministers of Laos and Vietnam will need to find a delicate way to preserve their political legitimacy while allowing sufficient popular representation for their increasingly demanding masses.

Foreign aid, on which much of the region still relies, can be as much of a curse as natural resources. The newly opened and opening economies of Cambodia, Laos, and, especially, Myanmar will have to pay particular attention to this threat: abundant foreign aid reduces pressure on the government to generate income through job creation, education, better training for workers, and other productive activities. Corruption, too, is a persistent ailment; the countries of the Mekong score extremely low on Transparency International's annual Corruption Perceptions Index. Thailand, at 88th in the world, does the best of the lot; Myanmar ranks a deplorable 172nd; and Laos does not fare much better. This disease will not disappear overnight, but it must ebb over time. If it does not, these countries will be stuck with subpar economic performance, and their regimes, with little popular legitimacy. Businesses and investors can lead by example, cultivating a sense of good governance and respect for regulations and laws. Thailand leads the way with its corporate social-responsibility programs and anticorruption campaigns.

Finally, the Mekong countries must avoid becoming their own worst enemies. Water conflict could become a real threat in the region in the next decade: Laos' dam building has already raised concerns among its downstream neighbors

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over water access and environmental degradation. Laos hosts the headquarters for the Mekong River Commission, an intergovernmental agency that works with Cambodia, Laos, Thailand, and Vietnam on hydroelectric development and water management. But the Laotian government too often flouts its rules. China must also be persuaded by its neighbors to join the commission, and to abide by its strictures.

MEKONG LIGHTS

With its combination of frontier markets (in Cambodia, Laos, and Myanmar) and emerging economies (in Thailand, Vietnam, and Yunnan Province), mainland Southeast Asia hardly constitutes a conventional target for investors. Frontier markets are typically the riskiest investments, since they are even less economically developed than emerging markets and often lack such basics as stable currencies and stock exchanges. Save Thailand, the region does not offer attractive stock markets. But it does offer promising retail, hospitality, agricultural, fishing, electronics, and automobile sectors. In car-obsessed Thailand, for example, the automotive industry, which includes such Japanese manufacturers as Honda, Isuzu, and Toyota, accounts for half a million jobs and over ten percent of GDP.

Growth in all the economies along the Mekong River, including those of Guangxi and Yunnan, should complement one another's development in these different sectors. Southern China and Thailand can provide capital and expertise, and Cambodia, Laos, Myanmar, and Vietnam can contribute labor, land, and natural resources. Infrastructure projects and manufacturing offer outside investors funding opportunities, and foreign companies can provide much-needed expertise and technology. Although there are short-term gains to be made in industries such as mining, forestry, and oil and gas, long-term investment should be the name of the game here.

Every October in Laos and Thailand, people gather along the banks of the Mekong to celebrate a Buddhist festival and witness what they insist is an unexplained natural phenomenon: bursts of light, known as "the Naga fireballs" or "the Mekong lights," rising from the river. Likewise, having shaken off the legacy of colonialism and great-power rivalries, the countries of mainland Southeast Asia are rising from the great river and could also catch fire. They have geography, natural resources, and increasingly connected and integrated populations on their side. The future is theirs—now they need to grab it.

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The 2013 Washington Institute for Near East Policy Book Prize

One of the most prestigious literary awards in the world, the prize honors books of outstanding scholarship, compelling writing, and cutting-edge insight. Our independent judges were Daniel Byman, a professor in the Security Studies Program at Georgetown University and research director of the Saban Center for Middle East Policy at the Brookings Institution; Michael Doran, the Roger Hertog Senior Fellow at Brookings and a former senior director at the National Security Council; and Judith Miller, an adjunct fellow at the Manhattan Institute, Fox News contributor, and former *New York Times* correspondent.

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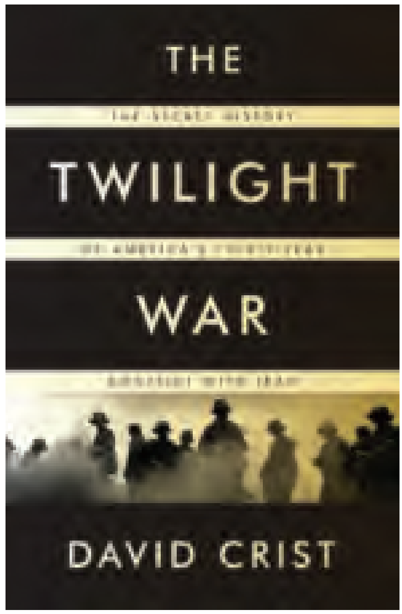

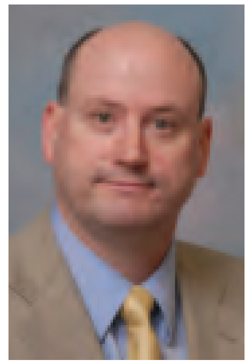

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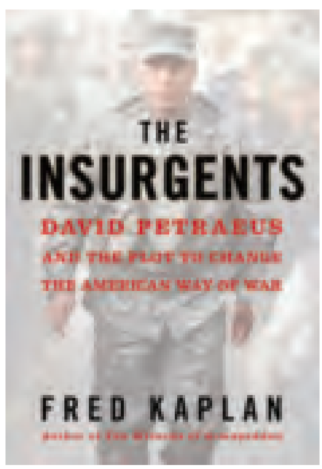
($30,000)



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Elliott Abrams
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The Ever-Emerging Markets

Why Economic Forecasts Fail

Ruchir Sharma

In the middle of the last decade, the average growth rate in emerging markets hit over seven percent a year for the first time ever, and forecasters raced to hype the implications. China would soon surpass the United States as an economic power, they said, and India, with its vast population, or Vietnam, with its own spin on authoritarian capitalism, would be the next China. Searching for the political fallout, pundits predicted that Beijing would soon lead the new and rising bloc of the BRICs—Brazil, Russia, India, and China—to ultimate supremacy over the fading powers of the West. Suddenly, the race to coin the next hot acronym was on, and CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey, and South Africa) emerged from the MIST (Mexico, Indonesia, South Korea, and Turkey).

Today, more than five years after the financial crisis of 2008, much of that euphoria and all those acronyms have come to seem woefully out of date. The average growth rate in the emerging world fell back to four percent in 2013. Meanwhile, the BRICs are crumbling, each for its own reasons, and while their summits go on, they serve only to underscore how hard it is to forge a meaningful bloc out of authoritarian and democratic regimes with clashing economic interests. As the hype fades, forecasters are left reconsidering the mistakes they made at the peak of the boom.

Their errors were legion. Prognosticators stopped looking at emerging markets as individual stories and started lumping them into faceless packs with catchy but mindless acronyms. They listened too closely to political leaders in the emerging world who took credit for the boom and ignored the other global forces, such as easy money coming out of the United States and Europe, that had helped power growth. Forecasters also placed far too much predictive weight on a single factor—strong demographics, say, or globalization—when every shred of research shows that a complex array of forces drive economic growth.

Above all, they made the cardinal error of extrapolation. Forecasters assumed that recent trends would continue indefinitely and that hot economies would stay hot, ignoring the inherently cyclical nature of both political and economic development. Euphoria overcame sound judgment—a process that has doomed economic forecasting for as long as experts have been doing it.

SINGLE-FACTOR SYNDROME

History shows that straight-line extrapolations are almost always wrong. Yet pundits cannot seem to resist them, lured on by wishful thinking and fear. In the 1960s, the Philippines won the right to host the headquarters of the Asian Development Bank based on

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the view that its fast growth at the time would make the country a regional star for years to come. That was not to be: by the next decade, growth had stalled thanks to the misguided policies of the dictator Ferdinand Marcos (but the Asian Development Bank stayed put). Yet the taste for extrapolation persisted, and in the 1970s, such thinking led U.S. scholars and intelligence agencies to predict that the future belonged to the Soviet Union, and in the 1980s, that it belonged to Japan. Then came the emerging-market boom of the last decade, and extrapolation hit new heights of irrationality. Forecasters cited the seventeenth-century economic might of China and India as evidence that they would dominate the coming decade, even the coming century.

The boom also highlighted another classic forecasting error: the reliance on single-factor theories. Because China's boom rested in part on the cheap labor provided by a growing young population, forecasters started looking for the next hot economy in a nation with similar demographics—never mind the challenge of developing a strong manufacturing sector to get everyone a job. There were the liberals, for whom the key was more transparent institutions that encouraged entrepreneurship—despite the fact that in the postwar era, periods of strong growth have been no more likely under democratic governments than under authoritarian ones. And then there were the moralizers, for whom debt is always bad (a bias reinforced by the 2008 credit crisis), even though economic growth and credit go hand in hand.

The problem with these single-factor theories is that they lack any connection to current events or an appreciation for the other factors that make each country unique. On the one hand, institutions and demographics change too slowly to offer any clear indication of where an economy is headed. On the other, those forecasters who have argued that certain national cultures are good or bad for growth miss how quickly culture can change. Consider Indonesia and Turkey, large Muslim-majority democracies where strong growth has debunked the view of Islam as somehow incompatible with development.

Sweeping theories often miss what is coming next. Those who saw geography as the key factor failed to foresee the strong run of growth during the last decade in some of the most geographically challenged nations on earth, including landlocked countries such as Armenia, Tajikistan, and Uganda. In remote Kazakhstan, rising oil prices lifted the economy out of its long post-Soviet doldrums.

The clarity of single-factor theories makes them appealing. But because they ignore the rapid shifts of global competition, they provide no persuasive scenario on which to base planning for the next five to ten years. The truth is that economic cycles are short, typically running just three to five years from peak to trough. The competitive landscape can shift completely in that time, whether through technological innovation or political transformation.

HERE AND NOW

Indeed, although forecasters hate to admit it, the coming decade usually looks nothing like the last one, since the next economic stars are often the last decade's castoffs. Today, for example, formerly stagnant Mexico has become one of the most promising economies in Latin America. And the Philippines, once a laughingstock, is now among the hottest economies in the world, with growth exceeding seven percent. Dismissed on the cover of *The Economist* five years ago as "the world's most dangerous place," Pakistan is suddenly showing signs of financial stability. It had one of the world's top-performing stock markets last year, although it is being surpassed by an even more surprising upstart: Greece. A number of market indices recently demoted Greece's status from "developed market" to "emerging market," but the country has enacted brutal cuts in its government budget, as well as in prices and wages, which has made its exports competitive again.

What these countries' experiences underscore is that political cycles are as important to a nation's prospects as economic ones. Crises and downturns often lead to a period of reform, which can flower into a revival or a boom. But such success can then lead to arrogance and complacency—and the next downturn. The boom of the last decade seemed to revise that script, as nearly all the emerging nations rose in unison and downturns all but disappeared. But the big bang of 2008 jolted the cycle back into place. Erstwhile stars such as Brazil, Indonesia, and Russia are now fading thanks to bad or complacent management. The problem, as Indonesia's finance minister, Muhammad Chatib Basri, has explained, is that "bad times make for good policies, and good times make for bad policies."

The trick to escaping this trap is for governments to maintain good policies even when times are good—the only way an emerging market has a chance of actually catching up to the developed world. But doing so proves remarkably difficult. In the postwar era, just about a dozen countries—a few each in southern Europe (such as Portugal and Spain) and East Asia (such as Singapore and South Korea)—have achieved this feat, which is why a mere 35 countries are considered to be "developed."

Meanwhile, the odds are against many other states' making it into the top tier, given the difficulty of keeping up productivity-enhancing reforms. It is simply human nature to get fat during prosperity and assume the good times will just roll on. More often than not, success proves fleeting. Argentina, Greece, and Venezuela all reached Western income levels in the last century but then fell back.

Today, in addition to Mexico and the Philippines, Peru and Thailand are making their run. These four nations share a trait common to many star economies of recent decades: a charismatic political leader who understands economic reform and has the popular mandate to get it enacted. Still, excitement should be tempered. Such reformist streaks tend to last three to five years. So don't expect the dawn of a Filipino or a Mexican century.

BALANCING ACT

If forecasters need to think small in terms of time, they need to think big when it comes to complexity. To sustain rapid growth, leaders must balance a wide range of factors, and the list changes as a country grows richer. Simple projects, such as paving roads, can do more to boost a poor economy than a premature

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push to develop cutting-edge technologies, but soon the benefits of basic infrastructure run their course.

The list of factors to watch also changes with economic conditions. Five years after the global financial crisis, too much credit is still a critical problem, particularly if it grows faster than GDP. Indeed, too much credit is weighing down emerging economies, such as China, which have been running up debt to maintain economic growth. Once touted as the next China, Vietnam has in fact beaten China to the endgame, but not the one it expected: Vietnam has already suffered a debt-induced economic meltdown and is only now beginning to pick up the pieces and shutter its insolvent banks.

To keep their economies humming, leaders need to make sure growth is balanced across national accounts (not too dependent on borrowing), social classes (not concentrated in the hands of a few billionaires), geographic regions (not hoarded in the capital), and productive industries (not focused in corruption-prone industries such as oil). And they must balance all these factors at a point that is appropriate for their countries' income levels. For example, Brazil is spending too much to build a welfare state too large for a country with an average income of $11,000. Meanwhile, South Korea, a country with twice the average income of Brazil, is spending too little on social programs.

Many leaders see certain economic vices as timeless, generic problems of development, but in reality, there is a balancing point even for avarice and venality. Inequality tends to rise in the early stages of economic growth and then plateau before it begins to fall,

typically at around the $5,000 per capita income level. On this curve, inequality relative to income level is much higher than the norm in Brazil and South Africa, but it is right in line with the norm—and therefore much less worrisome—in Poland and South Korea. The same income-adjusted approach also applies to corruption and shows, for example, that Chile is surprisingly clean for its income level, while Russia is disproportionately corrupt.

ASK A LOCAL

No amount of theory, however, can trump local knowledge. Locals often know which way the economy is turning before it shows up in forecasting numbers. Even before India's economy started slowing down, Indian businesspeople foretold its slump in a chorus of complaints about corruption at home. The rising cost of bribing government officials was compelling them to invest abroad, although foreign investors still poured in.

There is no substitute for getting out and seeing what is happening on the ground. Analysts who focus on dangerously high levels of investment in emerging nations use China as a test case, since investment there is nearly 50 percent of GDP, a level unprecedented in any developed country. But the risk becomes apparent only when one goes to China and sees where all the money is going: into high-rise ghost towns and other empty developments. On the flip side are Brazil and Russia, where anemic investment levels account for grossly underperforming service sectors, inadequate roads, and, in São Paulo, the sight of CEOs who dodge permanently clogged streets by depending on a network of rooftop helipads.

Economists tend to ignore the story of people and politics as too soft to quantify and incorporate into forecasting models. Instead, they study policy through hard numbers, such as government spending or interest rates. But numbers cannot capture the energy that a vibrant leader such as Mexico's new president, Enrique Peña Nieto, or the Philippines' Benigno Aquino III can unleash by cracking down on monopolists, bribers, and dysfunctional bureaucrats.

Any pragmatic approach to spotting the likely winners of the next emerging-market boom should reflect this reality and the fundamentally impermanent state of global competition. A would-be forecaster must track a shifting list of a dozen factors, from politics to credit and investment flows, to assess the growth prospects of each emerging nation over the next three to five years—the only useful time frame for political leaders, businesspeople, investors, or anyone else with a stake in current events. This approach offers no provocative forecasts for 2100, no prophecies based on the long sweep of history. It aims to produce a practical guide for following the rise and fall of nations in real time and in the foreseeable future: this decade, not the next or those beyond it. It may not be dramatic. But the recent crash highlighted just how dangerous too much drama can be.

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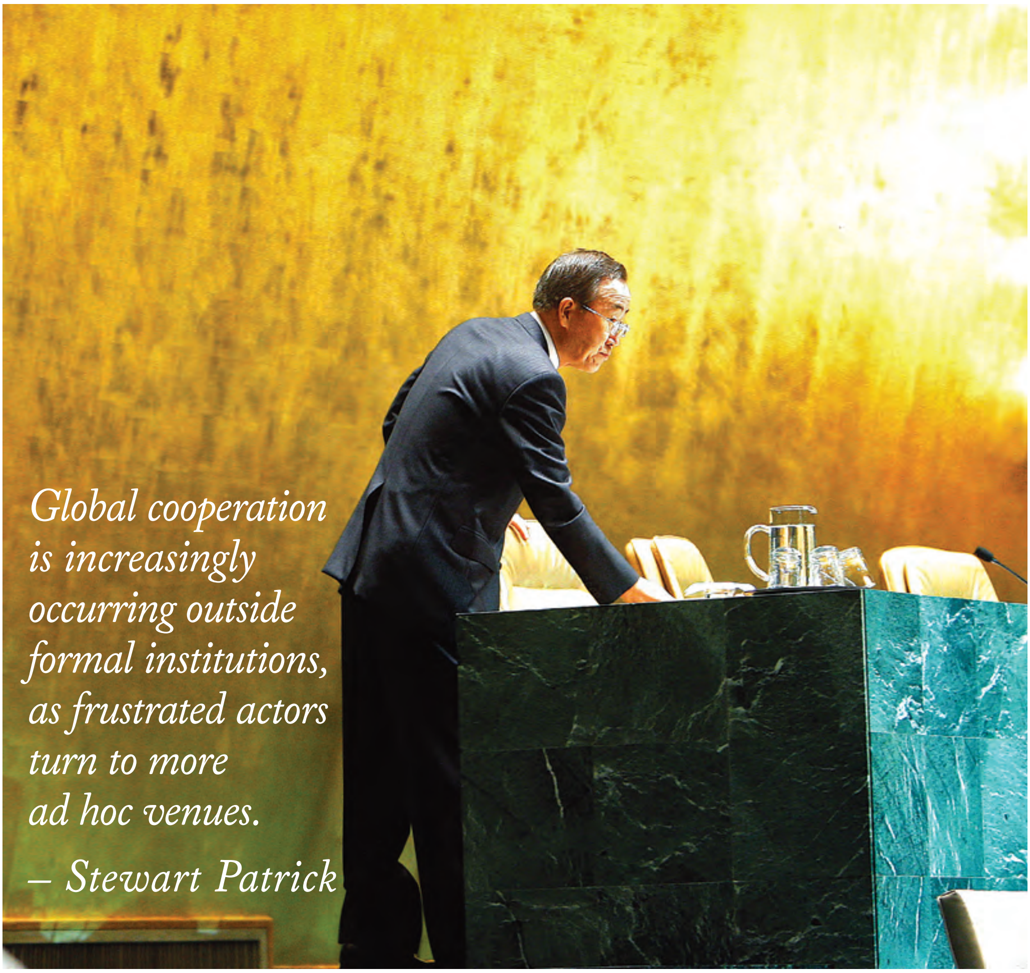
ESSAYS



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The Unruled World

The Case for Good Enough Global Governance

Stewart Patrick

While campaigning for president in 2008, Barack Obama pledged to renovate the dilapidated multilateral edifice the United States had erected after World War II. He lionized the generation of Franklin Roosevelt, Harry Truman, and George Marshall for creating the United Nations, the Bretton Woods institutions, and NATO. Their genius, he said, was to recognize that "instead of constraining our power, these institutions magnified it." But the aging pillars of the postwar order were creaking and crumbling, Obama suggested, and so "to keep pace with the fast-moving threats we face," the world needed a new era of global institution building.

Five years into Obama's presidency, little progress has been made on that front, and few still expect it. Formal multilateral institutions continue to muddle along, holding their meetings and issuing their reports and taking some minor stabs at improving transnational problems at the margins. Yet despite the Obama administration's avowed ambition to integrate rising powers as full partners, there has been no movement to reform the composition of the UN Security Council to reflect new geopolitical realities. Meanwhile, the World Trade Organization (WTO) is comatose, NATO struggles to find its strategic purpose, and the International Energy Agency courts obsolescence by omitting China and India as members.

The demand for international cooperation has not diminished. In fact, it is greater than ever, thanks to deepening economic interdependence, worsening environmental degradation, proliferating transnational threats, and accelerating technological change. But effective multilateral responses are increasingly occurring outside formal institutions, as frustrated actors

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turn to more convenient, ad hoc venues. The relative importance of legal treaties and universal bodies such as the UN is declining, as the United States and other states rely more on regional organizations, "minilateral" cooperation among relevant states, codes of conduct, and partnerships with nongovernmental actors. And these trends are only going to continue. The future will see not the renovation or the construction of a glistening new international architecture but rather the continued spread of an unattractive but adaptable multilateral sprawl that delivers a partial measure of international cooperation through a welter of informal arrangements and piecemeal approaches.

"Global governance" is a slippery term. It refers not to world government (which nobody expects or wants anymore) but to something more practical: the collective effort by sovereign states, international organizations, and other nonstate actors to address common challenges and seize opportunities that transcend national frontiers. In domestic politics, governance is straightforward. It is provided by actual governments—formal, hierarchical institutions with the authority to establish and enforce binding rules. Governance in the international or transnational sphere, however, is more complex and ambiguous. There is some hierarchy—such as the special powers vested in the permanent members of the UN Security Council—but international politics remain anarchic, with the system composed of independent sovereign units that recognize no higher authority.

Cooperation under such anarchy is certainly possible. National governments often work together to establish common standards of behavior in spheres such as trade or security, embedding norms and rules in international institutions charged with providing global goods or mitigating global bads. But most cooperative multilateral bodies, even those binding under international law, lack real power to enforce compliance with collective decisions. What passes for governance is thus an ungainly patchwork of formal and informal institutions.

Alongside long-standing universal membership bodies, there are various regional institutions, multilateral alliances and security groups, standing consultative mechanisms, self-selecting clubs, ad hoc coalitions, issue-specific arrangements, transnational professional networks, technical standard-setting bodies, global action networks, and more. States are still the dominant actors, but nonstate actors increasingly help shape the global agenda, define new rules, and monitor compliance with international obligations.

The clutter is unsightly and unwieldy, but it has some advantages, as well. No single multilateral body could handle all the world's complex transnational problems, let alone do so effectively or nimbly. And the plurality of institutions and forums is not always dysfunctional, because it can offer states the chance to act relatively deftly and flexibly in responding to new challenges. But regardless of what one thinks of the current global disorder, it is clearly here to stay, and so the challenge is to make it work as well as possible.

BIG GAME

The centerpiece of contemporary global governance remains the UN, and the core of the UN system remains the Security Council—a standing committee including the most powerful countries in the world. In theory, the Security Council could serve as a venue for coordinating international responses to the world's most important threats to global order. In practice, however, it regularly disappoints—because the five permanent members (the United States, the United Kingdom, France, Russia, and China) often disagree and because their veto power allows the disagreements to block action. This has been true since the UN's inception, of course, but the Security Council's significance has diminished in recent decades as its composition has failed to track shifts in global power.

The Obama administration, like its predecessors, has flirted with the idea of pushing a charter amendment to update the Security Council's membership but has remained wary due to concerns that an enlarged Security Council, with new and more empowered members, might decrease U.S. influence and leverage. But even if Washington were to push hard for change, the status quo would be incredibly hard to overturn. Any expansion plan would require approval by two-thirds of the 193 members of the UN General Assembly, as well as domestic ratification by the five permanent members of the Security Council. And even those countries that favor expansion are deeply divided over which countries should benefit. So in practice, everyone pays lip service to enlargement while allowing the negotiations to drag on endlessly without any result.

This situation seems likely to persist, but at the cost of a deepening crisis of legitimacy, effectiveness, and compliance, as the Security Council's composition diverges ever further from the distribution of global power. Dissatisfied players could conceivably launch an all-out political assault on the institution, but they are much more likely to simply bypass the council, seeking alternative frameworks in which to address their concerns.

The dysfunction of the UN extends well beyond the Security Council, of course. Despite modest management reforms, the UN Secretariat and many UN agencies remain opaque, and their budgeting and operations are hamstrung by outdated personnel policies that encourage cronyism. Within the UN General Assembly, meanwhile, irresponsible actors who play to the galleries often dominate debates, and too many resolutions reflect encrusted regional and ideological blocs that somehow persist long after their sell-by date.

With the Security Council dominated by the old guard, rising powers have begun eyeing possible alternative venues for achieving influence and expressing their concerns. Shifts in global power have always ultimately produced shifts in the institutional superstructure, but what is distinctive today is the simultaneous emergence of multiple power centers with regional and potentially global aspirations. As the United States courts relative decline and Europe and Japan stagnate, China, India, Brazil, Russia, Turkey, Indonesia, and others are flexing their muscles, expanding their regional influence and insisting on greater voice within multilateral institutions.

Global disorder is here to stay, so the challenge is to make it work as well as possible.

Despite these geopolitical shifts, however, no coherent alternative to today's Western order has emerged. This is true even among the much-hyped BRICS: Brazil, Russia, India, China, and, since 2012, South Africa. These countries have always lacked a common vision, but at least initially, they shared a confidence born of economic dynamism and resentment over a global economy they perceived as stacked to favor the West. In recent years, the BRICS have staked out a few common positions. They all embrace traditional conceptions of state sovereignty and resist heavy-handed Western intervention. Their summit communiqués condemn the dollar's privileges as the world's main reserve currency and insist on accelerated governance reforms within the international financial institutions. The BRICS have also agreed to create a full-fledged BRICS bank to provide development aid to countries and for issues the bloc defines as priorities, without the conditionality imposed by Western donors.

Some observers anticipate the BRICS' emerging as an independent caucus and center of gravity within the G-20, rivaling the G-7 nations. But any such bifurcation of the world order between developed and major developing powers seems a distant prospect, for as much divides the BRICS as binds them. China and Russia have no interest in seeing any of their putative partners join them as permanent Security Council members; China and India are emerging strategic competitors with frontier disputes and divergent maritime interests; and China and Russia have their own tensions along the Siberian border. Differences in their internal regimes may also constrain their collaboration. India, Brazil, and South Africa—boisterous multiparty democracies all—have formed a coalition of their own (the India–Brazil–South Africa Dialogue Forum, or IBSA), as have China and Russia (the Shanghai Cooperation Organization). Conflicting economic interests also complicate intra-BRICS relations, something that might increase as the countries' growth slows.

WELCOME TO THE G-X WORLD

The analysts Ian Bremmer and David Gordon have written about the emergence of a "G-Zero world," in which collective global leadership is almost impossible thanks to a global diffusion of power among countries with widely divergent interests. But what really marks the contemporary era is not the absence of multilateralism but its astonishing diversity. Collective action is no longer focused solely, or even primarily, on the UN and other universal, treaty-based institutions, nor even on a single apex forum such as the G-20. Rather, governments have taken to operating in many venues simultaneously, participating in a bewildering array of issue-specific networks and partnerships whose membership varies based on situational interests, shared values, and relevant capabilities.

A hallmark of this "G-X" world is the temporary coalition of strange bedfellows. Consider the multinational antipiracy armada that has emerged in the Indian Ocean. This loosely coordinated flotilla involves naval vessels from not only the United States and its NATO allies but also China, India, Indonesia, Iran, Japan, Malaysia, Russia, Saudi Arabia, South Korea, and Yemen. These countries might disagree on many issues, but they have found common cause in securing sea-lanes off the African coast.

At the same time, the G-X world permits the United States to strengthen its links within the traditional West. Take the surprisingly resilient G-8, composed of the United States, Japan, Germany, France, the United Kingdom, Italy, Canada, and Russia (plus the EU). For years, pundits have predicted the G-8's demise, and yet it still moves. The G-8 allows advanced market democracies to coordinate their positions on sensitive political and security issues—just as the parallel financially

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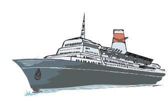

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focused G-7 permits them to harmonize their macroeconomic policies. With the exception of authoritarian Russia, unwisely added in 1997, G-8 members share similar worldviews and values, strategic interests, and major policy preferences. This like-mindedness facilitates policy coordination on matters ranging from human rights to humanitarian intervention, rogue states to regional stability.

The wealthy G-8 members also possess distinctive assets—financial, diplomatic, military, and ideological—to deploy in the service of their convictions. At the Deauville summit of May 2011, the G-8 moved quickly to offer diplomatic support and material assistance to the Arab Spring countries. That action reaffirmed the G-8 as a practical and symbolic anchor of the Western liberal order while reminding the world that the G-8 remains the overwhelming source of official development assistance.

In global governance, as elsewhere, necessity is the mother of invention, and the global credit crisis that struck with full force in 2008 led to the rise to prominence of a relatively new international grouping, the G-20. Facing the potential meltdown of the international financial system, leaders of the world's major economies—both developed and developing—shared an overriding interest in avoiding a second Great Depression. Stuck in the same lifeboat, they assented to a slew of institutional innovations, including elevating the G-20 finance ministers' group to the leaders' level, creating an exclusive global crisis-response committee.

The G-20 quickly racked up some notable achievements. It injected unprecedented liquidity into the world economy through coordinated national actions, including some $5 trillion in stimulus at the London summit of April 2009. It created the Financial Stability Board, charged with developing new regulatory standards for systemically important financial institutions, and insisted on new bank capital account requirements under the Basel III agreement. It revitalized and augmented the coffers of the once-moribund International Monetary Fund and negotiated governance reforms within the World Bank and the IMF to give greater voice to emerging economies. And its members adopted "standstill" provisions to avoid a recurrence of the ruinous tit-for-tat trade protectionism of the 1930s.

As the immediate panic receded and an uneven global recovery took hold, however, narrow national interests again came to the fore, slowing the G-20's momentum. For the past four years, the G-20—whose heterogeneous members possess diverse values, political systems, and levels of development—has struggled to evolve from a short-term crisis manager to a longer-term steering group for the global economy. The reform of major international financial institutions has also stalled, as established (notably European) powers resist reallocating voting weight and governing board seats. So what looked for a brief moment like the dawn of a newly preeminent global forum proved to be just one more outlet store in the sprawl.

GOVERNANCE IN PIECES

For much of the past two decades, UN mega-conferences dominated multilateral diplomacy. But when it comes to multilateralism, bigger is rarely better, and the era of the mega-conference is ending as major powers recognize the futility of negotiating comprehensive international agreements among 193 UN member states, in the full glare of the media and alongside tens of thousands of activists, interest groups, and hangers-on. Countries will continue to assemble for annual confabs, such as the Conference of the Parties to the UN Framework Convention on Climate Change (UNFCCC), in the Sisyphean quest to secure "binding" commitments from developed and developing countries. But that circus will increasingly become a sideshow, as the action shifts to less formal settings and narrower groupings of the relevant and capable. Already, the 17 largest greenhouse gas emitters have created the Major Economies Forum on Energy and Climate, seeking breakthroughs outside the lumbering UNFCCC. To date, the forum has underdelivered. But more tangible progress has occurred through parallel national efforts, as states pledge to undertake a menu of domestic actions, which they subsequently submit to the forum for collective review.

There is a more general lesson here. Faced with fiendishly complex issues, such as climate change, transnational networks of government officials now seek incremental progress by disaggregating those issues into manageable chunks and agreeing to coordinate action on specific agenda items. Call it "global governance in pieces." For climate change, this means abandoning the quest for an elusive soup-to-nuts agreement to mitigate and adapt to global warming. Instead, negotiators pursue separate initiatives, such as phasing out wasteful fossil fuel subsidies, launching minilateral clean technology partnerships, and expanding the UN Collaborative Program on Reducing Emissions from Deforestation and Forest Degradation in Developing Countries, among other worth-while schemes. The result is not a unitary international regime grounded in a single institution or treaty but a cluster of complementary activities that political scientists call a "regime complex."

Something similar is happening in global health, where the once-premier World Health Organization now shares policy space and a division of labor with other major organizations, such as the World Bank; specialized UN agencies, such as UNAIDS; public-private partnerships, such as the GAVI Alliance (formerly called the Global Alliance for Vaccines and Immunization); philanthropic organizations, such as the Bill and Melinda Gates Foundation; consultative bodies, such as the eight-nation (plus the EU) Global Health Security Initiative; and multi-stakeholder bodies, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria. The upshot is a disaggregated system of global health governance.

Sometimes, the piecemeal approach may be able to achieve more than its stagnant universalist alternative. Given the failure of the WTO's Doha Round, for example, the United States and other nations have turned to preferential trade agreements in order to spur further liberalization of commerce. Some are bilateral, such as the U.S.–South Korean pact. But others involve multiple countries. These include two initiatives that constitute the centerpiece of Obama's second-term trade agenda: the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership. The administration describes each as a steppingstone toward global liberalization. And yet future WTO negotiations will likely take a disaggregated form, as subsets of WTO members move forward on more manageable specific issues (such as public procurement or investment) while avoiding those lightning-rod topics (such as trade in agriculture) that have repeatedly stymied comprehensive trade negotiations.

THE RISE OF THE REGIONS

Ad hoc coalitions and minilateral networks are not the only global governance innovations worthy of mention. Regional organizations are also giving universal membership bodies a run for their money, raising the question of how to make sure they harmonize and complement the UN system rather than undermine it.

This dilemma is older than often assumed. In the months leading up to the San Francisco conference of 1945, at which the UN was established, U.S. and British postwar planners debated whether regional bodies ought to be given formal, even independent, standing within the UN

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(something British Prime Minister Winston Churchill, among others, had proposed). Most U.S. negotiators were adamantly opposed, fearing that an overtly regional thrust would detract from the UN's coherence or even fracture it into rival blocs. In the end, the Americans' universal vision prevailed. Still, Chapter 8 of the UN Charter acknowledges a legitimate subordinate role for regional organizations.

What few in San Francisco could have envisioned was the dramatic proliferation and increasingly sophisticated capabilities of regional and subregional arrangements, which today number in the hundreds. These bodies play an ever more important role in managing cross-border challenges, facilitating trade, and promoting regional security, often in partnership with the UN and other universal organizations. Consider peacekeeping on the African continent. Alongside classic UN operations, we now see a variety of hybrid models, in which the UN Security Council authorizes an observer or peacekeeping mission, which is then implemented by an ad hoc coalition (as in the NATO-led mission in Libya), a regional organization (as in the African Union Mission in Somalia, or AMISOM), or some combination of the two.

Regional organizations are giving universal bodies a run for their money.

This budding role for regional organizations poses policy conundrums. One is whether regional organizations ought to be allowed to serve as gatekeepers for UN-mandated enforcement actions. This contentious issue arose in 2011 after NATO launched Operation Unified Protector in Libya, with the authorization of the UN Security Council and the diplomatic support of the Arab League but not, critically, of the African Union. In January 2012, South African President Jacob Zuma, with South Africa occupying the rotating presidency of the UN Security Council, blasted the Western powers for exceeding the intent of Resolution 1973 in treating their mandate to protect Libyan civilians as a license for regime change. "Africa," he insisted, "must not be a playground for furthering the interests of other regions ever again." Seeking to tighten the relationship between the UN Security Council and regional organizations, Zuma introduced a resolution proposing a system of codetermination for authorizing enforcement actions. Predictably, this gambit met with solid opposition from the five permanent members, and some dismissed the move as populist showboating. But Zuma had given voice to a larger concern: the perceived legitimacy

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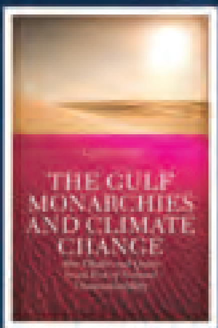

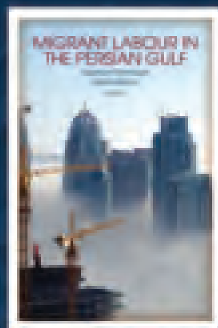

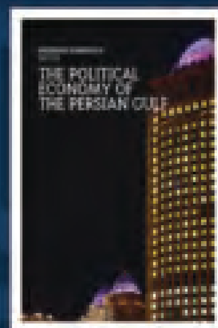

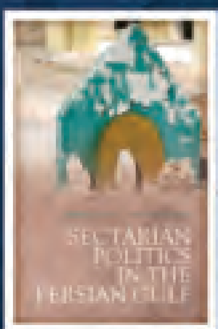

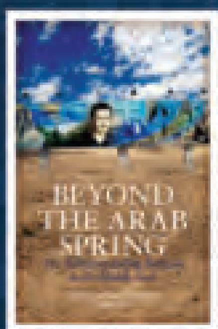

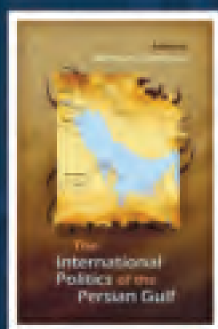

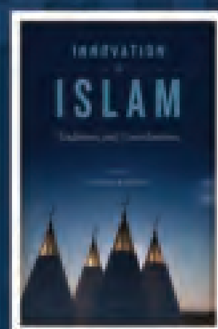

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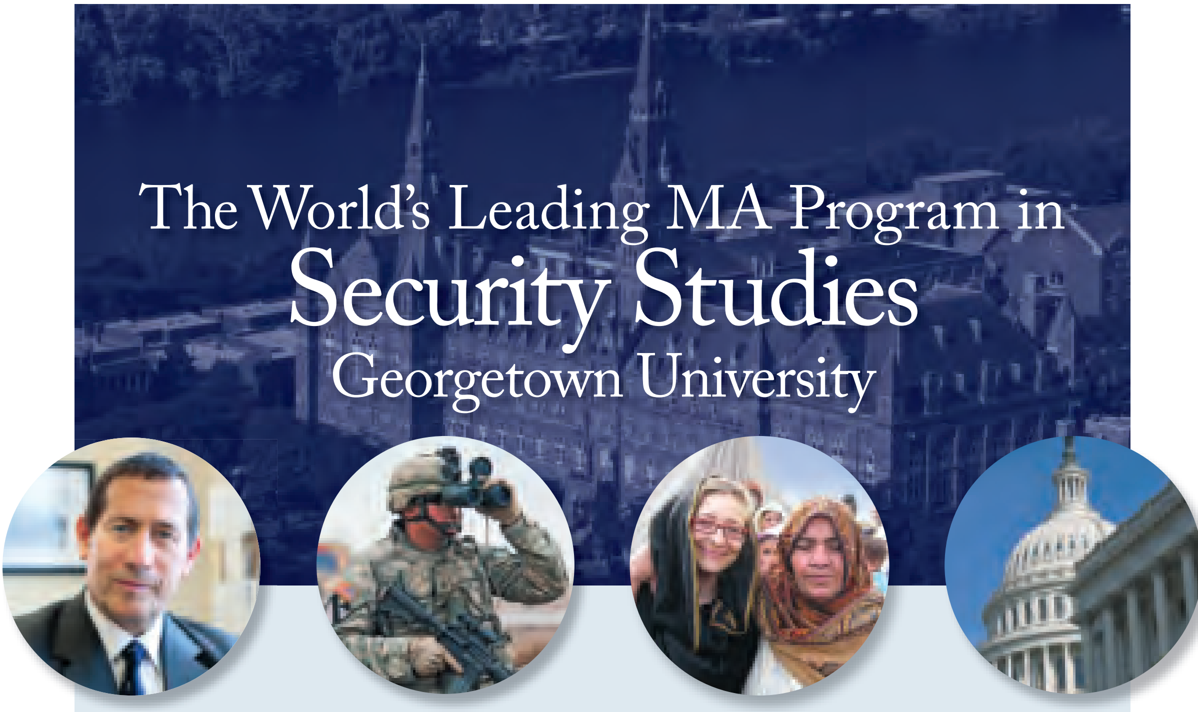

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and practical success of international interventions increasingly depends on support from relevant regional organizations.

Given how overstretched the UN and other global bodies can become, rising regionalism has distinct benefits. Regional bodies are often more familiar with the underlying sources of local conflicts, and they may be more sensitive to and invested in potential solutions. But they are in no position to replace the UN entirely. To begin with, regional organizations vary widely in their aspirations, mandates, capabilities, and activities. They are also vulnerable to the same collective-action problems that bedevil the UN. Their members are often tempted to adopt bland, lowest-common-denominator positions or to try to free-ride on the contributions of others. Local hegemons may seek to hijack them for narrow purposes. The ambitions of regional organizations can also outstrip their ability to deliver. Although the African Union has created the Peace and Security Council, for instance, the organization's capacity to conduct peacekeeping operations remains hamstrung by institutional, professional, technical, material, and logistical shortcomings. Accordingly, burden sharing between the UN and regional organizations can easily devolve into burden shifting, as the world invests unprepared regional bodies with unrealistic expectations.

GOVERNING THE CONTESTED COMMONS

If one major problem in contemporary global governance is the floundering of existing institutions when dealing with traditional challenges, another and equally worrisome problem is the lack of any serious institutional mechanism for dealing with untraditional challenges. The gap between the demand for and the supply of global governance is greatest when it comes to the global commons, those spaces no nation controls but on which all rely for security and prosperity. The most important of these are the maritime, outer space, and cyberspace domains, which carry the flows of goods, data, capital, people, and ideas on which globalization rests. Ensuring free and unencumbered access to these realms is therefore a core interest not only of the United States but of most other nations as well.

For almost seven decades, the United States has provided security for the global commons and, in so doing, has bolstered world order. Supremacy at sea—and, more recently, in outer space and online—has also conferred strategic advantages on the United States, allowing it to project power globally. But as the commons become crowded and cutthroat, that supremacy is fading. Rising powers, as well as nonstate actors from corporations to criminals, are challenging long-standing behavioral norms and deploying asymmetric capabilities to undercut U.S. advantages. Preserving the openness, stability, and resilience of the global commons will require the United States to forge agreement among like-minded nations, rising powers, and private stakeholders on new rules of the road.

From China to Iran, for example, rising powers are seeking blue-water capabilities or employing asymmetric strategies to deny the United States and other countries access to their regional waters, jeopardizing the freedom of the seas. The greatest flashpoint today is in the South China Sea, through which more than $5 trillion worth of commerce passes each year. There, China is locked in dangerous sovereignty disputes with Brunei, Malaysia, the Philippines, Taiwan, and Vietnam over some 1.3 million square miles of ocean, the contested islands therein, and the exploitation of undersea oil and gas reserves. Beijing's assertiveness poses grave risks for regional stability. Most dangerous would be a direct U.S.-Chinese naval clash, perhaps in response to U.S. freedom-of-navigation exercises in China's littoral waters or the reckless actions of a U.S. treaty ally or strategic partner.

Geopolitical and economic competition has also heated up in the warming Arctic, as nations wrangle over rights to extended continental shelves, new sea routes over Asia and North America, and the exploitation of fossil fuel and mineral deposits. To date, cooler heads have prevailed. In 2008, the five Arctic nations—Canada, Denmark, Norway, Russia, and the United States—signed the Ilulissat Declaration, affirming their commitment to address any overlapping claims in a peaceful and orderly manner. Some experts contend that the Arctic needs a comprehensive multilateral treaty to reconcile competing sovereignty claims, handle navigational issues, facilitate collective energy development, manage fisheries, and address environmental concerns. A more productive strategy would be to bolster the role of the Arctic Council, composed of the five Arctic nations plus Finland, Iceland, Sweden, and several indigenous peoples' organizations. Although this forum has historically avoided contentious boundary and legal disputes, it could help codify guidelines on oil and gas development, sponsor collaborative mapping of the continental shelf, create a regional monitoring network, and modernize systems for navigation, traffic management, and environmental protection.

The single most important step the United States could take to strengthen ocean governance, including in the Arctic, would be to finally accede to the UN Convention on the Law of the Sea, as recommended by the last four U.S. presidents, U.S. military leaders, industry, and environmental groups. Beyond defining states' rights and responsibilities in territorial seas and exclusive economic zones and clarifying the rules for transit through international straits, UNCLOS provides a forum for dispute resolution on ocean-related issues, including claims to extended continental shelves. As a nonmember, the United States forfeits its chance to participate in the last great partitioning of sovereign space on earth, which would grant it jurisdiction over vast areas along its Arctic, Atlantic, Gulf, and Pacific coasts. Nor can it serve on the International Seabed Authority, where it would enjoy a permanent seat with an effective veto. By remaining apart, the United States not only undercuts its national interests but also undermines its perceived commitment to a rule-based international order and emboldens revisionist regional powers. Both China in East Asia and Russia in the Arctic have taken advantage of the United States' absence to advance outrageous sovereignty claims.

At the same time, U.S. accession to the treaty would be no panacea. This is particularly true in East Asia, where China has been unwilling to submit its claims to binding arbitration under UNCLOS. Ultimately, the peaceful resolution of competing regional claims will require China and its neighbors in the Association of Southeast Asian Nations to agree on a binding code of conduct addressing matters of territorial jurisdiction and joint exploitation of undersea resources. This is something that Beijing has strenuously resisted, but it seems inevitable if the Chinese government wants to preserve the credibility of its "peaceful rise" rhetoric.

THE FINAL FRONTIER

The international rules governing the uses of outer space have also become outdated, as that domain becomes, in the words of former U.S. Deputy Secretary of Defense William Lynn, more "congested, contested, and competitive." As nations and private corporations vie for scarce orbital slots for their satellites and for slices of a finite radio-frequency spectrum, the number of actors operating in space has skyrocketed. Already, nine countries and the European Space Agency have orbital launch capabilities, and nearly 60 nations or government consortiums regulate civil, commercial, and military satellites. The proliferation of vehicles and space debris—including more than 22,000 orbiting objects larger than a softball—has increased the risk of catastrophic collisions. More worrisome, geopolitical competition among spacefaring nations, both established and emerging, raises the specter of an arms race in space.

Yet so far at least, there is little global consensus on what kind of regulatory regime would best ensure the stability and sustainable use of earth's final frontier. The basic convention governing national conduct in outer space remains the Outer Space Treaty of 1967. Although it establishes useful principles (such as a prohibition on sovereignty claims in space), that treaty lacks a dispute-resolution mechanism, is silent on space debris and how to avoid collisions, and inadequately addresses interference with the space assets of other countries.

To address these shortcomings, various parties have suggested options ranging from a binding multilateral treaty banning space weapons to an informal agreement on standards of behavior. Given the problems with a treaty-based approach, the Obama administration has wisely focused on seeking a nonbinding international code of conduct for outer space activities that would establish broad principles and parameters for responsible behavior in space. Such a voluntary code would carry a lesser obligation than a legally binding multilateral treaty, but it offers the best chance to establish new behavioral norms in the short term. Washington should also consider sponsoring a standing minilateral consultative forum of spacefaring nations.

LOST IN CYBERSPACE

Cyberspace differs from the oceans or outer space in that its physical infrastructure is located primarily in sovereign states and in private hands—creating obvious risks of interference by parties pursuing their own interests. Since the dawn of the digital age, the United States has been the premier champion of an open, decentralized, and secure cyberspace that remains largely private. This posture is consistent with the long-standing U.S. belief that the free flow of information and ideas is a core component of a free, just, and open world and an essential bulwark against authoritarianism. But this vision of global governance in cyberspace is now under threat from three directions.

The first is the demand by many developing and authoritarian countries that regulation of the Internet be transferred from ICANN, the Internet Corporation for Assigned Names and Numbers—an independent, nonprofit corporation based in Los Angeles, loosely supervised by the U.S.

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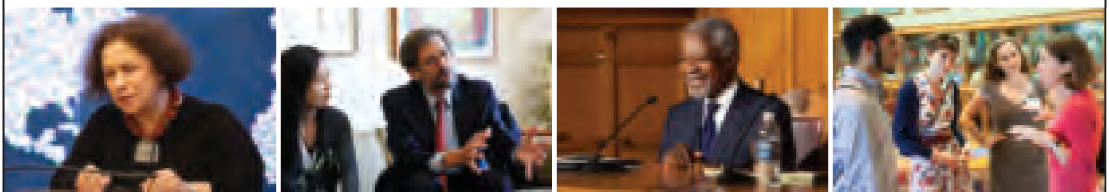

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Department of Commerce—to the UN's ITU (International Telecommunication Union). The second is a growing epidemic of cybercrime, consisting mostly of attempts to steal proprietary information from private-sector actors. Thanks to sophisticated computer viruses, worms, and botnets, what might be termed "cyber public health" has deteriorated dramatically. And there is no cyberspace equivalent to the World Health Organization for dealing with such dangers.

The third major flashpoint is the growing specter of cyberwar among sovereign states. Dozens of nations have begun to develop doctrines and capabilities for conducting so-called information operations, not only to infiltrate but if necessary to disrupt and destroy the critical digital infrastructure (both military and civilian) of their adversaries. Yet there is no broadly accepted definition of a cyberattack, much less consensus on the range of permissible responses; the normative and legal framework governing cyberwar has lagged behind cyberweapons' development and use. Traditional forms of deterrence and retaliation are also complicated, given the difficulty of attributing attacks to particular perpetrators.

No single UN treaty could simultaneously regulate cyberwarfare, counter cybercrime, and protect the civil liberties of Internet users. Liberal and authoritarian regimes disagree on the definition of "cybersecurity" and how to achieve it, with the latter generally seeing the free exchange of ideas and information not as a core value but as a potential threat to their stability, and there are various practical hurdles to including cyberweapons in traditional arms control and nonproliferation negotiations. So a piecemeal approach to governance in cyberspace seems more realistic. States will need to negotiate norms of responsibility for cyberattacks and criteria for retaliation. They should also develop transparency and confidence-building measures and agree to preserve humanitarian fundamentals in the event of a cyberwar, avoiding attacks on "root" servers, which constitute the backbone of the Internet, and prohibiting all denial-of-service attacks, which can cripple the Internet infrastructure of the targeted countries. Washington might start advancing such an agenda through a coalition of like-minded states—akin to the Financial Action Task Force or the Proliferation Security Initiative—expanding membership outward as feasible.

TECHNOLOGY AND THE FRONTIERS OF GLOBAL GOVERNANCE

The history of global governance is the story of adaptation to new technologies. As breakthroughs have been made, sovereign governments have sought common standards and rules to facilitate cooperation and mitigate conflict. For example, we now take for granted the world's division into 24 separate time zones, with Greenwich Mean Time as the base line, but in the middle of the nineteenth century, the United States alone had 144 local time zones. It was only the need to standardize train and shipping schedules in the late nineteenth century that convinced major countries to synchronize their time.

Today, the furious pace of technological change risks leaving global governance in the dust. The growing gap between what technological advances permit and what the international system is prepared to regulate can be seen in multiple areas, from drones and synthetic biology to nanotechnology and geoengineering.

When it comes to drones, the United States has struggled mightily to develop its own legal rationale for targeted assassinations. Initial foreign objections to U.S. drone strikes were concentrated within the target countries, but increasingly, their use has been challenged both domestically and internationally, and the rapid spread of drone technology to both state and nonstate actors makes it imperative to create clear rules for their use—and soon.

Rapid advances in biotechnology could pose even greater long-term threats. Scientists today are in a position to create new biological systems by manipulating genetic material. Such "synthetic biology" has tremendous therapeutic and public health potential but could also cause great harm, with rogue states or rogue scientists fabricating deadly pathogens or other bioweapons. At present, only an incomplete patchwork of regulations exist to prevent such risks. Nor are there any international regulatory arrangements to govern research on and uses of nanotechnology: the process of manipulating materials at the atomic or molecular level. Where regulation exists, it is performed primarily on a national basis; in the United States, for example, this function is carried out jointly by the Environmental Protection Agency, the Food and Drug Administration, and the National Institute of Standards and Technology. To make things even more complicated, most research and investment in this area is currently carried out by the private sector, which has little incentive to consider potential threats to public safety.

Finally, the threat of uncoordinated efforts at geoengineering—the attempt to slow or reverse global warming through large-scale tinkering with the planet's climate system—also demands regulation. Such schemes include seeding the world's oceans with iron filings (as one freelancing

U.S. scientist attempted in 2012), deflecting solar radiation through a system of space-based mirrors, and preventing the release of methane held in tundras and the ocean. Long dismissed as fanciful, such attempts to reengineer the earth's atmosphere are suddenly being taken seriously by at least some mainstream experts. As warming proceeds, countries and private actors will be increasingly tempted to take matters into their own hands. Only proper regulation has a chance of ensuring that these uncoordinated efforts do not go badly awry, with potentially disastrous consequences.

"GOOD ENOUGH" GLOBAL GOVERNANCE

As all these examples highlight, demand for effective global governance continues to outstrip supply, and the gap is growing. Absent dramatic crises, multilateral institutions have been painfully slow and lumbering in their response. So even as they try to revitalize the existing international order, diplomats and other interested parties need to turn to other, complementary frameworks for collective action, including ad hoc coalitions of the willing, regional and subregional institutions, public-private arrangements, and informal codes of conduct. The resulting jerry-rigged structure for global cooperation will not be aesthetically pleasing, but it might at least get some useful things done.

A decade ago, the Harvard scholar Merilee Grindle launched a broadside against the lengthy list of domestic good-governance reforms that the World Bank and other agencies insisted were necessary to encourage growth and reduce poverty in developing countries. She implored international donors to put their long, well-intentioned checklists aside and focus instead on "good enough governance." Rather than try to tackle all problems at once, she suggested, aid agencies should focus on achieving the minimal institutional requirements for progress. This advice to lower expectations and start with the necessary and possible is even more applicable in the international sphere, given all the obstacles in the way of sweeping institutional reform there. For the Obama administration and its colleagues and successors, achieving some measure of "good enough" global governance might be less satisfying than trying to replay the glory days of the Truman administration. But it would be much better than nothing, and it might even work.

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How China Is Ruled

Why It's Getting Harder for Beijing to Govern

David M. Lampton

China had three revolutions in the twentieth century. The first was the 1911 collapse of the Qing dynasty, and with it, the country's traditional system of governance. After a protracted period of strife came the second revolution, in 1949, when Mao Zedong and his Communist Party won the Chinese Civil War and inaugurated the People's Republic of China; Mao's violent and erratic exercise of power ended only with his death, in 1976.

The third revolution is ongoing, and so far, its results have been much more positive. It began in mid-1977 with the ascension of Deng Xiaoping, who kicked off a decades-long era of unprecedented reform that transformed China's hived-off economy into a global pacesetter, lifting hundreds of millions of Chinese out of poverty and unleashing a massive migration to cities. This revolution has continued through the tenures of Deng's successors, Jiang Zemin, Hu Jintao, and Xi Jinping.

Of course, the revolution that began with Deng has not been revolutionary in one important sense: the Chinese Communist Party (CCP) has maintained its monopoly on political power. Yet the cliché that China has experienced economic reform but not political reform in the years since 1977 obscures an important truth: that political reform, as one Chinese politician told me confidentially in 2002, has "taken place quietly and out of view."

The fact is that China's central government operates today in an environment fundamentally different, in three key ways, from the one that existed at the beginning of Deng's tenure. First, individual Chinese leaders have become progressively weaker in relation to both one

DAVID M. LAMPTON is George and Sadie Hyman Professor of China Studies and Director of SAIS-China at the Johns Hopkins School of Advanced International Studies. This essay is adapted from his book *Following the Leader: Ruling China, From Deng Xiaoping to Xi Jinping*, published by the University of California Press. © 2014 by the Regents of the University of California.

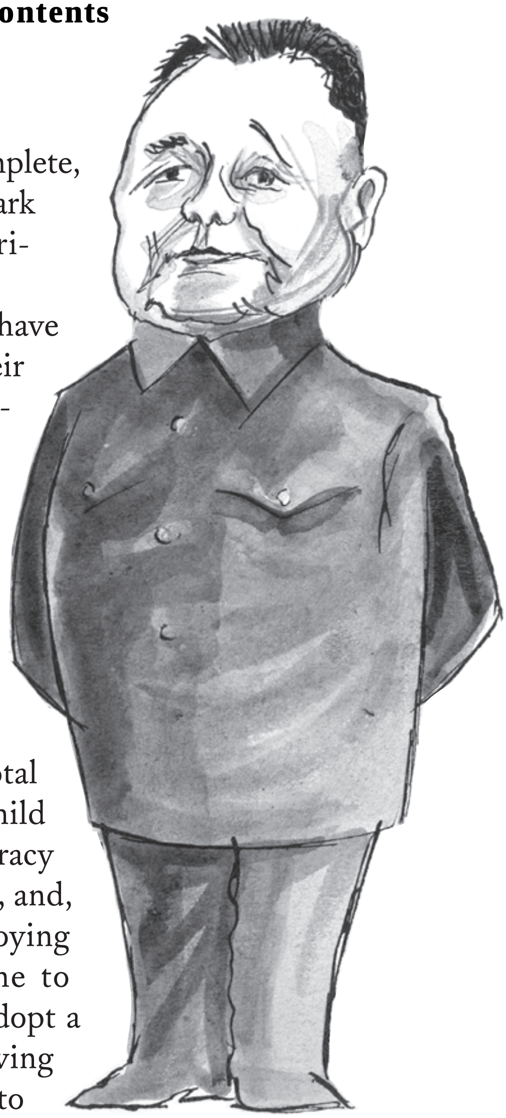
another and the rest of society. Second, Chinese society, as well as the economy and the bureaucracy, has fractured, multiplying the number of constituencies China's leaders must respond to, or at least manage. Third, China's leadership must now confront a population with more resources, in terms of money, talent, and information, than ever before.

For all these reasons, governing China has become even more difficult than it was for Deng. Beijing has reacted to these shifts by incorporating public opinion into its policymaking, while still keeping the basic political structures in place. Chinese leaders are mistaken, however, if they think that they can maintain political and social stability indefinitely without dramatically reforming the country's system of governance. A China characterized by a weaker state and a stronger civil society requires a considerably different political structure. It demands a far stronger commitment to the rule of law, with more reliable mechanisms—such as courts and legislatures—for resolving conflicts, accommodating various interests, and distributing resources. It also needs better government regulation, transparency, and accountability. Absent such developments, China will be in for more political turmoil in the future than it has experienced in the last four-plus decades. The aftershocks would no doubt be felt by China's neighbors and the wider world, given China's growing global reach. China's past reforms have created new circumstances to which its leaders must quickly adapt. Reform is like riding a bicycle: either you keep moving forward or you fall off.

NOT ALL LEADERS ARE THE SAME

According to the German sociologist Max Weber, governments can derive their authority from three sources: tradition, the qualities and charisma of an individual leader, and constitutional and legal norms. China, over the reform period, has shifted away from the first two types of legitimacy and toward something like the third.

Like Mao, Deng enjoyed a mix of traditional and charismatic authority. But the leaders who followed him earned their legitimacy in different ways. Jiang (who ruled from 1989 to 2002) and Hu (ruling from 2002 to 2012) to various extents were both designated as leaders by Deng himself, and Xi's elevation to the top position, in 2012, was the product of a collective political process within the CCP. Over time, a set of norms that regulate leadership selection has developed, including term and age limits, performance measures, and opinion polling within the party. Although important, these norms should not be mistaken for law—they are incomplete, informal, and reversible—but they do mark a dramatic departure from Mao's capricious system.



As the foundations of legitimacy have shifted, Deng's successors have seen their capacity to single-handedly initiate policies diminish. Although Deng did not enjoy the unbridled power that Mao did, when it came to strategic decisions, he could act authoritatively and decisively once he had consulted influential colleagues. Moreover, the scale and scope of his decisions were often enormous. Besides embarking on economic reform, Deng made other pivotal choices, such as rolling out the one-child policy in 1979, suppressing the Democracy Wall protest movement that same year, and, in 1989, declaring martial law and deploying troops in Beijing. And when it came to Taiwan, Deng felt secure enough to adopt a relaxed attitude toward the island, leaving the resolution of cross-strait relations to the next generation.

Jiang, Hu, and Xi, by contrast, have been more constrained. The difference was on full display in late 2012 and into 2013, as Xi took over from Hu. In the 1970s, in order to build ties with Japan, Deng was able to sidestep the explosive nationalist politics surrounding questions of sovereignty over the disputed Diaoyu Islands (known in Japan as the Senkaku Islands). But Xi, having just risen to the top post and eager to consolidate his power in the wake of Japan's September 2012 nationalization of the islands, felt obliged to act muscularly in response to Tokyo's move.

China, in other words, has gone from being ruled by strongmen with personal credibility to leaders who are constrained by collective decision-making, term limits and other norms, public opinion, and their own technocratic characters. As one senior Chinese diplomat put it to me in 2002, "Mao and Deng could decide; Jiang and the current leaders must consult."

China's rulers have strayed from Mao and Deng in another important respect: they have come to see their purpose less as generating enormous change and more as maintaining the system and enhancing its performance. Deng's goals were transformational. Deng sought to move China up the economic ladder and the global power hierarchy, and he did. He opened China up to foreign knowledge, encouraged China's young people to go abroad (an attitude influenced by his own formative years in France and the Soviet Union), and let comparative advantage, trade, and education work their magic.

Deng's successor, Jiang, came to power precisely because he represented a change in leadership style: in the wake of the 1989 Tiananmen Square protests, both the forces in favor of reform and those wary of it viewed him as capable and nonthreatening. But he eventually jumped off the fence on the side of rapid reform. Jiang got China into the World

Trade Organization, set the stage for its first manned space mission, and articulated, for the first time, that the CCP needed to bring large numbers of creative and skilled people into its ranks. During his 13-year rule, China's economy grew at an average annual rate of 9.7 percent.

Yet Jiang, by virtue of both his character and his circumstances, was far from the transformational strongman Deng was. An engineer by training, Jiang was practical and focused on making things work. In 1992, for example, he told a group of Americans that a decade earlier, when he was a lower-ranking official, he had visited Chicago and paid special attention to the city's garbage collection because he hoped to find a solution to the problem of littered watermelon rinds back home. He then boasted to the Americans that as mayor of Shanghai, he had saved land by building corkscrew-shaped bridge on-ramps that reduced the need to displace city residents. Precipitous social change this was not, but Jiang's preoccupations materially improved the lives of ordinary Chinese.

Governing China has become even more difficult than it was for Deng Xiaoping.

Hu and his premier, Wen Jiabao, proved less transformational still. The evolution was foreseeable even in 2002, on the eve of Hu's assumption of power. "Another trend will be toward collective leadership, rather than supreme leaders," a senior Chinese diplomat told me at the time. "Future leaderships will be collective, more democratic; they will seek consensus rather than make arbitrary decisions. But the downside is that they will enjoy lesser amounts of authority. It will be more difficult for them to make bold decisions when bold decisions are needed." Hu enacted virtually no political or economic reforms; his most notable achievement was enhancing relations with Taiwan. The charitable interpretation of Hu's years in office is that he digested the sweeping changes Deng and Jiang had initiated.

Following his promotion to top party leader in November 2012, Xi impressively consolidated his authority in 2013, allowing a vigorous debate on reform to emerge, even as he has tightened restrictions on freedom of expression. The core of the debate concerns how to reinvigorate economic growth and the degree to which political change is a precondition for further economic progress.

After the Central Committee meeting of November 2013 (the Third Plenum), the Xi administration stated its intention to "comprehensively deepen reform" and has created a group to do so. The need for such a body signals that many policy disputes remain and that the central government intends to stay focused on change until at least 2020. But there simply is no clear-cut path forward, because in some areas, China needs marketization; in others, it needs decentralization; and in still others, it needs centralization.

Although many ambiguities remain, the thrust of emerging policy is to have the market play a decisive role in allocating resources, with Beijing leveling the domestic playing field between state enterprises and nonstate firms and simplifying bureaucratic approval processes. Foreigners can find things to like in the government's promise to "relax investment access, accelerate the construction of free-trade zones, and expand inland and coastal openness." Such policies would have political consequences, too, and the meeting's communiqué mentioned the need for changes in the judiciary and in local governments, while vaguely suggesting more rights for peasants. That said, in calling for the creation of a national security committee, it identified both internal and external security as major concerns. A long march lies ahead.

THE FRACTURED SOCIETY

These changes in individual leadership style have coincided with another tectonic shift: the pluralization of China's society, economy, and bureaucracy. During the Mao era, leaders asserted that they served only one interest—that of the Chinese masses. The job of the government was to repress recalcitrant forces and educate the people about their true interests. Governance was not about reconciling differences. It was about eliminating them.

Since Mao, however, China's society and bureaucracy have fragmented, making it harder for Beijing to make decisions and implement policies. To deal with the challenge, the Chinese government, particularly since Deng, has developed an authoritarian yet responsive system that explicitly balances major geographic, functional, factional, and policy interests through representation at the highest levels of the CCP. Although the pathways for political self-expression remain limited, and elite decision-making opaque, China's rulers now try to resolve, rather than crush, conflicts among competing interests, suppressing such conflicts only when they perceive them to be especially big threats. They have attempted to co-opt the rank and file of various constituencies while cracking down on the ringleaders of antigovernment movements.

Many of China's powerful new interest groups are economic in nature. Labor and management now clash over working conditions and pay. Likewise, as Chinese businesses come to look more like Western corporations, they are only partially submissive to party directives. For example, as the scholar Tabitha Mallory has pointed out, the fishing industry has become increasingly privatized—in 2012, 70 percent of China's "distant-water" fishing companies were privately owned—making it far harder for the central government to prevent overfishing.

Meanwhile, in the state-owned sector, the China National Offshore Oil Corporation, or CNOOC, is supporting policies that favor more assertiveness in the South China Sea, where significant hydrocarbon deposits are thought to lie, and it has found common ground with the Chinese navy, which wants a bigger budget and a modernized fleet. On issues both foreign and domestic, interest groups have become increasingly vocal participants in the policy process.

China's bureaucracy has adapted to the proliferation of interests by becoming more pluralized itself. Officials use forums called "leading small groups" (*lingdao xiaozu*) to resolve fights among squabbling organizations and localities, and vice premiers and state councilors spend much of their time settling such disputes. Meanwhile, provinces, big cities such as Shanghai, and industrial and commercial associations increasingly rely on representatives in Beijing to promote their interests by lobbying national decision-makers—a model that has been replicated at the provincial level as well.

PEOPLE POWER

Mao almost never allowed public opinion to restrain his policies; the popular will was something he himself defined. Deng, in turn, did adopt reforms, because he feared that the CCP was close to losing its legitimacy, yet he only followed public opinion when it comported with his own analysis.

Today, in contrast, almost all Chinese leaders openly speak about the importance of public opinion, with the goal being to preempt problems. In August 2013, for instance, the state-run newspaper *China Daily* reminded readers that the National Development and Reform Commission had issued regulations requiring local officials

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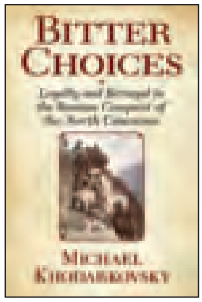

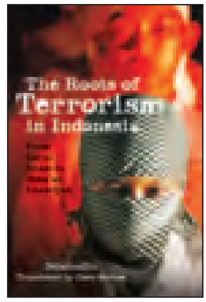

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to conduct risk assessments to determine the likelihood of popular disturbances in reaction to major construction projects and stated that such undertakings should be shut down temporarily if they generated "medium-level" opposition among citizens.

China has built a large apparatus aimed at measuring people's views—in 2008, the most recent year for which data are available, some 51,000 firms, many with government contracts, conducted polling—and Beijing has even begun using survey data to help assess whether CCP officials deserve promotion. "After Deng, there has been no strongman, so public opinion has become a kind of civil society," one pollster, who has seen more and more of his business come from the central government, told me in 2012. "In the United States, polling is used for elections, but in China, a major use is to monitor government performance."

Beijing now tries to resolve, rather than crush, conflicts among competing interests.

Such developments suggest that China's leaders now recognize that government must be more responsive, or at least appear that way. Indeed, since 2000, they have increasingly invoked public opinion in explaining their policies on exchange rates, taxes, and infrastructure. Public opinion may even lie behind the uptick in Beijing's regional assertiveness in 2009 and 2010. Niu Xinchun, a Chinese scholar, has argued that Beijing adopted a tougher posture in maritime disputes and other foreign issues during this period as a direct response to public anger over Western criticism of China's human rights record, especially in the run-up to the 2008 Olympic Games, when some Western leaders suggested that they might not attend. The Chinese were so fed up with France's behavior, in particular, that *China Daily* reported that the "Chinese people do not want the French president, Nicolas Sarkozy, to attend the opening ceremonies of the Beijing Olympics."

Beijing's greater responsiveness stems in large part from its recognition that as local governments, nonstate organizations, and individuals all grow more powerful, the central government is progressively losing its monopoly on money, human talent, and information. Take the question of capital. Ever since the Deng era, more and more of it has accumulated in coffers outside the central government. From 1980 to 2010, the portion of total state revenues spent at the local level rose from 46 percent to 82 percent. Meanwhile, the share of total industrial output produced by the state-owned sector dropped from 78 percent in 1978 to 11 percent in 2009. Of course, the state still holds firm control over strategic sectors such as those relating to defense, energy, finance, and large-scale public infrastructure, and ordinary Chinese still do not enjoy anything close to unlimited economic freedom. The change has also benefited corrupt local officials, military leaders, crime syndicates, and rogue entrepreneurs, all of whom can work against citizens' interests. But when people gain control over economic resources, they have far more choice in terms of where they live, what property they acquire, how they educate their children, and what opportunities they will pursue. This is not unfettered liberty, but it is certainly a beginning.

As for human capital, in the 1977–78 academic year, the first after the Cultural Revolution, some 400,000 students matriculated at Chinese universities; by 2010, that number had risen to 6.6 million. Moreover, many Chinese students now go abroad for education—in the 2012–13 academic year, more than 230,000 studied in the United States alone—and many are returning home after graduation. The result is that China now possesses a massive pool of talented individuals who can empower organizations and businesses outside of the state's control. Every day, these entities grow in number and power, and in some instances, they have begun performing duties that were traditionally handled by the state—or not handled at all. For example, the Institute of Public and Environmental Affairs, a nongovernmental organization that collects and publicizes data on factories' waste-disposal practices, has managed to pressure some companies that pollute into reforming their ways.

Ordinary Chinese are also gaining unprecedented access to information. More than half a billion Chinese now use the Internet. In addition to stanching the flow of information with the so-called Great Firewall, the government now has to fight information with information. In reaction to online rumors about the fallen CCP official Bo Xilai, for example, the government released limited portions of court testimony to Chinese social media. The central government has undertaken gargantuan efforts to both harness the benefits of the Internet and insulate itself from its most destabilizing effects.

At the same time, more and more Chinese citizens are flocking to cities. Urbanization tends to be associated with higher educational and income levels and elevated popular expectations. As one senior

Chinese economist put it to me in 2010, "In the city, people breathe the fresh air of freedom."

The combination of more densely packed urban populations, rapidly rising aspirations, the spread of knowledge, and the greater ease of coordinating social action means that China's leaders will find it progressively more challenging to govern. They already are. In December 2011, for example, *The Guardian* reported that Zheng Yanxiong, a local party secretary in Guangdong Province who had been confronted by peasants angry about the seizure of their land, said in exasperation, "There's only one group of people who really experience added hardships year after year. Who are they? Cadres, that's who. Me included."

CITIZENS OR SUBJECTS?

China's reformist revolution has reached a point that Deng and his compatriots could never have anticipated. China's top leaders are struggling to govern collectively, let alone manage an increasingly complex bureaucracy and diffuse society. Their job is made all the more difficult by the lack of institutions that would articulate various interests, impartially adjudicate conflicts among them, and ensure the responsible and just implementation of policy. In other words, although China may possess a vigorous economy and a powerful military, its system of governance has turned brittle.

These pressures could lead China down one of several possible paths. One option is that China's leaders will try to reestablish a more centralized and authoritarian system, but that would ultimately fail to meet the needs of the country's rapidly transforming society. A second possibility is that in the face of disorder and decay, a charismatic, more transformational leader will come to the fore and establish a new order—perhaps more democratic but just as likely more authoritarian. A third scenario is much more dangerous: China continues to pluralize but fails to build the institutions and norms required for responsible and just governance at home and constructive behavior abroad. That path could lead to chaos.

But there is also a fourth scenario, in which China's leaders propel the country forward, establishing the rule of law and regulatory structures that better reflect the country's diverse interests. Beijing would also have to expand its sources of legitimacy beyond growth, materialism, and global status, by building institutions anchored in genuine popular support. This would not necessarily mean transitioning to a full democracy, but it would mean adopting its features: local political participation, official transparency, more independent judicial and anticorruption bodies, an engaged civil society, institutional checks on executive power, and legislative and civil institutions to channel the country's diverse interests. Only after all these steps have been taken might the Chinese government begin to experiment with giving the people a say in selecting its top leaders.

The key questions today are whether Xi favors such a course, even in the abstract, and whether he is up to the task of seeing it through. Preliminary indications suggest that proponents of economic reform have gained strength under his rule, and the important policies adopted by the Third Plenum will intensify the pressure for political reform. But Xi's era has only just begun, and it is still too early to say whether his time in the military and experience serving in China's most modernized, cosmopolitan, and globally interdependent areas—Fujian, Zhejiang, and Shanghai—have endowed the leader with the necessary authority and vision to push the country in the direction of history. Xi and the six other current members of the Politburo Standing Committee, China's most powerful decision-making body, come from a wider range of educational backgrounds than have the members of previous Standing Committees. This diversity could presage a period of creativity, but it could also produce paralysis.

There is also the danger that those who climb to the top of a political system cannot see beyond it. But history offers hope: in China, Deng saw beyond Mao and the system he had fashioned, and in Taiwan, Chiang Ching-kuo ushered in liberalizing reforms in the 1980s that his father, Chiang Kai-shek, had prevented.

The dangers of standing still outweigh those of forging ahead, and China can only hope that its leaders recognize this truth and push forward, even without knowing where exactly they are headed. Should Xi and his cohort fail to do so, the consequences will be severe: the government will have forgone economic growth, squandered human potential, and perhaps even undermined social stability. If, however, China's new leaders manage to chart a path to a more humane, participatory, and rules-based system of governance—while maintaining vigorous economic growth and stability—then they will have revitalized the nation, the goal of patriots and reformers for over a century and a half.

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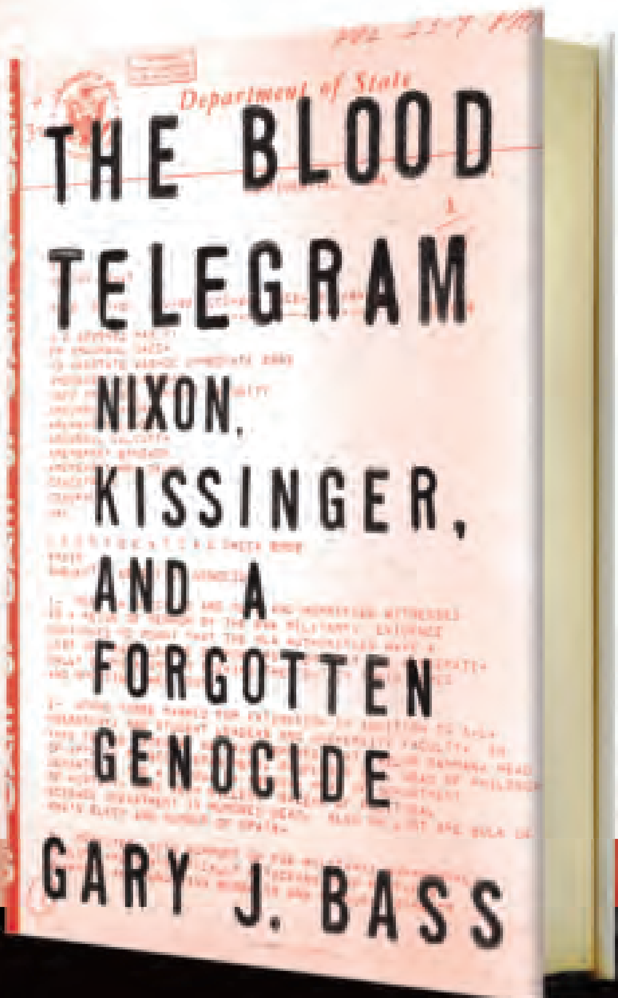

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America's Social Democratic Future

The Arc of Policy Is Long But Bends Toward Justice

Lane Kenworthy

Since March 2010, when U.S. President Barack Obama signed the Affordable Care Act into law, the ACA has been at the center of American politics. Tea Party activists and their allies in the Republican Party have tried to stymie the law at nearly every turn. The Republican-controlled House of Representatives has voted more than 40 times in favor of repealing or defunding it, and last October the House allowed a partial shutdown of the federal government in an attempt to block or delay the law. The controversy surrounding the ACA shows no sign of ending anytime soon.

Obamacare, as the law is commonly known, is the most significant reform of the U.S. health-care system in half a century. It aims to increase the share of Americans who have health insurance, improve the quality of health insurance plans, and slow the growth of health-care spending. But the fight over the law is about more than just health-care policy, and the bitterness of the conflict is driven by more than just partisan polarization. Obamacare has become the central battleground in an ongoing war between liberals and conservatives over the size and scope of the U.S. government, a fight whose origins stretch back to the Great Depression and the New Deal.

Opponents of President Franklin Roosevelt's innovations were silenced when the New Deal's reforms were locked in during the Truman and Eisenhower years, and the U.S. welfare state took another leap

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forward under Lyndon Johnson, whose Great Society agenda expanded public help for the poor and created the government-administered health insurance programs Medicare and Medicaid. But the following decades saw few major additions and some notable setbacks, including the failure of President Bill Clinton's health-care reform effort in 1994.

The passage of Obamacare has caused such controversy in part because it seems to signal a new stage of government activism, leading some conservatives to oppose it as a decisive and possibly inexorable turn to the left. "Precisely because the Affordable Care Act is the realization of a half-century long liberal dream," the conservative commentator Peter Wehner wrote recently in *The Weekly Standard*, "if it fails, it will be a crushing blow not just to Barack Obama but to American liberalism itself. Why? Because Obamacare is in many ways the avatar, the archetype, of modern liberalism. That's true in terms of its coercive elements, its soaring confidence in technocratic solutions, its ambition to centralize decisionmaking, and its belief that government knows best."

Such apocalyptic arguments vastly overstate Obamacare's practical significance. But they also obscure the more interesting reality, which is that the ACA represents another step on a long, slow, but steady journey away from the classical liberal capitalist state and toward a peculiarly American version of social democracy. Unlike in, say, northern Europe, where social democracy has been enacted deliberately and comprehensively over the years by ideologically self-aware political movements, in the United States, a more modest and patchy social safety net has been pieced together by pragmatic politicians and technocrats tackling individual problems. Powerful forces will continue to fight those efforts, and the resulting social insurance policies will emerge more gradually and be less universal, less efficient, and less effective than they would otherwise have been. But the opponents are fighting a losing battle and can only slow down and distort the final outcome rather than stop it. Thanks to a combination of popular demand, technocratic supply, and gradually increasing national wealth, social democracy is the future of the United States.

NORDIC MODELS

Social democracy originated in the early twentieth century as a strategy to improve capitalism rather than replace it. Today, people generally associate it with European social democratic political parties and the policies they have put in place, especially those in the Nordic countries, such as Denmark and Sweden. Over the course of the next half century, the array of social programs offered by the federal government of the United States will increasingly come to resemble the ones offered by those countries.

This prediction means something quite different today than it would have a generation ago, when the label "social democratic" referred quite narrowly to policies that made it easier for people to survive with little or no reliance on earnings from employment. In the 1960s and 1970s, the practice of social democracy mostly meant maintaining a large public safety net. Today, that's too narrow a conception. In recent decades, the Nordic countries have supplemented their generous social programs with services aimed at boosting employment and enhancing productivity: publicly funded child care and preschool, job-training and job-placement programs, significant infrastructure projects, and government support for private-sector research and development. At the same time, the Nordic governments have adopted a market-friendly approach to regulation. Although they maintain regulations to protect workers, consumers, and the environment, they balance those protections with a system that encourages entrepreneurship and flexibility by making it easy to start or close a business, to hire or fire employees, and to adjust work hours.

Opponents of American-style social democracy are fighting a losing battle.

As pioneered by the Nordic countries, modern social democracy means a commitment to the extensive use of government policy to promote economic security, expand opportunity, and ensure rising living standards for all. But it aims to do so while also safeguarding economic freedom, economic flexibility, and market dynamism, all of which have long been hallmarks of the U.S. economy. The Nordic countries' experience demonstrates that a government can successfully combine economic flexibility with economic security and foster social justice without stymieing competition. Modern social democracy offers the best of both worlds.

Still, the notion that the United States is likely to further increase the size and scope of its welfare state might seem blind to the reality of contemporary American politics. But step back and consider the long run. The lesson of the past hundred years is that as the United States grows wealthier, Americans become more willing to spend more to insure against risk and enhance fairness. Advances in social policy come only intermittently, but they do come. And when they come, they usually last.

That trend is likely to continue. U.S. policymakers will recognize the benefits of a larger government role in pursuing economic security, equal opportunity, and rising living standards and will attempt to move the country in that direction. Often, they will fail. But sometimes, they will succeed. Progress will be incremental, coming in fits and starts, as it has in the past. New programs and expansions of existing ones will tend to persist, because programs that work well become popular and because the U.S. policymaking process makes it difficult for opponents of social programs to remove them. Small steps and the occasional big leap, coupled with limited backsliding, will have the cumulative effect of significantly increasing the breadth and generosity of government social programs.

This is not a prediction about the timing or conditions under which specific policy advances will occur. It's a hypothesis about a probabilistic process. Over the long run, new programs will occasionally be created and existing ones will occasionally be expanded, and these additions and expansions are unlikely to be reversed.

FALLING SHORT

To understand why the United States is on the path to social democracy, one must recognize that although it is a rich country—and in the next half century, it will grow even richer—it nevertheless suffers from serious economic failings. These are deep-seated problems; although exacerbated by the Great Recession and the feeble recovery, they predate the country's recent economic troubles.

First, the United States does not ensure enough economic security for its citizens. Too many Americans have incomes so low that they struggle to make ends meet: among the 25 million households in the bottom fifth on the income ladder, average income is just $18,000 a year. Too many Americans experience sizable income declines: each year, about one in seven U.S. households suffers a drop in annual income of 25 percent or more. Too many Americans have no health insurance: even when Obamacare is fully implemented, between five and ten percent of U.S. citizens still won't have coverage, a far higher share than in any other rich nation. Finally, too many Americans will soon reach retirement age with little savings and inadequate pensions: average household savings as a share of disposable household income fell from ten percent during the 1970s to just three percent during the first decade of this century, many employees with defined-contribution pension plans contribute very

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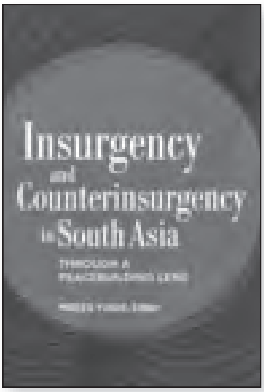

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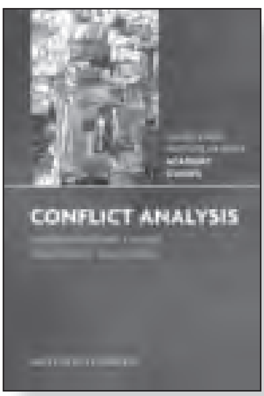

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little to them or cash them in early, and the bursting of the housing bubble depleted the sole asset of many middle-class homeowners.

Second, the country is failing in its promise of equal opportunity. Most women and many African Americans now have a much better chance to obtain an advanced education and to thrive in the labor market than did their counterparts a generation ago. Yet the story for Americans who grow up poor is much less encouraging. Among affluent countries for which data are available, the United States has one of the lowest levels of intergenerational earnings mobility. An American born into a family in the bottom fifth of incomes between the mid-1960s and the mid-1980s has roughly a 30 percent chance of reaching the middle fifth or higher in adulthood, whereas an American born into the top fifth has an 80 percent chance of ending up in the middle fifth or higher. Moreover, recent decades have witnessed large increases in the gaps between the test scores and college completion rates of children from low-income families and those from high-income families, and the same will likely be true for their earnings and incomes when they reach adulthood.

Third, too few Americans have shared in the prosperity their country has enjoyed in recent decades. In a good society, those in the middle and at the bottom ought to benefit significantly from economic growth. When the country prospers, everyone should prosper. But since the 1970s, despite sustained growth in the economy, the incomes of households in the middle and below have risen very slowly compared with those at the top. According to calculations by the Congressional Budget Office that account for inflation, the average income for households in the top one percent soared from $350,000 in 1979 to $1.3 million in 2007. For the bottom 60 percent, the rise was quite modest: from $30,000 to $37,000.

These failures owe in part to changes in the global economy, especially the increasing competition faced by U.S. firms. American companies selling goods or services in international markets confront foreign rivals that are far more capable than in the past. Domestic industries face more competition, too, as technological advances, falling construction and transportation costs, and deregulation have reduced barriers to entry. In addition, shareholders now want rapid appreciation in stock values. Whereas a generation ago, investors in a company were happy with a consistent dividend payment and some long-term increase in the firm's stock price, they now demand buoyant quarterly profits and constant growth.

These shifts benefit investors, consumers, and some employees. But they encourage companies to resist pay increases, drop health insurance plans, cut contributions to employee pensions, move abroad, downsize, and replace regular employees with temporary ones—or computers. Such cost-cutting strategies end up weakening economic security, limiting opportunities for low-skilled labor, and reducing income growth for many ordinary Americans—trends that are certain to continue into the foreseeable future. In the coming decades, more Americans will lose a job, work for long stretches without a pay increase, work part time or irregular hours, and go without an employer-backed pension plan or health insurance.

Some believe that the best way to address the stresses and strains of the new economy is to strengthen families, civic organizations, or labor unions. Those are laudable aims. But these institutions have been unraveling over the past half century, and although advocates of revitalizing them offer lots of hope, they can point to little evidence of success.

An influential faction in Washington favors a different solution: shrink the federal government. According to this view, reducing taxes and government spending will improve efficiency, limit waste, and enhance incentives for investment, entrepreneurship, and hard work, leading to faster economic growth. But this approach is predicated on the false notion that the growth of government limits the growth of the private sector. Over the course of the past century, the United States has gradually expanded government spending, from 12 percent of GDP in 1920 to 37 percent in 2007. Throughout that period, the country's growth rate remained remarkably steady. Other evidence comes from abroad: among the world's rich nations, those with higher taxes and government expenditures have tended to grow just as rapidly as those with smaller governments. Moreover, even if cutting taxes and reducing federal spending did produce faster growth, the record of the past few decades suggests that too little of that growth would benefit Americans in the middle and below.

Another possible response to this state of affairs is to grin and bear it. In this view, there is little anyone can do to ameliorate the ill effects of the modern economy, so the wisest course of action for ordinary Americans is to adjust their expectations and carry on. But the United States can do better than that—and the best way to address the country's socioeconomic failings is to expand public insurance.

RISKS AND REWARDS

Most of what social scientists call "social policy" is actually public insurance. Social Security and Medicare insure individuals against the risk of having little or no money after they retire. Unemployment compensation insures individuals against the risk of losing their jobs. Disability payment programs insure against the risk of individuals' suffering physical, mental, or psychological conditions that render them unable to earn a living.

Other U.S. public services and benefits are also insurance programs, even if people don't usually think of them that way. Public schools insure against the risk that private schools will be unavailable, too expensive, or of low quality. Retraining and job-placement programs insure against the risk that market conditions will make it difficult to find employment. The Earned Income Tax Credit insures against the risk that one's job will pay less than what is necessary for a minimally decent standard of living. Social assistance programs, such as food stamps and Temporary Assistance for Needy Families, insure against the risk of being unable to get a job but ineligible for unemployment or disability compensation.

Over the past century, the United States, like other rich nations, has created a number of public insurance programs. But to achieve genuine economic security, equal opportunity, and shared prosperity in the new economy, over the course of the next half century, the federal government will need to greatly expand the range and scope of its existing social insurance programs and introduce new programs.

The government could help low-income American households with one or more employed adults by increasing the statutory minimum wage and indexing it to inflation and by increasing the benefit offered by the Earned Income Tax Credit, particularly for households without children, for whom the credit currently provides only a small amount. For households in which no one is employed, the solution is more complicated. Those who can make it in the labor market should be helped and pushed to do so, which will require extensive, individualized assistance. The federal government should also increase the benefit levels and ease the eligibility criteria for its key social assistance programs: Temporary Assistance for Needy Families, general assistance, food stamps, housing assistance, and energy assistance.

Several initiatives could help reduce the incidence of large involuntary declines in income: public sickness insurance, paid parental leave, and expanded access to unemployment insurance. Currently, nearly one-third

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of American workers get no paid sick leave, U.S. law requires only 12 weeks of unpaid parental leave, and only 40 percent of unemployed Americans qualify for unemployment compensation. The United States would also benefit from a wage insurance program. For Americans who get laid off and cannot find a job that pays as well as their prior one, wage insurance would fill half of the gap between the former pay and the new lower wage for a year or two.

By boosting the incomes of poor households with children, an increase in the Child Tax Credit would help reverse the widening gap in inequality of opportunity. Schools help offset gaps in childrens' capabilities that result from differences in families and neighborhoods. Having children enter school earlier in life could reduce the disparities that exist when they arrive for kindergarten. Indeed, some analysts have concluded that the impact of schooling is largest during the prekindergarten years.

Social insurance allows a modern economy to hedge against risks without relying on stifling regulations.

For the elderly, a helpful addition to the U.S. safety net would be a supplemental defined-contribution pension plan with automatic enrollment. Employers that have an existing plan could continue it, but they would have to automatically enroll all employees and deduct a portion of their earnings unless an employee elected to opt out. Employees without access to an employer-sponsored plan would be automatically enrolled in the new universal retirement fund, and workers whose employers did not match their contributions would be eligible for matching from the government.

The final piece of the economic-security puzzle would take the form of increased federal spending on public child care, roads and bridges, and health care and federal rules mandating more holidays and vacations for workers. Such changes would raise all Americans' quality of life and free up their income for purchasing other goods and services.

What about shared prosperity? The best way to ensure that household incomes rise in sync with the economy would be to get wages and employment rising again for those in the middle and below. Adjusting for inflation, the wages of ordinary Americans have not increased since the mid-1970s, and the employment rate is lower now than it was in 2000. Policymakers also ought to consider a public insurance remedy: not only increase the benefit offered by the

Earned Income Tax Credit but offer the credit to middle-income Americans and index it to GDP per capita.

Of course, spending on insurance comes at a price. Americans will need to pay more in taxes. Moreover, the existence of insurance increases the incentive for people to engage in risky behavior or to avoid employment. However, insurance also has economic benefits. Better education and health care improve productivity. Bankruptcy protection encourages entrepreneurship. Unemployment compensation encourages a more mobile work force and makes it easier for workers to improve their skills. Programs such as the Child Tax Credit and the Earned Income Tax Credit enhance the educational and economic prospects of children who grow up in poor households. And, crucially, social insurance allows a modern economy to hedge against risks without relying on stifling regulations that specify what businesses can and cannot do.

The experience of the world's rich countries over the past century should allay the fear that growth in the size and scope of public social programs will weaken the U.S. economy. There surely is a level beyond which public social spending hurts economic growth. But the evidence indicates that the United States has not yet reached that level. In fact, the country is probably still well below it.

BIG PRICE TAG, BIGGER PAYOFF

Some observers, even many on the left, worry about the applicability of Nordic-style policies—which have succeeded in the context of small, relatively homogeneous countries—to a large, diverse nation such as the United States. Yet moving toward social democracy in the United States would mostly mean asking the federal government to do more of what it already does. It would not require shifting to a qualitatively different social contract.

But can the United States afford social democracy? Although the added cost of creating the new programs and expansions described above while also maintaining Social Security and Medicare would depend on the exact scope and generosity of the programs, a rough estimate of the cost is an additional ten percent of U.S. GDP, or around $1.5 trillion. (An economic downturn, such as the one precipitated by the financial crisis of 2008, tends to skew GDP and tax revenue figures, so it is best to use data from 2007, the peak year of the precrash business cycle.) If ten percent of GDP sounds massive, keep in mind two things: First, if U.S.

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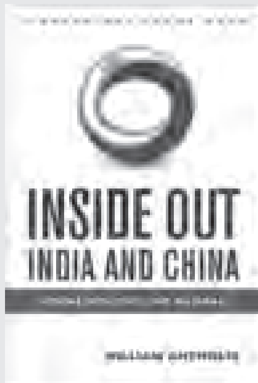

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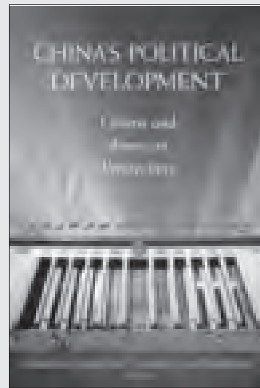

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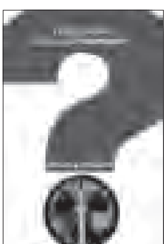

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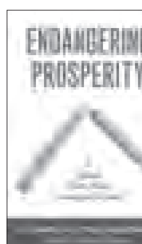

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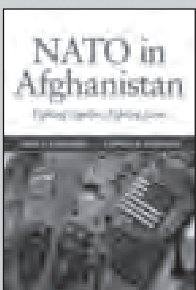

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government expenditures rose from 37 percent of GDP, their 2007 level, to around 47 percent, that would place the United States only a few percentage points above the current norm among the world's rich nations. Second, an increase in government spending of ten percent of GDP would be much smaller than the increase of around 25 percent that occurred between 1920 and today.

As a technical matter, revising the U.S. tax code to raise the additional funds would be relatively simple. The first and most important step would be to introduce a national consumption tax in the form of a value-added tax (VAT), which the government would levy on goods and services at each stage of their production and distribution. Analyses by Robert Barro, Alan Krueger, and other economists suggest that a VAT at a rate of 12 percent, with limited exemptions, would likely bring in about five percent of GDP in revenue—half the amount required to fund the expansions in social insurance proposed here.

In the long run, the GOP will come to resemble center-right parties in western Europe.

Relying heavily on a consumption tax is anathema to some progressives, who believe additional tax revenues should come mainly—perhaps entirely—from the wealthiest households. Washington, however, cannot realistically squeeze an additional ten percent of GDP in tax revenues solely from those at the top, even though the well-off are receiving a steadily larger share of the country's pretax income. Since 1960, the average effective federal tax rate (tax payments to the federal government as a share of pretax income) paid by the top five percent of households has never exceeded 37 percent, and in recent years, it has been around 29 percent. To raise an additional ten percent of GDP in tax revenues solely from this group, that effective tax rate would have to increase to 67 percent. Whether desirable or not, an increase of this magnitude won't find favor among policymakers.

A mix of other changes to the tax system could generate an additional five percent of GDP in tax revenues: a return to the federal income tax rates that applied prior to the administration of President George W. Bush, an increase of the average effective federal tax rate for the top one percent of taxpayers to about 37 percent, an end to the tax deduction for interest paid on mortgage loans, new taxes on carbon dioxide emissions and financial transactions, an increase in the cap on earnings that are subject to the Social Security payroll tax, and a one percent increase in the payroll tax rate.

POLITICAL SPEED BUMPS, NOT ROADBLOCKS

These kinds of tax reforms and the social insurance programs they would fund will not arrive all at once. It will be a slow process, partly owing to a series of obstacles that social democratic ideas are sure to face. But none of the barriers is likely to prove insurmountable.

One basic problem, critics might point out, is that Americans aren't fond of the idea of big government. Although this is true at an abstract level, when it comes to specific government programs, Americans tend to be strongly supportive. For instance, according to the National Opinion Research Center's General Social Survey, since the 1970s, a large majority of Americans—always over 80 percent and often more than 90 percent—have said that they believe the government currently spends the right amount or too little on assistance to the poor, on enhancing the nation's education system, on improving and protecting the nation's health, and on funding Social Security.

Skeptics might also note that expanding social programs will hinge on electoral success by Democrats, and it is possible that the Democratic Party's fortunes are dimming. Democrats have lost support among working-class whites, a main element of the New Deal coalition that dominated U.S. politics from the 1930s through the 1970s. Yet Democratic presidential and congressional candidates have fared well with a new electoral base of city-dwelling professionals, women, African Americans, and Latinos. The flood of private money into election campaigns, encouraged by the Supreme Court's 2010 *Citizens United* ruling, might put Democrats at a fundraising disadvantage. But private campaign contributions have been growing in importance for several decades, and so far, the Democrats have managed to keep up. And although demographics, electoral coalitions, and campaign funding certainly matter, the condition of the economy tends to be the chief determinant of the outcome of national elections. If Democrats manage the economy reasonably well when in they are in charge, they are likely to remain electorally competitive.

Another potential roadblock is the rightward shift in the balance of power among organized interests outside the electoral arena, which exert substantial influence on policymaking. Since the 1970s, businesses and affluent individuals have mobilized, while the labor movement has steadily declined in membership. Yet this shift has managed to only slow, not stop, the advance of progressive social policy.

A final potential obstacle to American social democracy is the structure of the U.S. political system, in which it is relatively easy to block policy changes through congressional maneuvering or effective vetoes. Given this structure, the kind of disciplined obstructionism demonstrated by congressional Republicans during Obama's tenure would surely threaten the forward march of public insurance. Sooner or later, however, Republican leaders will turn away from the staunch antigovernment orientation that has shaped the party's strategy and tactics in recent years. In the long run, the center of gravity in the Republican Party will shift, and the GOP will come to resemble center-right parties in western Europe, most of which accept a generous welfare state and relatively high taxes.

Three things could potentially trigger such a shift. One is a loss by a very conservative Republican candidate in an otherwise winnable presidential election. If the party were to nominate a member of its far-right or libertarian faction in 2016 or 2020, that candidate would almost certainly lose, which would prompt a move back toward the center. Another factor favoring Republican moderation is the growing importance to the party of working-class whites. Recently, several thoughtful and prominent right-of-center voices, such as David Brooks, Ross Douthat, David Frum, Charles Murray, Ramesh Ponnuru, and Reihan Salam, have noted that working-class whites are struggling economically and could benefit from government help. To shore up electoral support among this group, more top Republicans will come to favor—or at least not oppose—the expansion of programs such as the Child Tax Credit, early education, the Earned Income Tax Credit, Social Security, and even Medicare and Medicaid.

Perhaps most important, clear thinkers on the right will eventually realize that given Americans' desire for economic security and fairness, the question is not whether the government should intervene but how it should do so. An expansion of social programs would not necessarily mean more government interference in markets and weaker competition. Here again, the Nordic countries can show the way. The conservative Heritage Foundation collaborates with *The Wall Street Journal* in a project that grades countries on ten dimensions of economic freedom. Although the United States has lower taxes and lower government spending than the Nordic countries, Denmark, Finland, and Sweden score better, on average, on the other eight measures, including the right to establish and run an enterprise without interference from the state, the number of regulatory barriers to imports and exports, and the number of restrictions on the movement of capital. Americans want protection and support. To deliver those things, policymakers must choose between public insurance and regulation, and conservatives ought to prefer the former.

TWENTY-FIRST-CENTURY AMERICA

Perhaps what is most important to note about the United States' social democratic future is that it will not look dramatically different from the present day. The United States will not become a progressive utopia; rather, it will become a better version of its current self.

A larger share of adults will be employed, although for many, the workweek will be shorter and there will be more vacation days and holidays. Nearly all jobs will be in the service sector, especially teaching, advising, instructing, organizing, aiding, nursing, monitoring, and transporting; only around five percent will be in manufacturing or agriculture. Most Americans will change jobs and even careers more frequently than they do today. More Americans will work in jobs with low pay, will lose a job more than once during their careers, and will reach retirement age with little savings. Families, community organizations, and labor unions might grow even weaker than they are now.

But by filling in the gaps in the public safety net, the federal government will improve economic security, equal opportunity, and shared prosperity for most Americans in spite of these changes. A social democratic America will be a society with greater economic security and fairness. Its economy will be flexible, dynamic, and innovative. Employment will be high. Liberty will be abundant. Balancing work and family will be easier. Americans will pay higher taxes than they currently do, but the sacrifice will be worth it, because they will receive a lot in return.

The United States has come a long way on the road to becoming a good society, but it still has further to travel. Happily, its history and the experiences of other rich nations show the way forward. One reason the United States is a much better country today than it was a century ago is that the federal government does more to ensure economic security, equal opportunity, and shared prosperity. In the future, it will do more still, and the country will be better for it.

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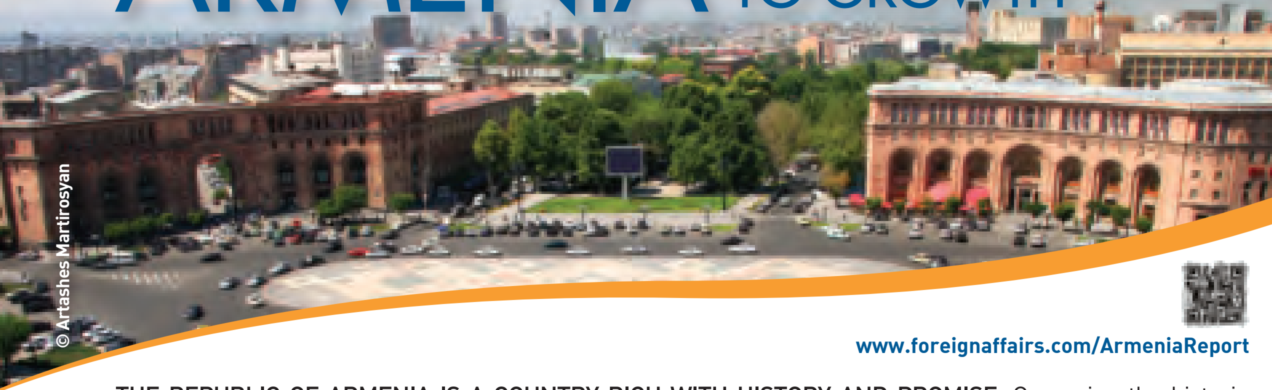
ARMENIA ROADMAP TO GROWTH



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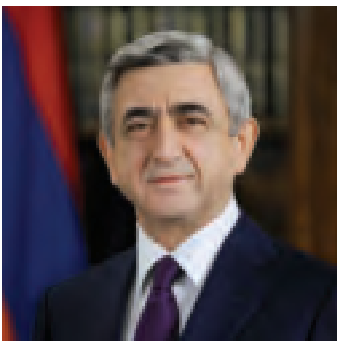
THE REPUBLIC OF ARMENIA IS A COUNTRY RICH WITH HISTORY AND PROMISE. Occupying the historic crossroads between Europe, the Middle East, and Asia, Armenia has a long tradition of trade and a strategic preference for open markets. Independent since 1991, Armenia has established itself as a strong regional player, outperforming its neighbors on many counts. Growth has resumed and is expected to stabilize at 5 percent annually, supported by an entrepreneurial population. Armenia is now in the process of transforming its economy, strengthening export-oriented industries and adding value to its existing industrial base.



Serzh Sargsyan, President of the Republic of Armenia

Armenia's return to form after a major economic slump in 2009 speaks volumes about the country's resilience and its ability to reinvent itself. Almost a decade of double-digit growth ended in the world economic crisis, when Armenia's economy contracted by 14 percent. But the country was quick to rebound and post-crisis Armenia looks to be in better shape than before. "These past five years have been a platform for growth recovery and growth development," says Tigran Sargsyan, Prime Minister of Armenia. "The outcome of the crisis is a new and more efficient economic structure."

Whereas before growth was largely fueled by the construction sector, today's growth is owed to the success of the country's trade- and export-oriented sectors: services, manufacturing, mining and processed agricultural products. On the back of exports, real GDP grew by 7.2 percent in 2012, up from 4.6 percent in 2011. For the years ahead, growth is expected to stabilize in the range of 5 percent. The government, having overseen the return to strength, is now pursuing the restructuring and diversification of the Armenian economy. "For the first time our government has declared a policy of export-oriented industrial development," explains Prime Minister Sargsyan. "Implementation of this policy will enable the transition from a resource-based economy to a knowledge- and high-technology–based economy."

Information technologies, pharmaceuticals, and precision engineering are some of the industries where Armenia has the power to excel. Priority is placed on products and services with high added value and low transportation costs, not least because of Armenia's geopolitical restrictions. Transit costs are high for landlocked Armenia, which has only two open borders, with Georgia and Iran. Armenia's other two neighbors, Turkey and Azerbaijan, both uphold a trade blockade over the unresolved Nagorno-Karabakh issue.

This situation has forced Armenians to seek alternatives for their trade relations and has nurtured a strong and undeterred entrepreneurial spirit. "We have a big competitive advantage, and that is our human resources," Armenian President Serzh Sargsyan is proud to point out. "Our people are very business-oriented. They want to compete locally, internationally and globally. You will hear teenagers in school talking about how they are going to start a business. It is a very powerful engine for the country, where society keeps pushing the government to create conditions that improve and create a more liberal business environment." Long-term government plans are designed to address the nation's aspirations and turn Armenia into a middle-income country by 2025, by prioritizing the creation of new high-quality and high-paying jobs, developing human capital, improving the social security system, and modernizing public administration.

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Open-Market Strategy

Foreign direct investment (FDI) inflows remain volatile for 2013, but Armenia has managed to build a reputation as a reliable and hospitable investment destination. The promotion of investment is one of the strategies leading to a diversification of the Armenian economy and the development of competitive industries. In 2012, Armenia recorded FDI inflows of more than $550 million, mostly from Russia, Europe, and Argentina. "Armenia is known the world over for its open investment regime," says Prime Minister Sargsyan. "We started radical reforms in the business and investment environment several years ago. As a result, we are now one of the most actively reforming countries in the world."

This is mirrored by the country's performance in the World Bank's 2014 "Doing Business" ranking, in which Armenia is now thirty-seventh, ahead of France. Similarly, the 2013 Index of Economic Freedom, published by the Heritage Foundation, rates Armenia's economic freedoms as greater than global and regional averages, and ranks the country thirty-eighth. Mark Davis, Director of the European Bank for Reconstruction and Development in Armenia, qualifies these rankings with personal experience. "It's a good place to do business. People speak the language of investors. There is a good level of transparency and partnership with local companies. It is possible to invest and actually be successful."

A dedicated law on foreign investments provides a range of incentives and protection against nationalization and changes in legislation. Importantly, investors have no limitations on the volume and type of foreign ownership and the number of foreign employees they may have.

Government plans to integrate with other markets are expected to give Armenia's export economy a boost by offering companies an extended playing field. "We are going to be very aggressive in removing all non-tariff and tariff restrictions in order to foster free trade agreements," says Vahram Avanesyan, Minister of the Economy. "This will give companies in the domestic market the opportunity to produce more efficiently."

The announcement by President Sargsyan in September 2013 that Armenia will join the Eurasian Customs Union (ECU) with Russia, Belarus, and Kazakhstan has to be understood in this context. "Membership will bring Armenia significant economic benefits: investments, foreign trade, and competitiveness in energy supply," explains Prime Minister Sargsyan. The move may conflict with free-trade negotiations with the European Union, but Armenia does not want to alienate its western trade partners and instead aims to maintain a balanced relationship, Prime Minister Sargsyan confirms. "Armenia gives great importance to expanding and deepening its economic cooperation with its key partners, particularly the European Union and the United States."

High-Competition Banking

Armenia's banking sector has been particularly interesting for investment. It came through the crisis unscathed, as Central Bank Chairman Arthur Javadyan explains. "The banking sector managed to withstand negative impacts of the global financial and economic crisis due to a high level of capitalization and liquidity, sustainable amounts of short-term foreign liabilities, and lack of investment in foreign securities, as well as relatively conservative regulation and supervision practices." The sector continues to grow in 2013, owing to a rise in lending and a rebound in remittances from the country's large diaspora.

The country profits from a stable banking system, which has adapted to the new economic landscape and grows alongside Armenia's economy. As Javadyan points out, "bank lending has undergone structural changes, and presently banks focus on the provision of loans to enterprises that could contribute to long-term economic development."

Seyran Sargsyan, Deputy Chairman of the Union of Banks, reinforces this point. "Armenian banks participate actively in the development of the economy. Their portfolio in all sectors of the economy is growing consistently," he says, adding that "Armenia's banking system has a high potential for further expansion and enlargement, given the upward adjustments of the macroeconomic environment."

The Armenian banking sector operates in a crowded market, with a total of twenty-one commercial banks, and is dominated by foreign banks, such as HSBC, Crédit Agricole, VTB Bank, and Byblos Bank. For Javadyan, this environment is conducive to growth. "The consolidation of the banking sector and the entry of international financial institutions in the financial sector of Armenia are key mechanisms for fostering competition," says Javadyan and underlines that "competition in the banking sector can provide new incentives for improving availability and affordability of financial services, thus contributing to the development of a banking culture among the population."

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A Wealth in Mining

Mining is an age-old tradition in Armenia. One of the world's oldest operating mines is located in Southern Armenia, where many of the country's mineral reserves are found. Armenia has significant deposits of molybdenum—a component metal of steel alloys used in high-end engineering and manufacturing—of which the country holds 7.6 percent of proven world reserves. Copper and gold reserves also exceed those of other countries in the region. With reserves of more than thirty metal and seventy nonmetal minerals, the country has won the attention of the international mining community. Players such as Cronimet Mining AG, Dundee Precious Metals Inc., GeoProMining, Global Gold Corp, Global Metals, and Lydian International are part of Armenia's rapidly expanding mining sector. Metal ore extraction has almost doubled in the past four years, expected to reach thirty-one million tons in 2013, compared to seventeen million tons in 2010. For Armenia, the mining sector is a principal source of export revenues, and it provides jobs and development in rural areas. Around fifteen thousand people work in mining, but more than a hundred thousand are supported by the mining sector, including satellite and supply companies. The challenge for Armenia is to integrate growth in the mining sector in development strategies for the country's long-term growth.

A Long-Term Investment

Cronimet Mining AG was among the first major international investors in Armenian mining. Part of an international integrated commodity company, it entered the market in 1995 and has since grown its commitment significantly. "We have strong business relations in Armenia and are happy to be here," says Thomas Heil, CEO of Cronimet Mining. In less than five years we achieved impressive results."

The company is the major shareholder in two main assets: the Plant of Pure Iron (PPI) in Yerevan, which produces ferromolybdenum and is the biggest molybdenum concentrate refinery in Armenia, and the Zangezur Copper Molybdenum Combine (ZCMC), the largest copper and molybdenum mine in the South Caucasus region. Since acquiring ZCMC in 2005, Cronimet Mining has invested $500 million in the mine. "We have fully modernized the company and revamped production facilities to increase the production volume," explains Heil. "This increased annual production to eighteen million tons of ore, a one hundred–percent increase since 2005."

Today, Cronimet Mining is the country's largest taxpayer and, with more than 3,200 employees, one of the largest private employers. This gives the company an additional responsibility in the country's development. "We have made many improvements in environmental safety, technical innovation and the

protection of the safety of our employees," Heil says. Some of the company's investments include support for educational facilities, such as schools and universities.

For the future, Heil sees expansion of Cronimet Mining in the region, but also further investment in Armenia. "Planned investments will depend on the availability of new and interesting projects, but will not be less than $100 million in the coming three years," says Heil. "We will continue investing in our two main assets, ZCMC and PPI, to extensively expand production volumes. Moreover, we recently acquired another molybdenum-copper deposit in Armenia. This asset will also require significant time and money to align completely with accepted international practices."

Set for Expansion

The Cypriot-registered company Global Metals came to Armenian mining more recently. In 2011, it started operations on the Sagamar mining project in the North of the country, producing copper and zinc concentrates with gold content. "Sagamar was our first step," explains Garen Ghazaryan, CEO of Global Metals. "It was a success story: we completed construction on time, we did it within the budget, and the technologies we selected work perfectly. This is one of the newest and biggest constructions made in Armenia, fitted with state-of-the-art equipment." Building on this first success, Global Metals was quick to seize other opportunities. It now runs a total of three projects, including two mining projects for copper molybdenum and gold in the South of Armenia. "So far we have invested a little more than $100 million in the country," says Ghazaryan. "And we have committed to invest another $100 million to build a concentrator next to the molybdenum deposit in southern Armenia."

With this new investment, Global Metals intends to vastly increase its operational presence in Armenia. "The Dastakert project in the South is going to be four times bigger than Sagamar in terms of operations," explains Ghazaryan. "The annual capacity of processing should reach two and half million tons per year." Construction is scheduled to start next year, to be completed by 2017. Global Metals is currently in the process of securing the necessary financing, for which it is now in negotiation with two banks and, as Ghazaryan points out, "the company is also looking for investors from abroad who might co-partner with us to build our new concentrators."

Attracting the interest of investors in Armenia remains a major challenge, Ghazaryan explains. "There is no proper information about Armenia. There is no awareness among investors about the country's business sectors, the economy, the way people live." For his part, he is very satisfied with the business environment Armenia has offered his company. "We feel the support of the Armenian government, having worked in Armenia for five to six years now," he says. "The government is ready to assist investors. There is good legislation, the banking system is developed, and you can find well educated and hard-working people, including geologists and technology experts."

Energy Opportunities

If Armenia wants to meet its long-term growth expectations, it will have to address the cost and security of energy supply. With no hydrocarbon reserves of its own, Armenia's domestic resources currently cannot meet more than 35 percent of total energy demand. This makes the country highly dependent on energy imports, in particular from Russia, but also from Iran and Georgia. Energy products, such as oil, gas, and nuclear fuel represent no less than 15 percent of the country's imports, weighing heavily on Armenia's trade balance. The problem is exacerbated by the low energy efficiency of the economy and the fact that much of Armenia's installed capacity has outlived itself. This includes Armenia's only nuclear power station, which contributes about 40 percent of the country's electricity, but is in line for decommissioning.

Armenia, therefore, has been investing in the modernization of its energy sector, rehabilitating and replacing existing equipment. A replacement of the nuclear power plant is now in discussion. "We want to develop the nuclear energy sector. Our mid-term goal is the replacement of the existing technology with new, more effective, and safer technology," explains Armen Movsissyan, Minister of Energy and Natural Resources. "We will incorporate the best mixed technologies from around the world in this project." In parallel, the government is taking other actions, including support for the development of renewable energies. "In our policy, renewable energy projects must be realized through the private sector. We created good conditions for investment in this area," says Movsissyan. "There has been particular success with small hydropower plants." In view of these developments, Armenia's energy sector is moving quickly from risk to opportunity.

High-End Technology

The country's investment in modern technologies is exemplified by the new Yerevan Thermal Power Plant (YTPP). Located just south of the capital Yerevan, YTPP is a gas-powered turbine plant, built to the highest international standards. Officially inaugurated in 2010, it replaced Armenia's very first power plant, which had been running for more than fifty years, far beyond its life expectancy. "We decided to build the new power plant as the old one had consumed its resources and had very low efficiency," explains Hovakim Hovhannisyan, General Director of the Yerevan Thermal Power Plant, who oversaw the technical planning process for the new installation. "The new plant meets 25 to 30 percent of electricity consumption in Armenia. Due to its much higher efficiency, it requires less gas per kilowatt hour, with a positive economic effect."

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For the implementation of the project, Armenia was able to secure financing from the Japan Bank of International Cooperation (JBIC), at favorable terms. "We signed our loan agreement in 2005 and were given a very soft loan with an interest rate of 0.75 percent per year over forty years and a ten-year grace period," says Hovhannisyan. The ensuing tender attracted international attention and secured advanced technologies for the new plant, as Hovhannisyan explains. "The gas turbine is from Alstom, the steam turbine is from Fuji, the heat recovery steam generator is from Sedae, and the automatic control system from Honeywell, all very strong international companies." Additional consulting services were provided by TEPCO and construction of the power plant was done by GS E&C, a Korean company, on a turn-key basis.

As proud as Hovhannisyan is to introduce new technologies to Armenia, he is equally proud to be nurturing domestic talent. "During construction, all our young specialists received training in Switzerland, Germany, Japan, and South Korea. We spent fifty to seventy thousand dollars on the training of each specialist. Now we have more than fifty young, trained specialists working in the power plant," says Hovhannisyan. "Training is important because the functioning and life expectancy of the power plant depend on specialists. We are already in our third year of training, continuously raising the quality of our staff." In the meantime, efforts are underway to construct a second combined-cycle power unit with a capacity of 400 to 450 megawatts.

Construction Sector Revamped

Pre-crisis, the construction sector was Armenia's major engine of growth. It played to the ambitions of a post-Soviet state that was released from the constraints of a central planning system. Private business and a wave of investments made possible the development of new residential and commercial buildings, allowing a new generation of construction companies to develop. The sector's growth has now cooled, but the businesses themselves have grown more stable, while government is reforming the sector with the aim of long-term sustainability. "Reforms in the sector are aimed at improving the business environment, regulating the procedures for construction of buildings, and simplifying the mechanisms for building permits," specifies Samvel Tadevosyan, Minister of Urban Development. The ministry has regulated land usage and urban construction in areas of special significance and is investing in the creation of technical databases that will facilitate construction, management, and rehabilitation of buildings. The government is also promoting the energy efficiency of buildings and supporting the construction industry with targeted actions.

"We study the global construction industry, new materials, technologies and experience in order to implement the production of new materials and technologies in Armenia," says Tadevosyan, citing one such action. In addition, the government is taking measures that are intended to aid the sector in its current situation. "Projects are being developed to provide long-term and low-interest loans to construction companies, to ensure further development and growth of the construction sector," says Tadevosyan. And with an eye on the future, he explains that "great importance is given to training and to raising the qualification of specialists in the sector," preempting a shortage of skills when growth resumes.

Innovation Leaders

The Elite Group, an Armenian property development company, is illustrative of the opportunities that are available in the construction sector. The company entered the business in 2000 as a privately funded enterprise, offering construction management services. It began by developing elite residential buildings, addressing a growing demand where Elite soon found its niche. "We pay a lot of attention to the choice of the site, individual architecture, and the comfort of our clients," explains Armen Mkoyan, CEO of Elite Group.

Today, Elite Group is the market leader in the Armenian construction sector and holds a broad portfolio. "We try to diversify the portfolio of our company and thus reduce our risks. Besides developing premium-class and business-class buildings, we started developing residential buildings for the middle class," says Mkoyan. "We also entered the hotel business and

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started planning and developing hotels in the resort centers of Armenia." Elite has completed construction of the Aghveran Resort Center, and other hotel projects are currently in development. Committed to applying international standards, Elite has also been able to secure funding from the European Bank of Reconstruction and Development (EBRD) and from the International Finance Corporation (IFC) for large-scale residential and mixed-purpose commercial developments.

Mkoyan is now ready for the company's next step of development and move to the international level, stating, "We want to launch an initial public offering (IPO). Together with EBRD and IFC we want to make the company an open joint-stock company and enter the international market."

Building With Excellence

Another company that developed to national recognition is the Spitak Tnak Construction Company. Founded in 2001, it quickly acquired a reputation for quality. "Since inception, our company has been faithful to its slogan, 'Build as you would build your own house, laying one stone after another,'" says Stepan Akhoyan, President of Spitak Tnak, describing the company's credo. "We couldn't imagine what the future scope of our projects would be. But from the very first day we believed in our success and our main goal was to ensure the high quality of our construction work."

Spitak Tnak now constructs everything from luxury residential homes and apartment blocks to hotels, business buildings, and golf courses. At the same time, it is involved in reconstruction and renovation work for clients including the National Academy of Sciences and HSBC Armenia. "A few years ago, the construction of residential buildings was still a dream for us," confesses Akhoyan, "but this is now considered a settled direction for our company." The company also decided to internalize certain capacities, as Akhoyan explains. "One of the milestones in the development and growth of Spitak Tnak was the creation of our own technical resources, which required a large investment. Now our technical resources include various types of equipment necessary for construction."

The contribution of Spitak Tnak to the Armenian construction business was officially recognized in 2008, when it received the Award for Quality Assurance of the Government of the Republic of Armenia, and a gold medal for a significant contribution in the field of urban development in Armenia.

"The company's plans for the coming years are to successfully finish a number of significant projects, ensuring quality and reinforcing the image of the company," says Akhoyan. This includes the construction of three government ministries, which are scheduled for completion in 2015. International expansion is next for Spitak Tnak. "Lately, we have been thinking of involving Western investors, which would make it possible to implement global projects," says Akhoyan, and concludes that "the success story of our company allows us to dream about international projects."

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Driving Armenia's Economic Growth

Armenia's new industrial policy is the country's strategic framework to achieving greater competitiveness and sustainable economic growth. It addresses the country's limited economic diversification and places a priority on the development of industries with a strong potential for export. "Our new industrial policy is based on eleven sectors which have strong preconditions of becoming an engine for Armenia's economic development," explains Robert Harutyunyan, General Director of the Armenian Development Agency. "These are IT, precision engineering, agriculture, food processing—in particular wine, brandy, canned products, and dairy products—jewelry and diamond processing, mining, biotechnology, and pharmaceuticals." The focus here is on sectors that could develop into the country's future drivers of growth, given mid-term and long-term support, by improving the regulatory framework, eliminating barriers to trade, and modernizing infrastructure. "The government's role is to create a favorable environment for doing business and to ease access to different markets," says Harutyunyan, stressing the vital role of open markets. "Armenia has a huge potential for large-scale production, but requires a larger consumer market, which can only be achieved by free access to nearby markets." The government conducts an open-market policy, reflected in its membership in the WTO, the conclusion of a free trade agreement with the Commonwealth of Independent States (CIS), and future participation in the Eurasian Customs Union.

In a more short-term perspective, the government puts the emphasis on sectors that have already exhibited strong growth in exports in recent years. As Harutyunyan explains, "We are first targeting those sectors that are most likely to deliver fast outcomes." Sectors such as IT and ICT, tourism, health, education, and agriculture have significant potential of further development with just moderate additional investment.

The IT and ICT sector is a case in point. "We are working quite extensively to help improve access to finance, particularly for small and medium-sized enterprises. Especially in areas where Armenia is showing some distinctive competitive advantage, such as in the IT and ICT sector," says Jean-Michel Happi, World Bank Country Manager for Armenia, Europe, and Central Asia. "Armenia has a very competitive labor force in this field, and I think it is the only industry in the country where you have job offers far exceeding supply." For Happi this is "an untapped potential," particularly if Armenia succeeds in expanding broadband coverage and providing better financial services.

In its efforts, the government has also been open to new approaches. It has entered a unique public-private partnership with a group of private sector

representatives from the United States, Russia, the European Union, and the Middle East, to lend support to the tourism, health, and education sectors. Known as the National Competitiveness Foundation (NCF), the partnership concerns itself with policy development, investment mobilization, and the implementation of projects that can create change in these growth sectors.

Regional Leader in Transport, Agribusiness, and Food Exports

Agriculture is very much part of Armenia's traditional economy. About 40 percent of the country's entire labor force is employed in the food services sector, providing an important livelihood for Armenia's rural areas. Food products are one of Armenia's greatest exports, representing no less than 14 percent of total exports. Owing to unique soil and climate conditions and the limited use of chemical fertilizers, Armenian agricultural products are of high quality and much appreciated in export markets, particularly Russia. This is feeding a growing food industry that includes products such as fresh fruits and vegetables, processed and canned foods, as well as juices and alcoholic beverages.

Spayka, a Yerevan-based company, has been a pioneer in this sector and has contributed much to the rise in Armenian food exports. Founded in 2001, with no starting capital, Spayka combines a successful transportation, packaging and processing business. "In the first three years of business we created our first transport fleet, consisting of fifteen European standard trucks," recalls Davit Ghazaryan, President of Spayka. "By 2005 we were a full-fledged company that was able to offer services to our Armenian clients." This fleet today stands at 115 trucks and Spayka continues the transportation and logistics business as a core part of the business, with remarkable success. "Spayka is the regional leader between Georgia, Azerbaijan, Armenia and southern Russia," says Ghazaryan. "We cover 50 to 52 percent of all imports and exports of third parties in Armenia."

Spayka's business was given a new spin when the company decided to invest in refrigerator trucks and refrigerated storage facilities, catering to the needs of the food industry and allowing it to handle the transportation of fresh food, vegetables, and fruits. With an investment of $33 million, Spayka created facilities that allow for the long-term storage of eight thousand tons of fresh goods. "The fact that we had centralized storage and export for third parties gave us the advantage of getting to know the market and the players," says Ghazaryan. "We decided to go further and start exporting foods under our own brand. We started working with farmers and procured fruits and vegetables that were subsequently processed and packaged at our facilities." In a move toward vertical integration, Spayka also began producing super light, plastic euro-pallets and boxes. These allow for lighter loads, making room for more produce instead. The

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packaging business is now successful in its own right.

These combined investments have made Spayka the largest exporter of food products in Armenia. Spayka's food exports are expected to reach twenty thousand tons this year, up from fifteen thousand tons last year. Growth could be faster still, if it were not for the constraints of the market, as Ghazaryan explains. "The main challenge that we have is the mismatch between the ambition of our company and the speed with which private agriculture and agribusiness is growing in Armenia," he says. "We are increasing our mobility and our capacity, but individual farmers and producers of agricultural products are lagging behind. We hope that within a few years we will have an agricultural sector that will meet our requirements."

Spayka is already thinking further. It intends to grow its fleet to one thousand trucks and open new markets for its food exports. At the moment, Spayka mainly exports to Russia, but this is about to change. As Ghazaryan explains, "We have completed the training stage and are now well developed. Our next step is to penetrate the European market, so that hopefully we see a diversification within a couple of years, dividing our business fifty-fifty between the Russian or CIS market and the European market." In the meantime, Spayka is launching its own cannery factory. "Developed in cooperation with Italian and Austrian specialists, the factory will be completed by the end of 2013 and have the capacity of producing more than forty-two million units of canned or packaged products per year. It will make Spayka the largest producer in the region for goods such as juices made from fresh fruit and vegetables, appetizers, and marinated canned products. And this, surely, won't be Spayka's last investment," adds Spayka's Head of Finances, Armand Hakobian.

Fish-Farming On the Rise

Surprisingly, for a country with no access to the sea, fish plays an increasingly important role in Armenia's exports. Lake Sevan and hundreds of other bodies of water support a local fishing industry, including a dynamic aquaculture sector. To companies like Unifish, a local producer of trout and sturgeon, fish-farming and international demand offer lucrative opportunities. Established in 2006, Unifish grew from national supplier to major exporter within a span of just four years. "In 2007 we produced a total of twenty-five tons of fish and in 2008 it was already one hundred tons," says Armen Mkrtchyan, Director of Unifish. "At the time, we supplied only the national market, with little export to Georgia and Ukraine."

Change came in 2009, when Armenia and Russia negotiated the possibility of fish exports to Russia, and the Russian certification agency cleared Armenian producers. "We started our exports in 2009, with intermediaries first. But we now supply fish directly to all the big supermarkets in Russia," says Mkrtchyan. "There is huge demand in the Russian market and we satisfy about 60 to 70 percent of this demand." Unifish considers future exports to the US, Singapore, and Malaysia, but for the time being Russia remains the focus of the company's activities. Unifish already enjoys a 95 percent share in the Russian market for sturgeon, but exports are on the rise. This now also includes caviar, as Mkrtchyan points out. "Last year, we exported twelve tons of red caviar to Russia and now red caviar is booked in advance by the Russian supermarkets. Also, we will export black caviar to Russia for the first time." Armenian caviar is highly sought after and Unifish expects to reach an annual production of one hundred to one hundred and fifty tons of black caviar and two to three hundred tons of red caviar in the coming five to six years.

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The grapes of Armenia

In 2011, archaeologists discovered the world's oldest known winemaking facility, dating back to 6100 BC, in an Armenian cave. Seeds founds on site were from the vitis vinifera grape, still used in wine production today. Viticulture has survived in Armenia to this day and is having a modern-day comeback. Armenian wines and brandies experience success on an international scale, owing to expanding quality production, fresh marketing, and more government support.

A Precious Tradition

Brandy is the only product of which Armenia has a sizeable percentage share of world exports, representing no less than 2.8 percent of global brandy exports. The best known and most successful of all Armenian brandies, ArArAt, has been in the market since the end of the nineteenth century. "ArArAt is an icon of Armenia, it is interlaced with its soul, history and traditions," says Ara Grigoryan, Chairman of the Board of the Yerevan Brandy Company, which produces ArArAt. "There are only certain varieties of grapes that can be used for authentic ArArAt brandy," he says, and explains, "We cooperate with the farmers and make a lot of investment in maintaining, improving, and encouraging the cultivation of grapes."

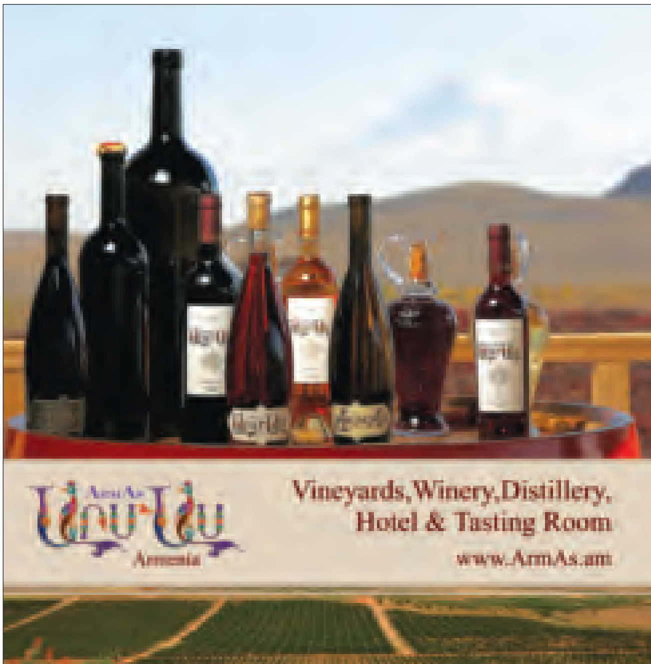
ArArAt is extremely popular in the region, and 90 percent of company sales are made in Russia, Belarus, Ukraine, Kazakhstan, and the brand's other traditional markets. Recognizing the brand's potential, Pernod Ricard acquired the Yerevan Brandy Company in 1998. "The decision of Pernod Ricard has been a win-win situation for both the country and the company," says Grigoryan. "In 1998, there were three producers of Armenian brandy who together were selling 1.6 million liters of brandy. The industry, at that time, was close to collapse and about to disappear. Today, we have more than thirty producers, and we are selling 15 million liters of brandy to Russia alone." A complete rebranding in the middle of the crisis in 2009 has greatly contributed to ArArAt's recent success. "If in 2011 and 2012 we were recovering from the crisis, we are now having the best year in the history of ArArAt Armenian Brandy," says Grigoryan. To keep up with demand, the company has now introduced double shifts.

A New Generation in Wine-Making

The taste for Armenian wines is also on the rise, as vineyards increasingly move towards producing premium wines. Producer Golden Grape ArmAs is the fresh face of Armenian wine and out to challenge the international competition. Financed by Armenian entrepreneur Armen Aslanian, the ArmAs winery was created entirely from scratch in 2007, designed and constructed by Italian architects, engineers, and wine industry professionals. The company's estate occupies a 180 hectare site in the Aragatsotn Province of Armenia, which was carefully selected based on soil and climate conditions conducive to producing exceptional wines from native varieties. "Our wines are made from the finest selection of our hand-picked, estate-grown grapes, and processed in a winery with latest enological equipment. We have ultimate quality control at every stage of the winemaking process," says Victoria Aslanian, Vice-President of Golden Grape ArmAs LLC. "In 2012, ArmAs released its first vintages, a selection of premium wines crafted by winemaker Emilio Del Medico. In 2015, ArmAs will release its first brandy, after aging in French and Karabakh oak barrels for three years."

Domestic demand is on the rise, as a new wine culture is taking hold in Armenia, but for larger producers such as ArmAs exports are inevitable. "While the market for wine in Armenia is expanding and has great potential, it is too small to consume the quantities that major wineries in Armenia are currently producing. Currently, ArmAs wines are set for export to the United States and Russia," explains Aslanian.

For Armenia, wine has become one of a number of promising sectors that will contribute to the country's long-term growth.



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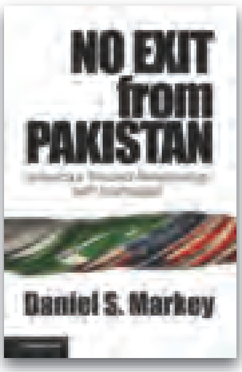

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Running the Pentagon Right

How to Get the Troops What They Need

Ashton B. Carter

War inevitably presents unexpected challenges. From Germany's use of mustard gas during World War I to North Vietnam's surprisingly effective use of its air defense system during the Vietnam War, the United States has always faced unanticipated threats in combat that have required agile responses. U.S. troops on the ground continually adjust to changing enemy tactics with the capabilities they have at hand. Yet the part of the Defense Department that trains and equips those troops has rarely been as flexible.

This is a paradox that would surprise most people outside its walls: the Pentagon is ill equipped to address urgent needs that arise during wartime. The Department of Defense has a fairly good track record of making smart and deliberate long-term acquisitions, as evidenced by the substantial qualitative advantage the United States holds over any potential adversary. Although the department still struggles to contain the costs of military systems, it has come a long way in providing better buying power for the taxpayer. The Pentagon has also, by sad necessity, pioneered advances in medical technology, particularly in such areas as prosthetic limbs and the treatment of traumatic brain injuries and posttraumatic stress disorder.

But the same system that excels at anticipating future needs has proved less capable of quickly providing technology and equipment to troops on the battlefield. I have spent much of the past five years, first as undersecretary of defense for acquisition, technology, and logistics and then as deputy secretary of defense, trying to address this shortfall. With the Iraq war over and the war in Afghanistan

ASHTON B. CARTER was U.S. Deputy Secretary of Defense from 2011 to 2013. From 2009 to 2011, he served as Undersecretary of Defense for Acquisition, Technology, and Logistics.

coming to a close, it is important to understand what prevented the Pentagon from rapidly meeting immediate demands during those wars, what enduring lessons can be learned from its efforts to become more responsive, and how to put in place the right institutions to ensure success against future threats when agility is crucial.

PURCHASING POWER

Introducing a new capability on the battlefield involves three main steps: deciding what is needed and selecting what to acquire from various alternatives, coming up with the money to pay for it, and fielding the capability (which includes delivering it to the troops and training them in how to use it). Over the course of the last decade, attempts to fast-track each of these steps ran up against a number of obstacles, ultimately hindering the Pentagon's responsiveness to the needs of American forces on the ground.

At the outset of the wars in Afghanistan and Iraq, the Pentagon made two fatal miscalculations. First, it believed these wars would be over in a matter of months. Accordingly, since it normally takes years to develop new capabilities, the Pentagon saw little value in making acquisitions unique to the environments of Afghanistan and Iraq that would be irrelevant by the time they were ready. Second, the Pentagon was prepared for traditional military-versus-military conflicts—a characterization that applied only to the early stages of the Iraq war. As a result, the military was not well positioned to fight an enemy without uniforms, command centers, or traditional organizational structures. The Pentagon initially failed to see the conflicts as requiring entirely new technologies and equipment, even as it became clear that improvised explosive devices (IEDs) and other makeshift tactics of an insurgency were more than nuisances—they were strategic threats to U.S. objectives.

The unexpected length and nature of the wars—particularly their evolution into protracted counterinsurgencies—demanded materiel solutions that the Pentagon had not planned for. The usual process of writing "requirements," an exhaustive process to determine what the military needs based on an analysis of new technology and future threats, would not suffice in Afghanistan and Iraq. That is because the system known inside the Pentagon as "require then acquire" demands complete information: nothing can be purchased until everything is known.

Additionally, the division of labor between the military services and the combatant commands complicated the Pentagon's ability to fund urgent needs. The services generally focus their investments on future capability requirements, force structure, and modernization, whereas the combatant commands are charged with fighting today's wars with current equipment using funds primarily appropriated for operations, not for equipment development or procurement. There was essentially no structure within the department to bridge the gap between immediate and longer-term requirements.

Next came delays in funding. The Pentagon usually crafts its requests for funding as far as two years in advance. It must submit detailed budgets to Congress and then wait until the money has been authorized and appropriated before getting any program off the ground. This lengthy lag time makes it difficult to pay for urgent needs. Furthermore, the Pentagon has little flexibility to finance new needs that arise outside the budget cycle. Any significant movement of funds requires securing permission from Congress, which can take months. The process can also lead to an unproductive competition for resources within the Pentagon and around the country, where those whose money is transferred make their voices heard in protest.

In Afghanistan and Iraq, the Pentagon saw little value in making acquisitions that would be irrelevant by the time they were ready.

The difficulties do not end as soon as Congress sets aside the money. To actually purchase anything, defense officials must navigate an intricate web of laws, regulations, and policies that are geared toward the acquisition of complex weapons systems and equipment in large quantities over years. The system was designed to foster fair competition among manufacturers and to maximize the buying power of taxpayers' dollars—but not to move quickly. Moreover, the officials responsible for acquisitions are loath to take risks, since they can be held personally accountable if something goes wrong. So when balancing cost, performance, and schedule for major acquisition projects, the last is often the least risky variable to compromise. The problem is that if an acquisition is necessary for the battlefield, every day of delay can risk the lives and safety of the troops.

Finally, in order to quickly field new capabilities, the Pentagon needed rapid contracting to transport the equipment and all the supplies and personnel necessary to sustain it. In landlocked Afghanistan, with primitive roads and few railways, this was especially challenging.

The troops also had to be trained to use the new equipment in the field, since it did not exist when they were preparing for deployment.

"THE TROOPS ARE AT WAR, BUT THE PENTAGON IS NOT"

In 2004, the Pentagon, faced with dynamic enemies in Afghanistan and Iraq, finally realized that it needed a better way of doing business. That year, Paul Wolfowitz, then the deputy secretary of defense, formed the Joint Rapid Acquisition Cell, a collaborative body that ascertained the needs of troops on the battlefield from information provided by U.S. Central Command, which oversees both Afghanistan and Iraq, and facilitated the responses of the military services. JRAC acted as the focal point within the Department of Defense for prioritizing among different requirements, identifying solutions, and enabling the funding and fielding of new equipment.

Wolfowitz also expedited the usually slow and deliberate system for determining needs and allocating resources. He established the Joint Urgent Operational Needs process to fill gaps in the troops' capabilities across the services that, if left unaddressed, could threaten lives and combat missions. JRAC then helped identify funds and make sure the right equipment got to the battlefield by assigning a military service or agency as a sponsor. Nonetheless, as the wars ground on, it became clear that the normal system, even with JRAC facilitating a new requirements process, was neither responding fast enough to the needs of the combatant commands nor taking advantage of impressive new technologies. As Secretary of Defense Robert Gates later said, "The troops are at war, but the Pentagon is not."

One of the first emerging threats in Afghanistan and Iraq to highlight this weakness was the IED, a kind of crude homemade bomb that insurgents often placed alongside roads to target troops when they were most vulnerable. IEDs have caused more than 60 percent of U.S. combat casualties in the two wars. What makes them such a formidable weapon is that they are easy to construct and can be assembled with readily available commercial materials, such as fertilizer. They are also difficult to detect and easily disguised in the surrounding terrain, such as in trash heaps or even animal carcasses. Long before these wars, IEDs had become the weapon of choice for guerillas and terrorists from Northern Ireland to Chechnya, and their use in asymmetric warfare had been extensively studied. But the widespread availability of new technologies, such as wireless transmitters, electronic triggers, and longer-lasting

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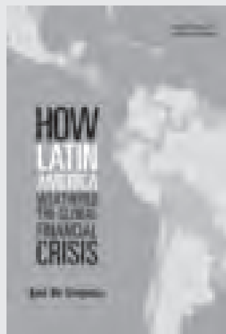

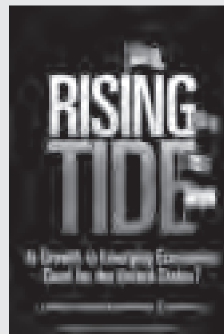

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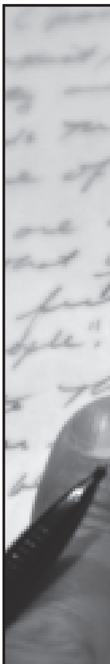

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The National Action Plan on Women, Peace, and Security, issued by the President in December 2011, states that "deadly conflicts can be more effectively avoided, and peace can be best forged and sustained, when women become equal partners in all aspects of peace-building and conflict prevention, when their lives are protected, their experiences considered, and their voices heard." In today's conflicts women are disproportionately victimized. Women are also emerging as agents for conflict resolution, bringing perspectives that may contribute to viable and lasting peace settlements.

This competition is intended to broaden the field of inquiry and stimulate scholarly research on questions related to the roles of women in modern conflict and the impact of women on conflict outcomes. The competition is open to scholars from all disciplines. Papers should be approximately 6,000 words long and suitable for publication in a peer-reviewed journal. Preference will be given to research-based papers with policy relevance. The contest is open to citizens of all countries but essays must be written in English.

The essays will be judged by a distinguished panel of scholars and practitioners: General James Mattis, USMC (ret.); Ambassador (ret.) Swanee Hunt; Dr. Kiron Skinner; and Ambassador (ret.) Christopher Hill.

Submissions should be sent online no later than April 15, 2014, to Mr. Richard Menard, and questions may also be directed to him, at richard.menard@usnwc.edu.

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batteries for detonators, rapidly increased their efficiency and potency in Afghanistan and Iraq. The sheer scope of their use in those wars caught the Pentagon off-guard and posed a grave risk to both campaigns, particularly since the American public's tolerance for casualties was tempered by expectations of short and easy wars.

In 2006, to better protect U.S. forces against this threat, then Deputy Secretary of Defense Gordon England, building on efforts in the army, established the Joint IED Defeat Organization (JIEDDO), which reported directly to him. Congress endorsed the idea and appropriated over $22 billion to combat IEDs—one of the few pockets of relatively flexible funding that legislators provided for rapid-response projects. Since then, JIEDDO has saved lives with such solutions as sensors that detect IEDs in the ground and electronic jammers that prevent their detonation. The organization has also covered the cost of critical counter-IED training for service members and, what is perhaps most valuable, funded the analysis of the enemy networks responsible for IED attacks, allowing U.S. forces to go on the offensive against what previously seemed a faceless threat.

JIEDDO helped double the number of counter-IED systems fielded by the Pentagon and cut in half the average amount of time it takes to get them to the battlefield. These efforts have contributed to lowering the rate of IED attacks that result in casualties by as much as 500 percent. And JIEDDO has helped reduce the severity of those IED attacks that do occur. By funding new protective undergarments, for example, JIEDDO made possible the roughly 32 percent drop from 2010 to 2011 in the number of catastrophic genital injuries to U.S. soldiers who were the victims of IEDs. At the Walter Reed medical center, I met the father of one soldier who had been wearing the undergarments when he stepped on an IED. The father approached me in the hallway, gave me a hug, and said, "My son will always have to use prosthetics to walk, but at least I still have a chance of being a grandfather."

Despite these significant successes, the increased attention and money provided by JIEDDO were not enough. Although the military deployed jammers and increased the armor on its Humvees, the insurgents found ways of building more effective IEDs, making U.S. vehicles and the troops inside them unacceptably vulnerable. Early on, field commanders had urged the creation of a new and more protective vehicle, but the perception within the Pentagon was that such a vehicle could not be funded and built before the wars ended and were thus unnecessary.

That skepticism was not limited to defense officials. In 2012, Vice President Joseph Biden recalled that when he was a senator, many of his colleagues on Capitol Hill opposed the development of an expensive counter-IED vehicle. He recounted one senator arguing that since the vehicles would not be needed once the wars were over, they were a total waste of money. Biden commented, "Can you imagine Franklin Roosevelt being told, 'We need *x* number of landing craft on D-Day, but once we land, we're not going to need them all again. So why build them?'"

It wasn't until 2007 that Gates decided—at the urging of then Lieutenant General Raymond Odierno, commander of the Multinational Corps in Iraq—to find a way to mitigate the threat to troops on the roads, regardless of the cost. Gates dubbed it "the highest-priority Department of Defense acquisition program" and immediately created a task force to accelerate the development and fielding of what became known as MRAPS: "mine-resistant, ambush-protected" vehicles. First led by John Young, who was undersecretary of defense for acquisition, technology, and logistics, and then by me when I served in that position, the MRAP Task Force was charged with taking "extraordinary steps" to cut through red tape, rally the defense industry, and deliver the vehicles.

With the support of Congress (including substantial flexible funding) and the attention of the most senior Pentagon officials, we decided to focus above all on getting MRAPS made quickly, accepting significant tradeoffs on less important parameters, such as the number of troops each could carry and their suitability for other kinds of conflicts. We considered only mature technology and chose manufacturers based on their ability to deliver the vehicles as soon as possible. The task force anticipated and helped alleviate potential industry bottlenecks that could have held up the process—for example, by paying to boost the production capacity of two tire-makers and by waiving regulations to allow the army to purchase specially hardened steel. The group also worked to standardize the vehicle's parts, such as turrets, jammers, and communications systems, across the various military services in order to expedite the fielding while also building a flexible design that could accommodate upgrades and improvements.

As a result of these efforts, we were able to build and ship more than 11,500 MRAPS to Iraq in 27 months and to build more than 8,000 all-terrain MRAPS for Afghanistan in only 16 months. Ultimately, we sent more than 24,000 MRAPS to the two theaters of war—the largest defense procurement program since World War II to go from decision to full industrial production in less than a year. Not only did these vehicles save thousands of lives; they also showed just how much can be accomplished with the full backing of leaders in Congress and the administration.

Task forces became the model of choice to address needs that could be met only outside the traditional processes. Another example of their effective use was for intelligence, surveillance, and reconnaissance (ISR) capabilities. The Department of Defense had well-established procedures for managing and allocating the ISR capabilities it had already developed, but it had limited experience in rapidly developing and fielding new ISR capabilities, especially down to the tactical level. To do so required thinking of aerostats and unmanned aircraft as consumable goods, more like body armor than satellites—that is, seeing them as tools that could be fielded quickly and operated by units in the field rather than by the intelligence agencies. Gates thus established the ISR Task Force in 2008, which successfully helped identify emerging urgent needs and technological opportunities and then bypass the normal roadblocks to procuring and fielding the resulting ISR tools.

Task forces worked well for specific individual problems, but few problems in wartime are narrowly defined, since military conflicts erase the boundaries between previously separate issues. Gates thus became frustrated with the Pentagon's inability to support the troops through the normal processes. Accordingly, in November 2009, he created the Counter-IED Senior Integration Group (SIG), which I headed alongside the director of operations for the Joint Chiefs of Staff. The group consisted of senior defense officials who met every three weeks to prioritize requirements and take stock of all counter-IED initiatives. Gates soon realized that this kind of high-level attention was needed for all urgent war-fighting requirements, not just counter-IED measures. So in June 2011, he converted the Counter-IED SIG into the Warfighter SIG, which became the Pentagon's central body for senior officials to weigh solutions to battlefield problems, locate the necessary resources to pay for them, and make the right acquisitions.

Gates soon expanded the Warfighter SIG's mandate further, to include what are called Joint Emergent Operational Needs. These are needs that arise in theaters where there are not ongoing wars but one could come at any moment, such as on the Korean Peninsula. We called the whole system of Joint Emergent Operational Needs and Joint Urgent Operational Needs "the fast lane." Even when the precise cost and ultimate specifications of a fast-lane project couldn't be fully known in advance, we got started anyway, standing the system on its head. In other words, instead of "require then acquire," this was "acquire then require."

According to a 2012 Government Accountability Office report, the heightened level of visibility within the Pentagon provided by the Warfighter SIG, together with the fast-lane process, decreased the median time needed to locate funding for projects from nine months to one month. The report found that initiatives that enjoyed attention from the top of the department were four times as likely to receive adequate funding as those that did not. The system is far from perfect, but it has injected some badly needed agility into the Pentagon's notoriously slow bureaucracy.

THE NEED FOR FLEXIBILITY

The challenge for the Pentagon now is to lock in these gains and make sure that the lessons of Afghanistan and Iraq are not forgotten. The clearest takeaway, as the Warfighter SIG has shown, is that wartime acquisition works best when senior leaders are paying attention. That's because only top officials can assume the risks that come with sidestepping general procedures. In practice, this means that the upper echelons of the department cannot simply issue policy guidance; they need to focus on specific threats and capability gaps. They must be willing to do so even when the projects are small in size and scope compared with the issues they normally deal with, given that winning wars and saving lives are at stake.

Furthermore, there must be a structure to the way senior officials grant their time and attention to such projects. Methods that bypass the normal acquisition process cannot be sustained if they rely solely on the support of a particular individual. And even the best ideas will remain unrealized if there are not clear procedures for bringing them to fruition—especially in the Department of Defense, which thrives on order and discipline. At the very least, the department ought to retain the nascent institutions that ultimately proved successful in Afghanistan and Iraq, such as the Warfighter SIG and JRAC.

Of course, the Pentagon cannot acquire any equipment or technology without adequate funding. And the current budget process simply does not allow for the development and deployment of solutions to urgent problems on the battlefield. The Department of Defense has developed several mechanisms for addressing such needs, and it must keep all of them in place.

First, Congress should continue to approve funds in limited quantities for general overall goals, such as the funds that paid for the MRAPs and other counter-IED initiatives, a process that offers the military the necessary flexibility to get capabilities from the laboratory all the way to the battlefield. The authority for this approach currently exists but is set to expire in 2015.

The ability to rapidly move a small percentage of the defense budget—known in the Pentagon as "reprogramming"—has allowed the department to pay for many capabilities not covered by a specific fund. Reprogramming enables crucial projects to move forward in weeks and months, rather than years, while still preserving Congress' role in approving funding. Another key tool that the Pentagon must retain is its congressionally authorized "rapid-acquisition authority," which allows the secretary of defense to repurpose up to $200 million a year from the $500 billion defense budget for the most urgent needs. Congress could help bolster the Pentagon's quick-reaction capabilities by expanding the scope of allowed acquisitions and increasing the funding available under this authority.

In urgent situations, the Pentagon will have to settle for an imperfect solution that nonetheless fills a gap.

In this era of tight resources, some in Congress have legitimate concerns about giving the Department of Defense more budgetary discretion. However, the amount needed for an effective flexible fund is a tiny fraction of the department's total budget—just enough to kick-start urgent initiatives while still taking the customary months to navigate the usual channels for the full funding of projects. The Pentagon's successful management of previous flexible funds demonstrates its ability to responsibly manage this flexibility.

Even with flexible funds and the right structures in place, the Pentagon also needs to get better at identifying threats as early as possible. This does not mean war-gaming for five to ten years down the line—something the department currently does in its Quadrennial Defense Reviews. Rather, it means determining what troops in the field need at any given moment. Staff at the command or headquarters level are often slow to recognize when a new threat becomes truly dangerous. During a war, the Pentagon must continuously scan the tactical environment and analyze how new dynamics impact the campaign. Initiatives such as the Warfighter SIG create a real-time bridge between ground-level troops and the department's senior leadership, allowing battlefield challenges to be quickly brought to the attention of the highest levels so that they can execute solutions accordingly. One example was the rapid processing of a Joint Urgent Operational Need to design and deploy a new type of body armor, based on insights from the ground, to correct for a battlefield vulnerability before insurgents were even aware of it. Another was the constant adjustment of MRAPs in response to feedback from troops. No detail, even the positioning of windows, was too small for the Warfighter SIG.

Moreover, the Pentagon must always have a watchful eye on the horizon, anticipating needs and gaps in capabilities before they become dire. These findings should drive rapid research and development, particularly experimentation with new or improved technologies and the building of prototypes. Investing in science and technology early on ensures that the Pentagon will have something on the shelf when it needs it, so that it does not have to start from scratch when it is too late. Technology that the Pentagon has already invested in has allowed it to respond rapidly through the Joint Emergent Operational Needs process to potential new threats in the Middle East and Asia. These technologies include improvements to weapons systems that allow them to operate in an electronically jammed environment, modified radars to improve detection and warning capabilities, and better methods of preventing electronic detection by enemies. Similarly, the department was able to quickly initiate the development of improvements to the Patriot missile defense system to keep pace with emerging threats in the Asia-Pacific region.

Once the Pentagon identifies emerging threats, its leaders need to approve responses to them, since those in the thick of combat cannot be expected to have all the insight needed to judge and prioritize requests. Time is of the essence at this stage; the need for the MRAP, for example, was identified by forces in the field soon after they started encountering roadside bombs, but leaders let the request linger for too long before acting on it. As soon as a need has been identified as urgent, the Pentagon must improve the way it assesses potential solutions. Normally, such evaluations require a series of time-consuming steps, such as conducting market surveys, hosting events at which the military can inform vendors of its needs, requesting bids, and conducting months-long selection processes. In normal times, this system allows the Pentagon to acquire the best technologies on the market at the best prices. In urgent situations, it will have to settle for something that is good enough—an imperfect solution that nonetheless fills a gap.

KEEPING UP WITH A CHANGING BATTLEFIELD

Afghanistan and Iraq provided much of the impetus for the Pentagon to sidestep its traditional ways of doing business. After all, it is difficult for anyone in Washington to deny funding or prevent initiatives when the men and women at war need them. But what happens when the last troops have left Afghanistan, and the slowness of the acquisition process no longer appears to be a life-and-death problem? Simply learning the lessons of the wars is not enough; the Pentagon must institutionalize those lessons so that it does not have to start anew the next time they are relevant. In fact, many of these changes need to happen immediately, as the country faces potential new threats.

In my final year at the Pentagon, under the leadership of Leon Panetta and then Chuck Hagel, we considered various models for how to build on the successful initiatives of the past decade. The first possibility we considered was to tweak, but largely leave in place, the way the Pentagon operated before the wars in Afghanistan and Iraq, with the military services remaining solely responsible for their own forces. That approach would allow the Pentagon to avoid creating any new permanent organizations, a significant plus during a time of austerity. Distributing responsibility across the services would also enable each of them to draw on their deep knowledge of land, air, and naval warfare. The downside is that the military services tend to prioritize investments in their own long-term modernization requirements—unlike the combatant commands, which are primarily concerned with immediate battlefield needs—and thus may not be best equipped to move quickly and take risks. Under this plan, there would still not be a clear mechanism for adjudicating conflicts between the services and the combatant commands. Spreading the responsibility for acquisitions across the military could also result in redundancies or gaps.

An alternative model would be to create an entirely new agency with rapid-acquisition and contracting authorities. Such a body would directly support the combatant commands by anticipating battlefield needs, determining the appropriate responses, and procuring the necessary technology and equipment. Although this approach would correct for many of the shortfalls of the first model, creating a brand new organization, with its own bureaucracy and overhead costs, would strain the Pentagon in an era of tight budgets. A new centralized agency might also find itself disconnected from the rich expertise of the military services.

We ultimately decided to pursue a hybrid approach that draws on the advantages of both models. The Warfighter SIG will continue to meet regularly, supported by JRAC, to ensure that the Pentagon's senior leadership remains focused on responding quickly to battlefield needs. JIEDDO and the ISR Task Force will get smaller but will be retained to meet the Pentagon's enduring requirement for fulfilling urgent needs. The comptroller's office is also working to institutionalize funding mechanisms for both Joint Urgent Operational Needs and Joint Emergent Operational Needs. These mechanisms should allow department leaders to quickly reprogram funds and make use of the rapid-acquisition authority.

By making these structures more permanent, the Pentagon hopes to retain the ability to meet the urgent needs of the troops long after the end of operations in Afghanistan. It is already using the Joint Emergent Operational Needs process to upgrade munitions and targeting systems for operations over water, in order to respond to the potential use of speedboats by Iran to swarm U.S. naval vessels in the Persian Gulf. The military has also developed and built prototypes for improvements to a penetrating bomb that would allow it to target hardened, deeply buried facilities. And last year, the Department of Defense decided to build the Field Deployable Hydrolysis System, a transportable system that can destroy chemical weapons stockpiles wherever they are found. This system was developed as part of the Joint Emergent Operational Needs process months before the United States knew it would be discussing the destruction of Syria's chemical weapons. It is now ready for deployment whenever required—a capability that enabled the U.S. government to include this possibility in its recent UN negotiations.

Institutionalizing these practices will also allow them to be applied beyond Central Command, which has overseen most of the fighting during the past decade—a particularly relevant factor as the Obama administration continues its "rebalance" to the Asia-Pacific region and focuses more on threats from other parts of the world, such as Africa. For example, JIEDDO has already begun to support missions of U.S. Africa Command, and its expertise will help combat IED threats in such countries as Mali and Somalia.

When wars end, leaders are often eager to move on to the next challenge. That is why it is crucial to make permanent the institutional innovations resulting from the hard-earned lessons of Afghanistan and Iraq, while the experiences are still fresh. Too many lives were lost in the early years of those wars because the Pentagon failed to keep up with a changing battlefield. Never again should it make the same mistake.

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The Rise and Fall of the Failed-State Paradigm

Requiem for a Decade of Distraction

Michael J. Mazarr

For a decade and a half, from the mid-1990s through about 2010, the dominant national security narrative in the United States stressed the dangers posed by weak or failing states. These were seen to breed terrorism, regional chaos, crime, disease, and environmental catastrophe. To deal with such problems at their roots, the argument ran, the United States had to reach out and help stabilize the countries in question, engaging in state building on a neo-imperial scale. And reach out the United States did—most obviously during the protracted campaigns in Afghanistan and Iraq.

After a decade of conflict and effort with precious little to show for it, however, the recent era of interventionist U.S. state building is drawing to a close. And although there are practical reasons for this shift—the United States can no longer afford such missions, and the public has tired of them—the decline of the state-building narrative reflects a more profound underlying truth: the obsession with weak states was always more of a mania than a sound strategic doctrine. Its passing will not leave the United States more isolationist and vulnerable but rather free the country to focus on its more important global roles.

THE BIRTH OF A PARADIGM

In the wake of the Cold War, contemplating a largely benign security environment, many U.S. national security strategists and practitioners concluded that the most important risks were posed by the fragility of state structures and recommended profound shifts in U.S. foreign and defense policy as a result. In an interconnected world, they argued, chaos, violence, and grievances anywhere had the potential to affect

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U.S. interests, and weak states were factories of such volatility. Experiences in Somalia, Haiti, and the former Yugoslavia helped fuel the concern, and by 1994, the CIA was funding a state-failure task force to get a handle on the problem.

In 1997, the Clinton administration released Presidential Decision Directive 56, "Managing Complex Contingency Operations," which began with the assertion that "in the wake of the Cold War, attention has focused on a rising number of territorial disputes, armed ethnic conflicts, and civil wars that pose threats to regional and international peace." A new focus of U.S. policy, accordingly, would be responding to such situations with "multi-dimensional operations composed of such components as political/diplomatic, humanitarian, intelligence, economic development, and security."

Critics of a realist persuasion objected to the emerging narrative, arguing that the Clinton administration's forays into state building in peripheral areas represented a strategic folly. And during his 2000 presidential campaign, George W. Bush ran as the candidate of foreign policy humility, arguing in part that nation building was a dangerous distraction. His adviser Condoleezza Rice grumbled that U.S. troops should not be asked to escort toddlers to school; his vice presidential candidate, Dick Cheney, suggested that a Bush administration would end U.S. participation in Balkan operations; and the day before the election, Bush himself declared, "Let me tell you what else I'm worried about: I'm worried about an opponent who uses 'nation building' and 'the military' in the same sentence."

But the 9/11 attacks swept these hesitations aside, as the practical implications of an interventionist "war on terror" became apparent. The first page of the Bush administration's 2002 National Security Strategy argued that "America is now threatened less by conquering states than we are by failing ones. We are menaced less by fleets and armies than by catastrophic technologies in the hands of the embittered few."

The new consensus was bipartisan. The Democratic foreign policy hand Susan Rice, for example, wrote in 2003 that Bush was "wise to draw attention to the significant threats to our national security posed by failed and failing states." Where the right emphasized security and terrorism, the left added humanitarian concerns. Development specialists jumped on the bandwagon as well, thanks to new studies that highlighted the importance of institutions and good governance as requirements for sustained economic success. In his 2004 book, *State-Building*, the political scientist Francis Fukuyama wrote, "Weak and failing states have arguably become the single most important problem for international order." *The Washington Post* editorialized the same year that "weak states can compromise security—most obviously by providing havens for terrorists but also by incubating organized crime, spurring waves of migrants, and undermining global efforts to control environmental threats and disease." This argument, the paper concluded, "is no longer much contested." A year later, the State Department's director of policy planning, Stephen Krasner, and its newly minted coordinator for reconstruction and stabilization, Carlos Pascual, argued in these pages that "in today's increasingly interconnected world, weak and failed states pose an acute risk to U.S. and global security. Indeed, they present one of the most important foreign policy challenges of the contemporary era."

From one angle, the concern with weak states could be seen as a response to actual conditions on the ground. Problems had always festered in disordered parts of the developing world. Without great-power conflict as an urgent national security priority, those problems were more clearly visible and harder to ignore. From another angle, it could be seen as a classic meme—a concept or intellectual fad riding to prominence through social diffusion, articles by prominent thinkers, a flurry of attention from the mainstream press, and a series of foundation grants, think-tank projects, roundtables, and conferences.

From a third angle, however, it could be seen as a solution to an unusual concern confronting U.S. policymakers in this era: what to do with a surplus of national power. The United States entered the 1990s with a dominant international position and no immediate threats. Embracing a substantially reduced U.S. global role would have required a fundamental reassessment of the prevailing consensus in favor of continued primacy, something few in or around the U.S. national security establishment were prepared to consider. Instead, therefore, whether consciously or not, that establishment generated a new rationale for global engagement, one involving the application of power and influence to issues that at any other time would have been seen as secondary or tertiary. Without a near-peer competitor (or several) to deter or a major war on the horizon, Washington found a new foreign policy calling: renovating weak or failing states.

THE DECLINE OF A STRATEGIC NARRATIVE

The practical challenges of state-building missions are now widely appreciated. They tend to be long, difficult, and expensive, with success demanding an open-ended commitment to a messy, violent, and confusing endeavor—something unlikely to be sustained in an era of budgetary austerity. But the last decade has driven home intellectual challenges to the concept as well.

The threat posed by weak and fragile states, for example, turned out to be both less urgent and more complex and diffuse than was originally suggested. *Foreign Policy*'s Failed States Index for 2013 is not exactly a roster of national security priorities; of its top 20 weak states, very few (Afghanistan, Iraq, and Pakistan) boast geostrategic significance, and they do so mostly because of their connection to terrorism. But even the threat of terrorism isn't highly correlated with the current roster of weak states; only one of the top 20, Sudan, appears on the State Department's list of state sponsors of terrorism, and most other weak states have only a marginal connection to terrorism at best.

A lack of definitional rigor posed a second problem. There has never been a coherent set of factors that define failed states: As the political scientist Charles Call argued in a powerful 2008 corrective, the concept resulted in the "agglomeration of diverse criteria" that worked to "throw a monolithic cloak over disparate problems that require tailored solutions." This basic methodological flaw would distort state-building missions for years, as outside powers forced generic, universal solutions onto very distinct contexts.

The specified dangers were never unique to weak states, moreover, nor would state-building campaigns necessarily have mitigated them. Take terrorism. The most effective terrorists tend to be products of the middle class, often from nations such as Saudi Arabia, Germany, and the United Kingdom, not impoverished citizens of failed states. And terrorist groups operating in weak states can shift their bases of operations: if Afghanistan becomes too risky, they can uproot themselves and move to Somalia, Yemen, or even Europe. As a result, "stabilizing" three or four sources of extremist violence would not render the United States secure. The same could be said of threats such as organized crime, which finds comfortable homes in functioning but troubled states in Asia, eastern Europe, and Latin America.

As the scholar Stewart Patrick noted in a 2006 examination of the purported threats issuing from weak states, "What is striking is how little empirical evidence underpins these assertions and policy developments. Analysts and policymakers alike have simply presumed the existence of a blanket connection between state weakness and threats

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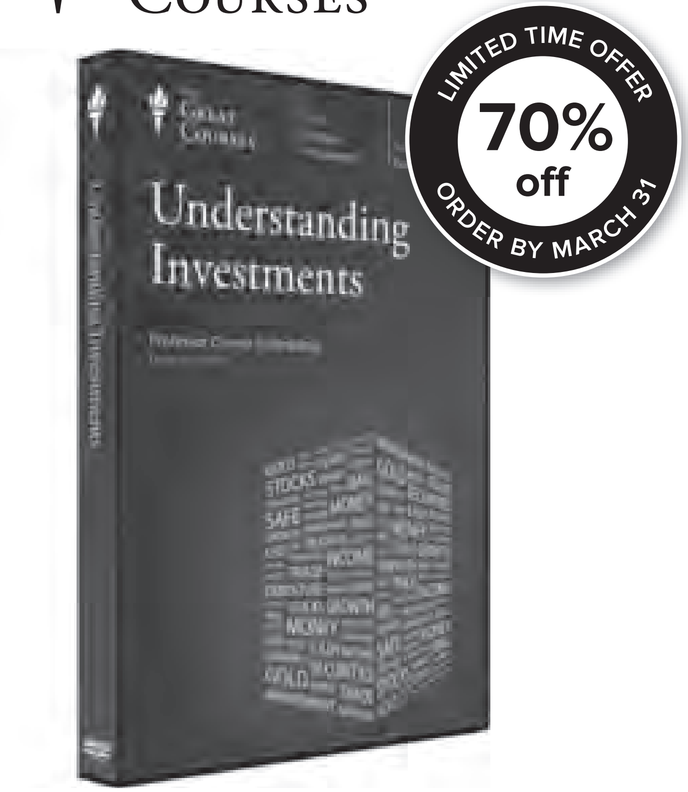

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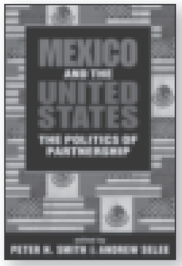

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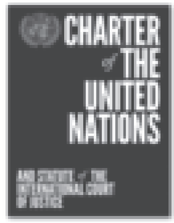

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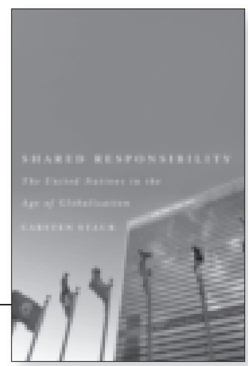

Shared Responsibility
The United Nations in the Age of Globalization
CARSTEN STAUR

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to the national security of developed countries and have begun to recommend and implement policy responses."

And although interconnectedness and interdependence may create risks, the dangers in such a world are more likely to come from strong, well-governed states with imperfect regulations than weak ones with governance deficiencies. Financial volatility that can shake the foundations of leading nations and cyberattacks that could destabilize energy or information networks pose more immediate and persistent risks than, say, terrorism.

A third problem was misplaced confidence about the possibility of the mission's feasibility. The last decade has offered an extended, tragic reminder of the fact that forcible state building simply cannot be accomplished by outsiders in any sustainable or authentic way. When a social order has become maladapted to the globalizing world—when governing institutions are weak, personalized, or kleptocratic; corruption is rampant; and the rule of law is noticeable by its absence—there are simply no proven methods for generating major social, political, economic, or cultural change relatively quickly.

As the Australian political scientist Michael Wesley argued in a brilliant 2008 essay, state weakness is primarily a political problem, and yet state building is often conceived and executed as if it were an apolitical exercise. "The intention of remaining aloof from politics while concentrating on technocratic reforms has proved unrealistic," he wrote. "Even seemingly technocratic tasks confront international administrators with essentially political decisions: the nature and basis of elections; which pressure groups to consult; the reintegration or de facto separation of ethnic communities; school curricula; degrees of public ownership of enterprises; the status of women; and so on. However technocratic their intention, state-building missions inevitably find themselves factored into local rivalries."

In trying to force change on recalcitrant governments and societies, moreover, outside interventions undermine internal motives for reform by transferring responsibility for a better future from local leaders to external actors. The outside power needs cooperation from its local clients more than they need its sponsorship. The result is a dependency paradox that impedes reform. As success stories from South Korea to Chile show, the path from state weakness to strength has to be traveled by the states themselves, gradually and fitfully, most often under the influence of strong, decisive leadership from visionary architects of governance. It is an organic, grass-roots process that must respect the unique social, cultural, economic, political, and religious contexts of each country. And although it can be encouraged and even modestly shaped by outside contributions and pressure, it cannot be imposed.

A fourth problem with the state-building obsession was that it distorted the United States' sense of its central purpose and role in global politics. Ever since World War II, the United States has labored mightily to underwrite the stability of the international system. It has done this by assembling military alliances to protect its friends and deter its enemies, by helping construct a global architecture of trade and finance, and by policing the global commons. These actions have helped buttress an interdependent system of states that see their dominant interests in stability rather than conquest.

Playing this role well demands sustained attention at all levels of government, in part to nurture the relationships essential to crisis management, diplomacy, and multilateral cooperation of all kinds. Indeed, the leading danger in the international system today is the peril that, assaulted by a dozen causes of rivalry and mistrust, the system will fragment into geopolitical chaos. The U.S. experience since the 1990s, and growing evidence from Northeast Asia, suggests that if the relatively stable post–Cold War era devolves into interstate rivalry, it will be not the result of weak states but that of the escalating regional ambitions, bitter historical memories, and flourishing nationalisms of increasingly competitive states. The U.S. role in counteracting the broader trends of systemic disintegration is therefore critical. The United States is the linchpin of a number of key alliances and networks; it provides the leadership and attractive force for many global diplomatic endeavors, and its dominant military position helps rule out thoughts of aggression in many quarters.

The weak-state obsession has drawn attention away from such pursuits and made a resurgence of traditional threats more likely. Focusing on two seemingly endless wars and half a dozen other potential "stability operations" has eroded U.S. global engagement, diminished U.S. diplomatic creativity, and distracted U.S. officials from responding appropriately to changes in the global landscape.

When one reads the memoirs of Bush administration officials, the dozen or more leading global issues beyond Afghanistan, Iraq, and the "war on terror" begin to sound like background noise. Top U.S. officials appear to have spent far more time between 2003 and 2011, for example, managing the fractious mess of Iraqi politics than tending to relationships with key global powers. As a consequence, senior U.S. officials have had less time to cultivate the leaders of rising regional powers, from Brazil to India to Turkey. Sometimes, U.S. actions or demands in state-building adventures have directly undermined other important relationships or diplomatic initiatives, as when Washington faced the global political reaction to the Iraq war.

Such tradeoffs reflect a hallmark of the era of state building: secondary issues became dominant ones. To be fair, this was partly the fault of globalization; around-the-clock media coverage now constantly shoves problems a world away onto the daily agendas of national leaders. Combined with the United States' self-image as the indispensable nation, this intrusive awareness created political pressure to act on issues of limited significance to core U.S. interests. Yet this is precisely the problem: U.S. perceptions of global threats and of the country's responsibility to address them have become badly and perhaps permanently skewed. A great power's reservoir of strategic attention is not infinite. And the United States has become geopolitically hobbled, seemingly uninterested in grand strategic initiatives or transformative diplomacy, as its attention constantly dances from one crisis to another.

A fifth problem flowed directly from the fourth. To perform its global stabilizing role, the United States needs appropriately designed, trained, and equipped armed forces—forces that can provide a global presence, prevail in high-end conflict contingencies, enable quick long-range strike and interdiction capabilities, and build and support local partners' capacities. The state-building mission has skewed the operations, training, equipping, and self-conception of the U.S. military in ways that detract from these responsibilities.

Much of the U.S. military has spent a decade focusing on state building and counterinsurgency (COIN), especially in its training and doctrine, to the partial neglect of more traditional tasks. Massive investments have gone into COIN-related equipment, such as the MRAP (mine-resistant, ambush-protected) vehicles built to protect U.S. troops from improvised explosive devices, draining billions of dollars from other national security resources. The result of these choices has been to weaken the U.S. military's ability to play more geostrategic and, ultimately, more important roles. Between a demanding operational tempo, the requirements of refitting between deployments, and a shift in training to emphasize COIN, the U.S. military, especially its ground forces, lost much of its proficiency in full-spectrum combat operations. Simply put, the U.S. military would be far better positioned today—better aligned with the most important roles for U.S. power, better trained for its traditional missions, better equipped for an emerging period of austerity—had the state-building diversion never occurred.

AN ALTERNATIVE MODEL

None of this is meant to suggest that a concern for the problems posed by weak or failing states can or should disappear entirely from the U.S. foreign policy and national security agendas. Counterterrorism and its associated tasks will surely remain important, and across the greater Middle East—including Afghanistan after 2014—internal turmoil may well have external consequences requiring some response from Washington. Effective local institutions do contribute to stability and growth, and the United States should do what it can to nurture them where possible. The difference is likely to be in the priority Washington accords such efforts. The January 2012 Defense Strategic Guidance, for example, reflected the judgment that "U.S. forces will no longer be sized to conduct large-scale, prolonged stability operations" and announced an intention to pursue "innovative, low-cost, and small-footprint approaches" to achieving objectives. Recently, the vice chairman of the Joint Chiefs of Staff, Admiral James "Sandy" Winnefeld, went even further: "I simply don't know where the security interests of our nation are threatened enough to cause us to lead a future major, extended COIN campaign."

In the future, the United States is likely to rely less on power projection and more on domestic preparedness, replacing an urgent civilizing zeal with defensive self-protection. This makes sense, because the most appropriate answer to the dangers inherent in an era of interdependence and turbulence is domestic resilience: hardened and redundant networks of information and energy, an emphasis on local or regional self-sufficiency to reduce the cascading effects of systemic shocks, improved domestic emergency-response and cybersecurity capacities, sufficient investments in pandemic response, and so forth. Equally important is a resilient mindset, one that treats perturbations as inevitable rather than calamitous and resists the urge to overreact. In this sense, the global reaction to the recent surge in piracy—partly a product of poor governance in African states—should be taken as a model: no state-building missions, but arming and protecting the ships at risk.

When it does reach out into the world to deal with weak states, the United States should rely on gradual progress through patient, long-term advisory and aid relationships, based on such activities as direct economic assistance tailored to local needs; training, exchanges, and other human-capacity-development programs; military-to-military ties; trade and investment policies; and more. The watchwords should be patience, gradualism, and tailored responses: enhancing effective governance through a variety of models attuned to local patterns and needs, in advisory and supportive ways.

As weak states continue to generate specific threats, such as terrorism, the United States has a range of more limited tools available to mitigate them. It can, for example, return terrorism to its proper place as a law enforcement task and continue to work closely with foreign law enforcement agencies. It can help train and develop such agencies, as well as local militaries, to lead in the fight. When necessary, it can employ targeted coercive instruments—classic intelligence work and clandestine operations, raids by special operations forces, and, with far greater selectivity than today, remote strikes—to deal with particular threats, ideally in concert with the militaries of local allies.

Some will contend that U.S. officials can never rule out expeditionary state building because events may force it back onto the agenda. If al Qaeda were to launch an attack that was planned in restored Taliban strongholds in a post-2014 Afghanistan, or if a fragmentation and radicalization of Pakistani society were to place nuclear control at risk, some would recommend a return to interventionist state building. Yet after the United States' recent experiences, it is doubtful that such a call would resonate.

The idea of a neo-imperial mission to strengthen weak states and stabilize chaotic societies always flew in the face of more important U.S. global roles and real mechanisms of social change. There is still work to be done in such contexts, but in more prudent and discriminate ways. Moving on from the civilizing mission will, in turn, make possible a more sustainable and effective national security strategy, allowing the United States to return its full attention to the roles and missions that mean far more to long-term peace and security. One of the benefits of this change, ironically, will be to allow local institutional development to proceed more organically and authentically, in its own ways and at its own pace. Most of all, the new mindset will reflect a simple facing up to reality after a decade of distraction.

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NAFTA's Economic Upsides

The View From the United States

Carla A. Hills

In the 20 years since it entered into force, the North American Free Trade Agreement has been both lauded and attacked in the United States. But to properly assess NAFTA's record, it is important to first be clear about what the agreement has actually done. Economically speaking, the answer is a lot. By uniting the economies of Canada, Mexico, and the United States, NAFTA created what is today a $19 trillion regional market with some 470 million consumers. The U.S. Chamber of Commerce figures that some six million U.S. jobs depend on trade with Mexico and another eight million on trade with Canada. NAFTA was the first comprehensive free-trade agreement to join developed and developing nations, and it achieved broader and deeper market openings than any trade agreement had before.

NAFTA did that by eliminating tariffs on all industrial goods, guaranteeing unrestricted agricultural trade between the United States and Mexico, opening up a broad range of service sectors, and instituting national treatment for cross-border service providers. It also set high standards of protection for patents, trademarks, copyrights, and trade secrets. To preserve the rights of investors, it prohibited barriers such as local-content and import-substitution rules, which require producers to ensure that specified inputs are produced domestically.

For the United States, the economic consequences of these reforms—which have also had social, political, and cultural impacts—have been dramatic. If North America is to remain a uniquely competitive region, however, it will need to build on NAFTA's success by opening markets beyond its borders.

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TRADE AND GROWTH

Nafta ignited an explosion in cross-border economic activity. Today, Canada ranks as the United States' largest single export market, and it sends 98 percent of its total energy exports to the United States, making Canada the United States' largest supplier of energy products and services. Mexico is the United States' second-largest single export market. Over the past two decades, a highly efficient and integrated supply chain has developed among the three North American economies. Intraregional trade flows have increased by roughly 400 percent, from around $290 billion in 1993 to over $1.1 trillion in 2012. Every day, nearly $2 billion in goods and services cross the United States' northern border and roughly $1 billion worth cross its southern border.

Today, thanks to nafta, North Americans not only sell more things to one another; they also make more things together. About half of U.S. trade with Canada and Mexico takes place between related companies, and the resulting specialization has boosted productivity in all three economies. For every dollar of goods that Canada and Mexico export to the United States, there are 25 cents' worth of U.S. inputs in the Canadian goods and 40 cents' worth in the Mexican goods. By way of comparison, there are four cents' worth of U.S. inputs in Chinese goods going to the American market and two cents' worth for Japanese goods.

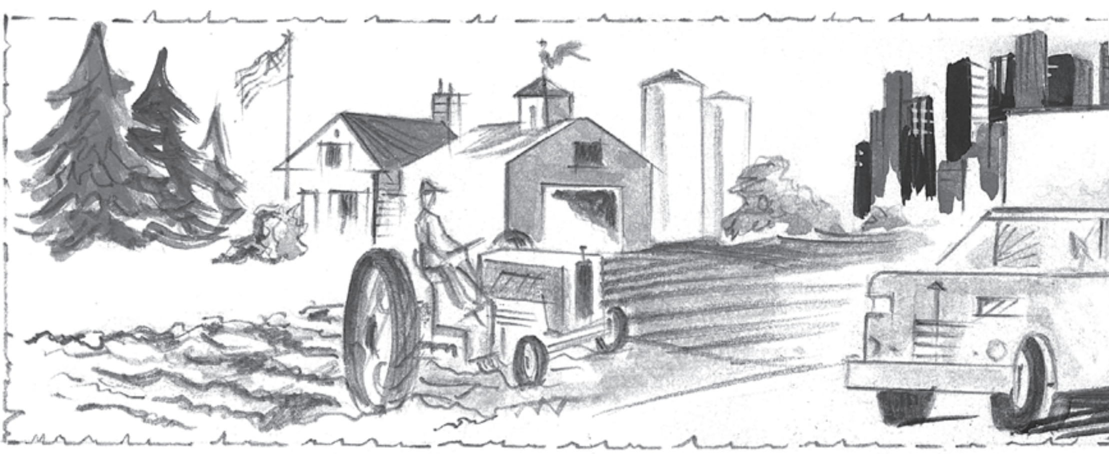
Nafta has also caused cross-border investment to soar. Since the treaty was signed, the United States, Canada's largest source of foreign capital, has invested more than $310 billion in Canada, and Canada, the United States' fifth-largest source of foreign capital, has invested over $200 billion in the United States. Mexico has also made major investments north of its border since nafta was signed, especially in the cement, bread, dairy, and retail sectors, thereby contributing to U.S. jobs and tax revenues. Similarly, U.S. investment in Mexico has grown substantially, with about half of it going to the manufacturing sector and much of that share flowing to the automotive industry. The United States derives a unique benefit from its investments in Canada and Mexico because a large percentage of that output returns home as imports of intermediate goods, which allows U.S. firms to focus on the higher-end task of assembling finished products.

The United States' expanded economic collaboration has created another economic benefit: a boom in intraregional travel by businesspeople, tourists, and students. According to the U.S. Department of

Commerce, in 2011, Americans made nearly 12 million trips to Canada and spent almost $8 billion there, and they made 20 million trips to Mexico (the top destination for U.S. tourists) and spent over $9 billion there. The United States' neighbors returned the favor, with Canadians making 21 million trips to the United States and spending $24 billion there and Mexicans making more than 13 million trips and spending almost $8 billion.

In spite of this impressive economic record, NAFTA has its critics. Most of those who attack it on economic grounds focus on Mexico, not Canada, and claim that the partnership is one-sided: that NAFTA is Mexico's gain and America's pain. But the economic data prove otherwise. Last year, roughly 14 percent of U.S. exports went to Mexico—more than went to Brazil, Russia, India, and China combined. Indeed, Mexico buys more U.S. goods than the rest of Latin America combined, and more than France, Germany, the Netherlands, and the United Kingdom combined. Although economists still debate whether NAFTA has caused a net gain or a net loss in U.S. jobs, they agree that the market openings it created have generated more export-related jobs in the United States, which pay an average of 15 to 20 percent more than those focused purely on domestic production.

With 116 million consumers who have a combined purchasing power of more than $1 trillion, Mexico represents a major market opportunity for U.S. entrepreneurs large and small. But small U.S. enterprises, lacking the global reach of major corporations, benefit in particular from Mexico's proximity and openness. Mexicans purchase about 11 percent of the exports of small and medium-size U.S. companies, which account for more than half of all job creation in the United States. Even Mexican exports worldwide benefit the U.S. economy, because of their high percentage of U.S. content.



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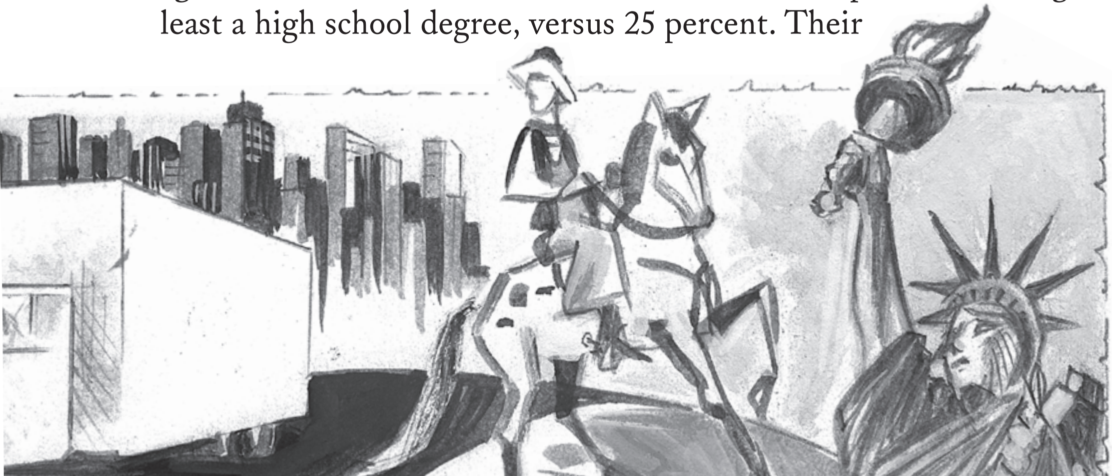
And making the picture even brighter, for every dollar that Mexico earns from its exports, it spends 50 cents on U.S. goods.

MOVING NORTH AND SOUTH

Another of NAFTA's positive effects has been the increased sharing of talent. Today, Canadians constitute about three percent of the United States' total foreign-born population, and Mexicans constitute about 30 percent. Americans make up about four percent of Canada's foreign-born population and roughly 70 percent of Mexico's. The Canadians and Mexicans who live in the United States are younger than the overall U.S. population. And according to a study conducted by the Kauffman Foundation, immigrants in the United States are almost twice as likely to start a new business as native-born Americans.

Complaints about U.S. immigration policy focus primarily on concerns about Mexico. What are the facts? According to the Pew Hispanic Center, 34 million Hispanics of Mexican origin live in the United States, roughly two-thirds of whom were born there. Of those born in Mexico, the majority arrived in the United States after 1990, encouraged by the growth of cross-border travel, trade, investment, and business collaboration that NAFTA stimulated. About half of them reside in the United States legally. In recent years, however, as the Mexican economy has expanded and created more jobs, both illegal and legal immigration from Mexico to the United States has plummeted. Compared with 1990, today, as a result of higher-than-average birthrates, the number of U.S.-born people of Mexican origin has more than doubled. Also, compared with their predecessors from that year, today's Mexican immigrants tend to be older, with an average age of 38, versus 29, and better educated, with 41 percent holding at least a high school degree, versus 25 percent. Their



numbers have had a cultural impact, too. Holidays such as Cinco de Mayo are widely celebrated across America. As a nation of immigrants, the United States celebrates its cultural diversity.

In addition to contributing youth, talent, and cultural diversity, these immigrants are having an impact on politics. In the 2012 presidential election, Hispanic voters composed ten percent of the electorate, up from eight percent in 2004. They lean Democratic and tend to hold more liberal views on immigration policy. An exit poll conducted during the 2012 election asked voters what should happen to unauthorized immigrants working in the United States, and 77 percent of Hispanic respondents, compared with 65 percent overall, said that these immigrants should be given a chance to apply for legal status.

Hispanics' growing numbers have contributed to a shift in the balance of political power in some battleground states. In 2012, President Barack Obama carried 75 percent of the Hispanic vote in Colorado and 70 percent in Nevada, winning both states. As Hispanics' share of the U.S. population increases, their political voice should only grow stronger. Increasingly, they are joining politically interested civic groups; the United States now has 2.3 million Hispanic business owners and 1.2 million Hispanic military veterans.

BEYOND NAFTA

The economic, political, and social integration that has taken place in North America since NAFTA went into effect has made the region one of the most competitive on the planet. But the rest of the world has not stood still. Supply chains encircle the globe, and bilateral and regional trade agreements to which the United States is not a party are giving other countries preferential access to key markets.

To ensure that the U.S. economy continues to grow and remain competitive, the United States needs to keep North America's supply chains working at maximum efficiency and global markets open to North American products, services, investment, and ideas. There are a number of actions the United States could take, building on the NAFTA platform, to create new commercial opportunities. For example, when the U.S. government evaluates a potential trade arrangement, it should assess the benefits not only on a national basis but also on a regional basis. In that regard, it was encouraging to see Canada and Mexico join the negotiations of the Trans-Pacific

Partnership, a proposed free-trade agreement among 12 countries in Asia and the Americas.

Similarly, as the United States negotiates the Transatlantic Trade and Investment Partnership with the 28 countries that compose the EU, it would benefit immensely by including Canada and Mexico, which would add 150 million consumers and $3 trillion in GDP, making an even stronger agreement. Doing so would reduce needless complexity, too, since Mexico has had a free-trade agreement with the EU since 2000 and Canada just concluded one in October 2013. For entrepreneurs on both sides of the Atlantic, having to deal with three separate agreements with different rules of origin and different customs measures would add unnecessary costs and regulatory headaches. It would also erode the hugely beneficial economic integration North America has achieved thanks to NAFTA. A single agreement among the three countries of North America and the EU would bring badly needed regulatory coherence to more than half of the world's trading volume.

In addition, having all three North American governments participate in the negotiations would give them an opportunity to upgrade the provisions of NAFTA that were not especially relevant 20 years ago, such as those dealing with digital data flows. Finally, such a deal could facilitate the economic reforms of Mexican President Enrique Peña Nieto, who is seeking to open up Mexico's energy sector to foreign investment. Pointing to the benefits that Mexico could obtain from a mega-agreement that involved half of global GDP could help Peña Nieto build political support for his energy reforms, which the United States strongly supports.

In just 20 years, NAFTA has succeeded in spurring an enormous amount of economic activity throughout Canada, the United States, and Mexico. But in order to maximize future growth, North American universities, think tanks, and business organizations will need to better educate the public about the tremendous gains that can come from increased regional economic integration. Given how closely NAFTA has drawn the nations of North America together—not just economically but also politically, culturally, and socially—this is a goal they can and should strive to achieve.

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NAFTA's Unfinished Business

The View From Canada

Michael Wilson

In 1992, when Canadian Prime Minister Brian Mulroney sat down with Mexican President Carlos Salinas and U.S. President George H. W. Bush to sign the North American Free Trade Agreement, free trade was still a matter of fierce national debate in Canadian politics. NAFTA was meant to build on the U.S.-Canadian free-trade agreement that Mulroney had signed at the beginning of 1988, and his support for that deal had cost his party 34 parliamentary seats in federal elections later that year, which had focused almost exclusively on the issue.

Today, however, the debate in Canada over the merits of free trade is settled. Few dispute that NAFTA has produced large and measurable gains for Canadian consumers, workers, and businesses. In 1993, trade within North America amounted to around $290 billion; by 2012, that number had skyrocketed to over $1.1 trillion—a nearly fourfold increase. Over the same period, U.S. and Mexican investment in Canada tripled. Canada has created 4.7 million net new jobs since 1993, and the North American economy has more than doubled, with a combined GDP increasing from $8 trillion in 1993 to $19 trillion in 2012. Perhaps more important, NAFTA produced a sea change in how Canadians think about their role in the global economy: no longer wary of U.S. dominance, they have grown confident that they can compete against the best.

Judged solely in terms of liberalizing trade, NAFTA has succeeded. But those of us who championed NAFTA hoped the agreement would be something more: a means to deepen integration among the three economies. Unfortunately, when measured against this more ambitious

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benchmark, NAFTA has fallen well short of expectations. The good news is that it's not too late to play catch-up. But to do so, policymakers in Canada, the United States, and Mexico must start working together now to tear down more fully the barriers that still stand in the way of complete economic integration.

BORDER BARRIERS

NAFTA did make some progress in integrating the continent's economies, and Canadian, U.S., and Mexican companies quickly began collaborating more on joint production. The automotive sector is the most frequently cited example of this phenomenon—car parts now cross national borders multiple times during the assembly process—but it applies equally to other important sectors, such as beef, with animals raised in one country and slaughtered in another. "Made in North America" may not appear on any labels, but it reflects the true origin of many continental exports.

That said, the reality is that two decades after NAFTA came into force, efforts to advance the cause of North American economic integration have stalled. One reason for the lack of progress lies in the deep-seated skepticism of free trade prevalent among average Americans, which U.S. policymakers have never been able to overcome. Canadians, on the other hand, are more supportive of open trade with the United States, which they credit with boosting the Canadian economy. The negative impacts so feared in the 1988 elections—the end of Canada's social programs and, more broadly, its way of life—simply never materialized.

The 9/11 attacks also played a role in setting back economic integration. Both Canada and the United States understandably tightened their border security in response, but the new restrictions profoundly reduced the relative ease of movement between the two countries. Consider one data point: same-day crossings from the United States to Canada fell from 25.3 million in 2001 to less than 7.7 million in 2012, the lowest number since record keeping began in the 1970s. Indeed, in most years since 9/11, the U.S.-Canadian border has posted double-digit declines in same-day traffic originating from the United States.

Today, there seems to be little hope of advancing North American economic integration through trade policy. Progress would require overcoming the hefty political baggage associated with NAFTA in the United States. It would also run headlong into strong support in Congress for "Buy American" provisions, as well as misguided suspicions that more liberalized rules for the temporary entry of businesspeople would open a backdoor to immigration reform.

Moreover, efforts at further economic integration would require a change in the orientation of the Office of the U.S. Trade Representative. Whether hemmed in by the realities of U.S. politics or simply reflecting a mercantilist mindset, that office has long shown little interest in taking a joint approach to trade policy with Canada and Mexico. The talks over the proposed Trans-Pacific Partnership exemplify this phenomenon, with Washington negotiating tariff reductions bilaterally with each participant, including Canada and Mexico, for fear that others will free-ride off its negotiating leverage.

ONE CONTINENT, ONE ECONOMY

Even though trade policy stands on rocky ground, there are other, more fertile soils in which the seeds of greater continental cooperation can be planted. The first concerns the border. In early 2011, Canada and the United States embarked on an intensive effort to rethink the way they manage their 5,500-mile boundary and created a steering committee of officials from the Canadian Cabinet Office and the White House to oversee it. As a result, Ottawa and Washington are now implementing a detailed action plan to deal with threats at the ports of first arrival and even overseas, before they reach the U.S.-Canadian border.

The plan calls for increased intelligence sharing and a unified approach to screening cargo, under the principle of "cleared once, accepted twice." Already, both countries have harmonized the inspection of air passenger baggage and air cargo, and they have taken steps toward mutually recognizing each other's "trusted trader" programs, which reduce hassle at the border for businesses that meet certain security standards.

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So far, however, it remains unclear whether the plan's ambition will be matched by its execution. The real test will be whether the plan's various pilot projects, which have been experimenting with new ways to speed up border clearance for various industries, are ever brought up to scale. The United States has embarked on a similar border-streamlining effort with Mexico, suggesting that a longer-term objective might be "cleared once, accepted thrice." As a first step, the three governments should consider developing a joint "trusted traveler" program involving common screening criteria and information sharing.

Another way to stimulate North American economic growth involves regulatory reform. Echoing their efforts to streamline border crossings, Canada, the United States, and Mexico have established "cooperation councils" to unify their regulations. In support of that work, U.S. President Barack Obama issued an executive order in 2012 mandating that U.S. government agencies identify and eliminate unnecessary regulatory differences with U.S. trading partners. Over the past three years, the U.S.-Canada Regulatory Cooperation Council, led by top officials in both countries, has identified ways to align rules for several industries, including the agricultural, transportation, and health-care product sectors.

The hope is that these efforts will overcome the so-called tyranny of small differences between the two countries' regulatory regimes, which drive up costs for businesses. In December 2012, for example, Health Canada and the U.S. Food and Drug Administration announced that they had completed their first joint review of a veterinary drug, part of a new process for simultaneous approval of such pharmaceuticals. But there is room for expansion: the U.S.-Canadian and U.S.-Mexican cooperation councils should meet

regularly to share best practices and identify new areas for joint work, an approach that business leaders from across the continent endorsed in a 2013 open letter to the three heads of state.

ROOM FOR IMPROVEMENT

Policymakers should also seize opportunities for greater cooperation on energy security and climate change. Even as the Keystone XL pipeline project remains the subject of intense debate, vast pipeline and transmission networks are already sending energy south. Today, Canada exports more oil to the United States than does any other country: at least 2.3 million barrels a day, or 99 percent of Canadian crude oil exports. That oil makes a vital contribution to U.S. energy security and will do so for the foreseeable future, even after taking into account the rapid growth in U.S. domestic production caused by the shale oil boom.

In recognition of this reality, in 2009, Obama and Canadian Prime Minister Stephen Harper established a "clean energy dialogue," which so far has focused on energy efficiency, carbon capture and storage, the electricity grid, and clean energy research and development. Mexico, for its part, is pushing ahead with a major reform of its energy sector, which may open the market to foreign firms for the first time in decades. If it is carried out, this reform should attract new investment and technology to develop offshore and shale deposits, augmenting production and enhancing North America's energy security.

To improve on these efforts, all three countries can and should work together to responsibly develop unconventional resources, build and maintain energy infrastructure, and promote higher energy-efficiency standards. Although the global economic recession has pushed climate change lower down on the world's agenda, this is likely to be a temporary phenomenon, and North American governments share much common ground on the issue. Canada and the United States have long cooperated on transborder air-quality issues, such as ozone pollution, and all three countries are already members of the UN's Climate and Clean Air Coalition, which aims to reduce short-lived climate pollutants.

Preparing for pandemic disease is another area ripe for trilateral engagement. In 2005, spurred by concerns about the emergence of a new avian flu, the leaders of Canada, the United States, and Mexico agreed to develop a plan for fighting it. Updated in 2012, the plan outlined a continental framework for detecting, monitoring, and controlling influenza outbreaks, without unnecessarily restricting the movement of people, animals, or goods. Senior officials in all three countries have backed its implementation, and the three countries are now examining closely a range of actions, covering governance, communications, training, surveillance, and border measures, to contain outbreaks and limit their economic damage, particularly disruptions to travel.

Finally, the three countries should make common cause on security. Canada and the United States have enjoyed a long history of military cooperation, especially through the jointly staffed North American Aerospace Defense Command, which was created during the Cold War. Ottawa and Washington also both worry about drug smuggling and human trafficking through Mexico, and they operate programs to train Mexico's police, improve its administration of justice, and prevent crime. Convening at the White House in April 2012, the three heads of state agreed to do more to fight transnational crime, and in March of that year, their defense ministers met in Ottawa to discuss ways to deepen security cooperation, with a follow-up meeting planned for this year in Mexico. In 2012, the three defense ministries developed the first continental threat assessment, and they are now planning joint disaster-response simulations.

As supply chains become increasingly globalized, the prospects for a comprehensive trade agreement under the Doha Round of the World Trade Organization fade even further, and as new competitors emerge in Asia and South America, the case for a more integrated North American economy has never been stronger. Twenty years after NAFTA entered into force, it will be up to a new generation of policymakers to make the case for North America. For now, the prospects for trilateral cooperation on trade look less hopeful, on account of U.S. reluctance, but policymakers have taken promising steps on other areas of cooperation. Further progress, however, will depend on leadership from the top. Given the scale of the potential benefits, the continent's leaders have every reason to provide it.

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NAFTA's Mixed Record

The View From Mexico

Jorge G. Castañeda

When the North American Free Trade Agreement was proposed, it set off a vigorous debate across the continent about its benefits and drawbacks. Today, 20 years after it came into effect, perhaps the only thing everyone can agree on is that all sides greatly exaggerated: NAFTA brought neither the huge gains its proponents promised nor the dramatic losses its adversaries warned of. Everything else is debatable. Mexico, in particular, is a very different place today—a multiparty democracy with a broad middle class and a competitive export economy—and its people are far better off than ever before, but finding the source of the vast changes that have swept the country is a challenging task. It would be overly simplistic to credit NAFTA for Mexico's many transformations, just as it would be to blame NAFTA for Mexico's many failings.

The truth lies somewhere in between. Viewed exclusively as a trade deal, NAFTA has been an undeniable success story for Mexico, ushering in a dramatic surge in exports. But if the purpose of the agreement was to spur economic growth, create jobs, boost productivity, lift wages, and discourage emigration, then the results have been less clear-cut.

PLUSES AND MINUSES

Without a doubt, NAFTA has drastically expanded Mexican trade. Although exports began increasing several years before the treaty was finalized, when President Miguel de la Madrid brought the country into the General Agreement on Tariffs and Trade (the predecessor of the World Trade Organization) in 1985, NAFTA accelerated the trend.

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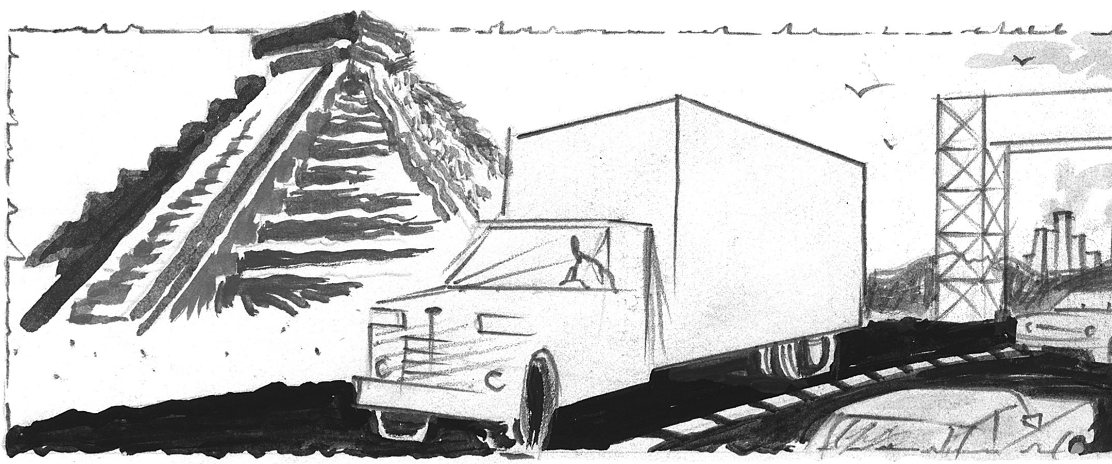
Mexico's exports leapt from about $60 billion in 1994 (the year NAFTA went into force) to nearly $400 billion in 2013. Manufactured goods, such as cars, cell phones, and refrigerators, compose a large share of these exports, and some of Mexico's largest firms are major players abroad. Moreover, the corollary of that export boom—an explosion of imports—has driven down the price of consumer goods, from shoes to televisions to beef. Thanks to this "Walmart effect," millions of Mexicans can now buy products that were once reserved for a middle class that was less than a third of the population, and those products are now of far superior quality. If Mexico has become a middle-class society, as many now argue, it is largely due to this transformation, especially considering that Mexicans' aggregate incomes have not risen much, in real terms, since NAFTA entered into force.

NAFTA also locked in the macroeconomic policies that have encouraged, or at least allowed, these gains for the Mexican consumer and the country. Although the Mexican government made undeniable economic policy mistakes in 1994 (when it froze the exchange rate and loosened credit), in 2001 (when it failed to pump-prime modestly), and again in 2009 (when it underestimated the magnitude of the contraction), over the long run, the authorities have kept in place sound public finances, low inflation, liberal trade policies, and a currency that has been unpegged and, since 1994, never overvalued.

This package has not been without its costs, but it has fostered a remarkable period of financial stability, bringing down interest rates and providing credit for myriad Mexicans. Over five million new homes—albeit often ugly, small, and far removed from workplaces—have been constructed and sold over the past 15 years, largely because families now have access to low, fixed-rate mortgages in pesos. Although no clause in NAFTA explicitly mandated orthodox economic management, the agreement ended up straitjacketing a government accustomed to overspending, overpromising, and underachieving. It prevented Mexico from returning to the old days of protectionism and large-scale nationalizations and caused the prices of tradable goods on both sides of the border to converge. As a result, NAFTA made Mexico's traditional gargantuan deficits no longer viable, since they were now generators of currency crises, as in late 1994.

NAFTA's political effects on Mexico are harder to assess. Many of those who disagreed with the deal, like me, opposed it because it looked like a last-minute propping up of the authoritarian political system, which had been devised in the late 1920s and was on its last legs in the mid-1990s. And indeed, to the dismay of those who believed that 1994 was the right time for Mexico to leave the Institutional Revolutionary Party (PRI) behind and move on to a full-fledged representative democracy, NAFTA did provide life support to what the writer Mario Vargas Llosa famously called "the perfect dictatorship," which otherwise might have succumbed to the democratic wave sweeping Latin America, eastern Europe, Africa, and Asia at the time. But many other Mexicans with equally valid democratic credentials consider NAFTA directly responsible for the PRI's loss of power in 2000. Without the trade deal, the logic goes, U.S. President Bill Clinton would never have agreed to the $50 billion U.S. bailout of Mexico in 1995, which some believe he made conditional on President Ernesto Zedillo's acceptance of free and fair elections five years later, regardless of who won.

Both cases are difficult to prove. Multiple crises befell Mexico in 1994: the Zapatista rebel uprising in the state of Chiapas broke out; the PRI's presidential candidate, Luis Donaldo Colosio, was assassinated; and the economy overheated, leading to a financial crisis in December of that year. Had NAFTA been rejected in late 1993, the PRI might well have lost the 1994 elections, since it would have suffered a tremendous setback and would have been unable to undertake the spending spree that ratification allowed. Conversely, one could argue that by committing any Mexican president to prudent economic policies and ever-closer relations with the United States, NAFTA helped speed the end of the PRI era by guaranteeing that no government could stray far from the policies that the Mexican business sector and Washington preferred. Politically, then, NAFTA either contributed to Mexico's democratic transition or postponed it



by six years; although the former assessment is understandable, the latter is more plausible.

Whatever the case, NAFTA helped open Mexicans' minds. Mexican society had begun a process of modernization well before the 1990s, but by increasing all types of cross-border exchanges, the treaty accelerated the shift toward an attitude that has stressed Mexico's victimization less and been less introspective and history-obsessed. Although the change has yet to cause a permanent retooling of Mexico's foreign policy, everyday Mexicans' views of the world, and of the United States in particular, have evolved thanks in large part to the trade agreement.

GROWING FLAT

Despite the real benefits NAFTA has wrought for Mexico, the economic growth so many of the treaty's advocates imagined would ensue has remained elusive. Since 1994, the nation has been governed by five presidents from two parties, and the world has lived through the longest expansion in modern U.S. economic history, the worst recession since the Great Depression, and a commodity boom fueled by insatiable Chinese and Indian demand. That period was long and eventful enough to cancel out any aberrations. During this time, Mexico experienced two years of major economic contraction (1995 and 2009), two years of zero growth (2001 and 2013), and four years of high performance (1997, 2000, 2006, and 2010). But the country has averaged only 2.6 percent annual GDP growth.

Meanwhile, Mexico's per capita income rose slowly during the past two decades, from $6,932 in 1994 to $8,397 in 2012, in constant U.S. dollars, according to the World Bank—an average yearly rate of

just 1.2 percent. Over the same period, Brazil, Chile, Colombia, Peru, and Uruguay experienced far greater growth in per capita GDP. And as a percentage of the United States' per capita income, Mexico's has barely budged, drifting from 17 percent in 1994 to 19 percent today. Real GDP per hours of work has increased by a meager 1.7 percent, meaning that productivity has remained flat, although there has been some improvement in the automobile sector (which was already doing well in the early 1990s), in the aeronautic sector (which did not yet exist), and in a number of so-called maquiladoras, factories in free-trade zones, in the north. Accordingly, real incomes in the manufacturing sector and the rest of the formal economy have remained stagnant, even if the fall in the price of some goods has softened the blow for workers.

Despite impressive trade numbers, NAFTA has delivered on practically none of its economic promises for Mexico.

One important reason for these disappointing results is Mexico's failure to develop at home enough of what economists call "backward linkages": connections to upstream industries that produce the materials for assembly further down the supply chain. In 1994, 73 percent of Mexico's exports were composed of imported inputs; by 2013, the number had actually risen, to 75 percent. As a result, employment in the manufacturing sector has stayed unchanged, and so have salaries. Not even the tourism industry, Mexico's largest employer, has performed that well. The number of Americans visiting Mexico today is twice what it was two decades ago, but Mexico's market share of U.S. tourism has stayed flat, and the sector is growing at the same rate as before. Similarly, the maquiladoras created only about 700,000 jobs over the past 20 years, or, on average, 35,000 per year. During this period, roughly one million Mexicans entered the job market every year, and the country's population rose from approximately 90 million to 116 million, which explains why the average wage differential between U.S. and Mexican workers has not shrunk.

It should come as no surprise, then, that the number of Mexican-born people living in the United States, legally and otherwise, jumped from 6.2 million in 1994 to almost 12 million in 2013. (And that second number takes into account the temporary slowdown in

Mexican immigration to the United States between 2008 and 2012 and the nearly one million deportations of Mexicans from there between 2009 and 2013.) Thus, NAFTA has also failed to achieve its goal of discouraging emigration: as Mexican President Carlos Salinas said when the treaty was up for debate, "we want to export goods, not people."

The absence of backward linkages in Mexico's export sector stems from foreigners' unwillingness to invest in Mexico, a problem that dates back to the 1980s. That decade, the country's economy collapsed, mainly as a result of the excessive debt incurred by the earlier administrations of President Luis Echeverría and President José López Portillo. In 1989, Salinas was able to bring down the country's foreign debt burden, but only at the cost of renouncing virtually any new foreign borrowing. The only alternative was to dramatically boost foreign direct investment, chiefly from the United States. And the only avenue for that was NAFTA: an agreement that would lock in sound economic policies and access to the U.S. market, providing investors with the certainty they required. Through NAFTA, Mexico sought to increase its foreign direct investment as a percentage of GDP to as much as five percent, far above what it had ever been before.

That didn't happen. In 1993, the last year before NAFTA took effect, foreign direct investment in Mexico stood at $4.4 billion, or 1.1 percent of GDP. In 1994, the number leapt to $11 billion, or about 2.5 percent of GDP. But it remained stuck around there until 2001, when it rose to 4.8 percent, and then began a steady decline. If one takes the average of foreign direct investment for 2012 (a very bad year) and 2013 (a very good year), one finds that Mexico now receives only around $22 billion annually in foreign direct investment—slightly less than two percent of GDP, well below the figures for Brazil, Chile, Colombia, Costa Rica, and Peru.

Foreign investors have proved particularly unwilling to channel capital into export-industry supply chains. Because domestic investment, public and private, has moved remarkably little since 1994, neither has the overall level of capital formation, which has averaged about 20 percent of GDP since the mid-1990s. At that rate, Mexico can attain only the mediocre growth it has known for 20 years. In other words, despite impressive trade numbers, NAFTA has delivered on practically none of its economic promises.

THE PATHS NOT TAKEN

A relevant question, however, is how the Mexican economy would have performed without NAFTA. It is difficult to see why it would have fared much worse. For one thing, growth was greater in other Latin American countries that did not have free-trade agreements with the United States for all of the 1990s and much of the next decade, including Brazil, Chile, Colombia, Peru, and Uruguay. Moreover, Mexico grew faster in per capita terms from 1940 to 1980, and the population was rising then at a faster rate than it is now. Had the Mexican government attempted to revive the unsustainable economic policies it pursued in the 1970s, things probably would have been worse. But it had already abandoned most of them by the mid-1980s, and many other countries have managed to adopt free-market policies without the benefit of a free-trade agreement. Thus, there is little reason to believe that in the absence of NAFTA, Mexico's productivity, attractiveness for foreign investment, employment levels, and wages over the past 20 years would have been systematically lower, unless the government had attempted a return to the policies of the 1970s and early 1980s—an improbable scenario.

There are other counterfactuals worth considering. Perhaps a different NAFTA would have worked better for Mexico. Many, including me, favored a more comprehensive, EU-style agreement. Such a treaty would have allowed for greater labor mobility and included the energy sector. And it would have offered various forms of resource transfers from the wealthy United States and Canada to poorer Mexico, akin to those that helped Italy in the 1960s, Ireland in the 1970s, Spain and Portugal in the 1980s and 1990s, and Poland more recently. Such changes still may not have helped, but Mexico's low investment and productivity figures are partly a consequence of its shabby infrastructure, which could have been improved with U.S. and Canadian money. One could also argue that had Mexico opened up its oil industry to foreign investment just after the Gulf War, the decision would have sparked an investment boom (like the one some expect today) and would have convinced Washington to contemplate some type of immigration reform in exchange. There is no way to prove that different choices would have led to different outcomes, but in light of the picture today, they might have been worth trying.

As for the road ahead, some believe that President Enrique Peña Nieto's energy, education, tax, and banking reforms will, by themselves, finally generate the five percent annual growth that has escaped Mexico since 1981. But that assessment looks too optimistic, absent other measures. Although it is conceivable that the gap between Mexico and the United States might finally narrow on its own, the better option for Mexico would be to embrace proactive policies and ideas. Indeed, perhaps this realization explains why the notion of North American integration, taken up by President Vicente Fox in 2001 and then left by the wayside, has begun to gain traction again. Whether in books or task forces in the United States and, to a lesser degree, Mexico, there is a growing sense that it is time to take new steps toward North American economic integration. Only Mexico can drive such a process, and for now, its government is shying away from bold foreign policy endeavors. That reluctance could change, however, if the current reforms are rejected or passed in such a diluted form that they fail to stimulate growth.

Instead of traveling down the same road for another 20 years, policymakers should consider a more ambitious path. They need not attempt to replicate the European model of integration, but they should include many of the items left off the table in 1994, such as energy, immigration, infrastructure, education, and security. In other words, despite the treaty's disappointing results, maybe Mexico needs more NAFTA, not less.

CORRECTION APPENDED (January 24, 2014)

This article has been revised to correct errors in the original version regarding Mexico's per capita income between 1994 and 2012.

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Iceland's Saga

A Conversation With Ólafur Ragnar Grímsson

By all rights, Iceland—a remote Arctic island inhabited by just 320,000 people—should be a forgotten backwater. And for most of its history, it was. But in recent decades, the former Danish colony has begun to attract outsized attention from abroad. After its banks were fully privatized in 2003, foreign money poured into the financial sector, which grew to almost ten times the size of national GDP before bursting in a matter of days in October 2008. More lasting may be Iceland's potential as a player in its Arctic backyard, where climate change is opening up new shipping routes and resource opportunities. As Iceland's first political science professor, its finance minister from 1988 to 1991, and its president since 1996, Ólafur Ragnar Grímsson has studied and survived these shifts of fortune. He spoke with *Foreign Affairs* senior editor Stuart Reid outside Reykjavik in October.

As the Arctic opens up, is the region going to see increased geopolitical competition or a more peaceful path to shared development?

For over half a century, the Arctic was perhaps the most militarized region in the world, with vast nuclear arsenals on land and in the ocean. So it was understandable that people came to climate change in the Arctic with this Cold War model of confrontation. However, among the people who have lived in the Arctic for hundreds and even thousands of years, there is a different culture. There's a culture of cooperation, an awareness that you cannot survive in this tough environment unless you rely on others and others rely on you.

Somehow, Russia, the United States, Canada, and the five Nordic countries—Finland, Sweden, Norway, Denmark, Iceland—developed through the Arctic Council a way of discussing and deciding. It also helped that among the Arctic states, the majority had a strong Nordic tradition of cooperation based on the rule of law, democratic dialogue, and formal arrangements. In addition, the Russian leadership realized early on that even Russia, with all its power, would not be able to succeed in the Arctic unless it engaged others.

And this has proven to be so. The Russians have solved their disputes with Norway. They have taken the lead with America in concluding the two treaties that the Arctic Council has now approved. President Putin has for three years now come annually to Arctic conferences organized by the old Russian Geographical Society, making, in my book, very enlightened speeches. So now, when China, Japan, India, and other Asian countries, as well as the leading European powers, come to our territory, there's already an established way of doing things. I believe—or hope, at least—

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*Iceland's president in Davos,
Switzerland, January 2011*

that these newcomers will be sophisticated enough to respect what has already been established. The Arctic will not be the Wild West.

It is fascinating how people in other parts of the world are beginning to look at this Arctic model and ask themselves, "If nations that confronted each other for over half a century in the most dramatic military buildup the world has ever seen were able within a few years to move to constructive, legally based cooperation, why can't we?" That is why some of us, including myself, have been bringing this Arctic experience to China, India, and Nepal in the Himalayas. I had a meeting with people from Bhutan just before you came.

What do you predict the Arctic will look like economically in, say, 20 years?
Experience has told me to stop predicting the future of the Arctic. In the first years of this century, I got to know the late governor [Walter "Wally"] Hickel from Alaska, who was secretary of the interior in the Nixon administration and twice the governor of Alaska and was very active all throughout his life on Arctic issues. About eight years ago, he invited me to a conference in Anchorage, in Alaska, and there was this young Russian scholar who had just finished his master's thesis at either Harvard or MIT on the Northern Sea Route. Everybody at this conference thought this young man was, in a nerdish way, wasting his time on something that might become relevant only in the middle of the twenty-first century. But we now know what has happened.

If anybody had told me eight years ago that Singapore would have a special division in its foreign ministry on Arctic issues, or that the Arctic Council, which in the first years of this century was still a rather weak talking shop, would accept the leading economies of Asia and Europe as partners, I'm not sure I would have accepted that.

Speaking of things that weren't predicted, let's talk about the financial crisis. When did you realize that Iceland's financial sector was collapsing?
It was a process of a number of days or a few weeks when it all came down. When the first bank was coming down, we didn't realize the other banks would go down, as well. Gordon Brown went on global television and announced we were a bankrupt country, which was utter nonsense, an outrageous statement. I'd go so far as to call it financial terrorism. Everybody believed him. Nobody believed us. The British government put us together with al Qaeda and the Taliban [when it used antiterrorism legislation to freeze the assets of an Icelandic bank]. I mean, a founding member of NATO and a strong ally of Britain, a country without any armed forces whatsoever—we would be the last country to be put on such a list. But this meant that all business connections for Icelandic companies were closed down all over the world. Gordon Brown would never have dared to wage financial war against France or Germany or any other bigger country. It was kind of a Falklands moment for him, and he hoped he would be popular like Thatcher became after the Falklands War.

When we tried to engage America, our long-standing ally, they said, "Sorry, guys, we are simply too preoccupied with other things." We were left alone. With every Western door closed to us, we turned to the Chinese, which then led to currency swaps between the Central Bank of Iceland and the central bank of China.

How did Iceland let its banks get so big? That's a question that will be debated for a long time. Remember, this is a nation that still reads the sagas from the thirteenth century. We have a long historical memory. But let me offer some preliminary reflections.

First of all, the prevailing ideology in the Western world from the '80s onwards was that the more you deregulated, the more you privatized, the more freedom of maneuver you gave to the financial markets, the better we would all be off. All of us, not just in Iceland but also in western Europe and the United States, lost our historical memory that capitalism is a system of regular crisis. We somehow thought that we had found a formula where capitalism was no longer a system of crisis but had continuous success year after year after year.

Secondly, we were unfortunate to privatize our banks when the global financial market was overflowing with money. So they had very easy access to finance from the European banks, from the American banks, and others. They entered into the exuberant times.

Thirdly, in the late '90s and the early part of this century, computers started to transform banking, so that the old methods of regulating and controlling were becoming outdated. There was a technological element to the financial crisis, because banking had become machine-based rather than people-based. In a matter of seconds, you could make deals that would take you weeks and months before.

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I am often asked the question, "Why did you believe in the success of the banks?" Which I did. I mean, I supported them. I helped them expand. Voices of warning started to come in 2007, from some specialists and advisers, and I listened. But I then asked myself, "What are the rating agencies saying about the Icelandic banks?" I was minister of finance 20 years ago, so like almost every finance minister, I was subjected to the idea that the rating agencies were the golden judges of financial health. I made the mistake of believing what they were saying about the Icelandic banks, because they were giving all of them an extraordinarily clean bill of health—Moody's, Standard & Poor's, Fitch, all of them. So I said to myself, wrongly, "Yeah, there are these people issuing warnings, but they aren't the rating agencies."

Then I looked at what the pillars of European and Western banking—Deutsche Bank, Royal Bank of Scotland, etc.—were doing. They were all engaging in extensive financial cooperation with the Icelandic banks and wanted to increase it. So I said to myself, mistakenly, that the rating agencies and all these established pillars of Western banking couldn't be wrong.

We have examined our mistakes very thoroughly. I don't know of any other country in the world that has executed examinations and judicial processes following such a crisis. We established a special commission headed by a Supreme Court judge, which issued a report in nine volumes examining not just the failure of the banks but also the failures of the business community, the government, the presidency, the media, the universities—everybody. We established a special prosecutor's office to look for law breaking, which became the largest legal office in our country and is now conducting cases against a number of the former bankers. We changed the leadership of the central bank and of the financial regulatory authority, and we executed a number of other legal changes and regulatory changes.

But did you ever wonder what a small country with an economy traditionally based on fishing and aluminum smelting was doing with a giant financial sector?
You have to remember it was a very fast process. That was part of the problem. It was almost impossible for us to keep track of what the banks were doing in Sweden, Norway, Denmark, Britain and Germany, Austria, the Netherlands. We didn't have the bureaucratic institutions and the financial supervisory authorities to keep track of all of that. And there was no pan-European surveillance mechanism to monitor all these different operations. None of our political institutions were capable of keeping track of all of that.

That was why I looked towards the rating agencies. I looked towards the big European banks when we started to have doubt, and I saw their almost unanimous conclusion that this was a healthy business. And on the other hand, the banks offered a new generation of Icelanders who had educated themselves in international business schools an opportunity to globalize their capabilities while being rooted in Iceland. For a small nation, it's always a challenge not to lose your most capable people.

How is the recovery going?
We recovered much better than anybody could have expected and predicted. There are still problems. People are still

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suffering. But unemployment is about five percent. Economic growth is one percent to two percent. Paradoxically, the tourism sector, the energy sector, the fishing sector, and the IT sector are doing much better than they were before.

That's another aspect of the banking crisis that should also be relevant to America and the Western world. We didn't realize until after the banks collapsed that they had in fact become high-tech companies, hiring mathematicians, programmers, and computer scientists who normally would go into high-tech or IT sectors. Many of our export-driven, high-tech companies in the four or five years before the banks collapsed could no longer hire the best technical people because the banks offered them higher salaries and bigger bonuses.

But when the banks collapsed, this pool of talent was suddenly on the market, and within six months, it had all been taken up by the high-tech and the IT companies. That sector has excelled in the last four years, more than in the four years prior to the crisis. I tell many of my American friends on Wall Street that one of the lessons of the Icelandic experience is that if you want your country to be competitive in the twenty-first-century economy, a big financial sector is fundamentally bad news.

WikiLeaks began in Iceland. What do you make of the organization?

This is still a work in progress for me intellectually, because what I have witnessed in this country is that information technology and mobile phones have completely transformed our traditional political systems. After the banks collapsed, the shock to the nation led to almost a revolutionary situation in Iceland, one of the most peaceful and secure countries in the world. The police had to guard the parliament and the prime minister's office day and night. The police had to guard the central bank, so the crowd would not go in and take it over. We then started to see demonstrations created by people nobody had heard of—housewives, individuals who used Facebook, Twitter, and the Internet to mobilize.

In Iceland, young people sincerely believe that the information revolution is a similarly fundamental transformation of our Western societies as the class struggle was in the eighteenth and the nineteenth centuries. That is why the Pirate Party managed to get people into our parliament in the election this year. One of them, Birgitta Jónsdóttir, has led an effort to make Iceland a kind of safe haven for information. Just as there are locations where you can keep your money without being taxed, there is now a need for similar safe havens to protect your information from the authorities. I think one of the reasons why the founder of WikiLeaks and some of his partners stayed in Iceland is that they found people here who thought in this way.

Was this why in 2011 the Icelandic government kicked out FBI agents who were in the country investigating WikiLeaks?

That was not because of WikiLeaks; it was because of a general principle that we are a sovereign nation. With all due respect, you don't send the police forces of another nation—whether it's Norway, Denmark, or the United States—to come and start operating within our territory.

Iceland is a tiny nation with no military. What's the grand strategy for a country like that?
There was never a grand plan to create an open political system without a military. It simply grew naturally out of our history. Remember that the parliament is older than the church in this country. We became a nation with one political system in the year 930 because we established the rule of law and a parliament that met once a year in Thingvellir.

We have demonstrated we can establish the republic, become independent, move from being among the poorest countries in Europe to one of the most affluent in the world, despite the financial crisis, based on an entirely peaceful, nonviolent, nonmilitary political system where the fundamental assumption is you trust other people. That's why when you came here [to the presidential residence], we didn't inspect you. There's a gate out there, but it's partly a joke because there's no fence.

Then there was the Cold War, and strategically, Iceland became important. We had an American military base and became a founding member of NATO; we have no armed forces of our own, so our contribution was the American base. It lasted for more than half a century, until George Bush, Dick Cheney, and Donald Rumsfeld decided to close it down seven years ago.

So now, for more than half a decade, we have been a country without a single person bearing arms, with zero military presence. Contrary to traditional thinking, it is possible to have a successful state—highly engaged in international diplomacy, with extensive relations with Russia, the United States, Canada, the Nordic countries, China, India, France, Germany, and others—without any military element whatsoever. And the people who spearheaded that transformation were George Bush, Dick Cheney, and Donald Rumsfeld.

Progressive values seem to take hold first in the Nordic and Scandinavian countries, and then spread to the rest of Europe, and then to North America. Iceland, for example, allowed gay civil unions back in 1996. What explains this pattern?
You've heard of the Nordic model. It's a system where there is a highly competitive market economy but also an extensive network of social welfare institutions. It's proof that socialized medicine and universal education are not, as they are called in America, some socialist conspiracy but an integral part of a successful market economy—because you don't find any business association in any of the Nordic countries wanting to change the nature of the Nordic social welfare state, health service, and education.

It started with education and health care and then extended to immigrants, to women, to gay people, and others. Creating legal barriers that would separate people on the basis of some strange notion was contrary to what we were about. The reason perhaps that this was easier was that the Nordic model proved so successful, and cooperation between the Nordic countries is so tight that a social reform that started in one Nordic country could spread very quickly to the others.

Iceland also seems to punch above its weight culturally. Was this an intentional plan?
No, it's not a conscious decision. Throughout the centuries, this was a

nation that always respected those who could tell a story or create a poem. In recent decades, this literary tradition—assuming that everybody can be a storyteller—was transformed into the field of theater first, then music, and then filmmaking.

Perhaps in a naive, arrogant way, we assume that we can perform like the best in the biggest countries. It's just a given. That's why some people are very surprised when they come to Iceland and see Bjork in a restaurant or in the street. But no Icelander pays any attention to her, because it's just normal. And if young kids that nobody had heard of, like Of Monsters and Men, suddenly have a hit on the American charts a year or so after they were founded, it's good, but it's not considered remarkable.

So there are distinct advantages to being a small island nation.

Yes, but we have always looked to other countries, as well. Even in medieval times, the Icelandic chieftains and poets went to the courts of the Norwegian kings and traveled to Greenland, and they created this system of trade between Greenland, Iceland, and Europe 700 or 800 years ago. More than half a century ago, we created student loan funds that give every Icelandic student the right to go anywhere in the world they want and study whatever they decide to study, and they can get a long-term loan with a very low interest rate. This has meant that we have had this continuous stream of people who go for some years to different parts of the world, and 80 percent, 90 percent of them come back within five or ten years.

I had this fascinating conversation with Larry Summers when he was president of Harvard. He asked me how many Icelandic students are studying abroad. And I said at least 9,000 or 10,000. Then he asked how many come back. And I said that within ten years or so, definitely 80 percent, and in 15 years, maybe 85 percent. He made the calculation, multiplying by 1,000 to get the size of the American population. If every year, there were between nine and ten million American students studying in centers of excellence in different parts of the world, and every year, at least seven million or eight million of them came back into the United States, within a decade, 70 million people would come. He started talking about what an impact it would have on America. I've always thought it was an interesting analogy. Of course, it's difficult to execute.

But if you are small and want to be successful and you have the cultural heritage that we have, there is no limit to what you can do. Maybe that was bad when we thought we could also excel in banking, but it's good in the cultural area. Iceland is not an isolated small nation. It's a small nation that has been outward-looking and sought experience, education, and influence from anywhere in the world. And it has heralded the notion that you should not be afraid to compare yourself with the best.

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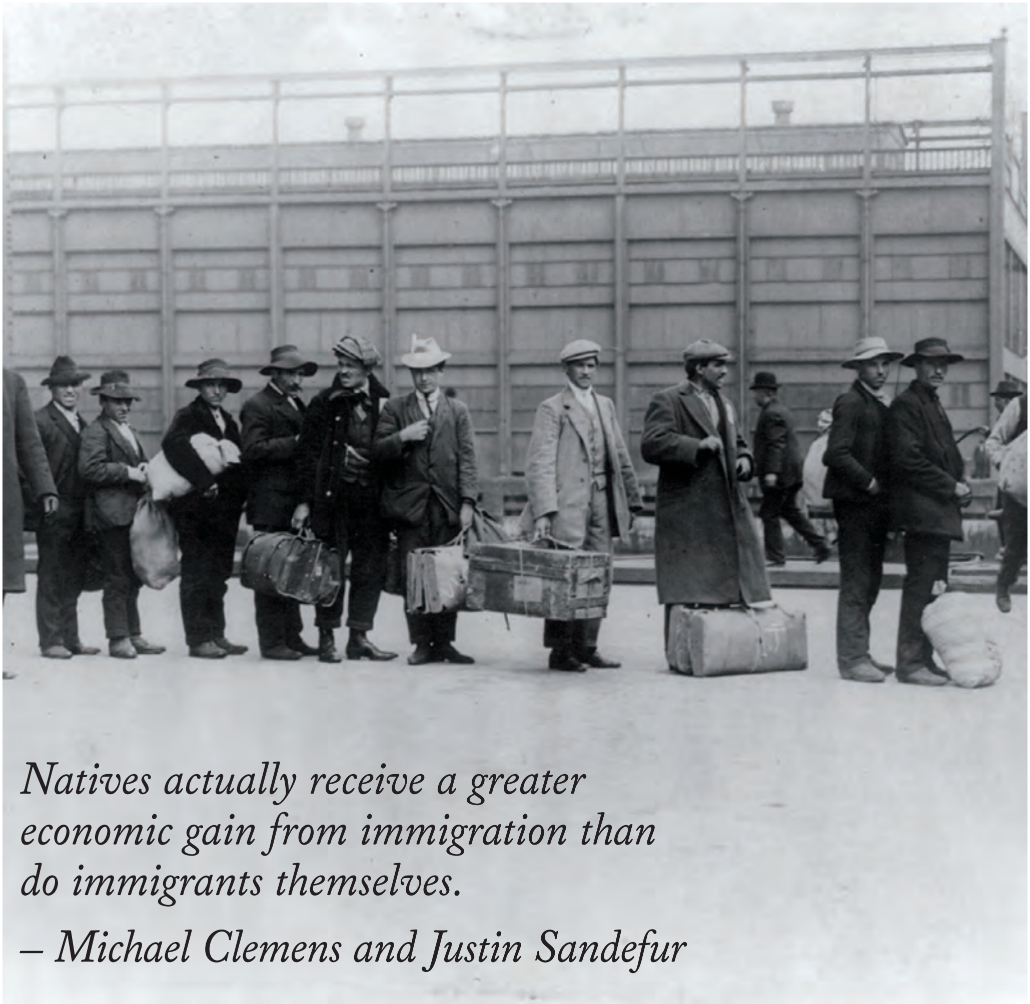
REVIEWS & RESPONSES



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Let the People Go

The Problem With Strict Migration Limits

Michael Clemens and Justin Sandefur

Exodus: How Migration Is Changing Our World
BY PAUL COLLIER. Oxford University Press, 2013, 309 pp. $27.95.

On May 29, 2013, British immigration officers raided the Alternative Tuck Shop, a café just down the road from Oxford University's economics department, where South Asian and Middle Eastern employees serve tea, scones, and sandwiches. The agents seized two young men, one from Bangladesh and one from Algeria, under suspicion of working in the United Kingdom without authorization. And they shuttered the business temporarily, meaning that hungry Oxford economists would have to walk farther down Holywell Street for their midday panini.

One of their number, Paul Collier, has just published an extended apologia for the tight strictures on immigration that led to this raid, arguing for a global system of coercive quotas on people moving from poorer countries to richer ones. Such quotas, he writes in *Exodus*, would serve the "enlightened self-interest" of immigrants' host countries and constitute an act of "compassion" for immigrants and their countries of origin. Collier argues that at a certain point, immigration begins to harm both host and origin countries, that many countries are near or past that point, and that even in countries that have so far remained unharmed, "preventative policies are greatly superior to reactive ones."

It is refreshing to see the grand case against immigration served up by someone of Collier's intelligence and credentials. But although Collier styles his book as a balanced review of the research literature, it is in fact a one-sided polemic that stands mostly outside academic research—by Collier or anyone else. Far from advancing a convincing case for a moderate middle path, the book offers an egregious collection of empirical and logical errors about the sociological and economic consequences of immigration. And they lead Collier to propose policies that would greatly harm, not help, the millions of people seeking to escape their homelands in search of a better life.

THE MASH OF CIVILIZATIONS

Although Collier is best known for his work on Africa, *Exodus* is preoccupied with the social costs of immigration for rich countries, such as the United Kingdom and the United States. According to Collier, "culturally distant" immigrants threaten "the mutual regard on which high-income societies depend." To make his case, he takes readers on a fascinating tour of recent research into the political economy of Africa, tracing the roots of modern-day corruption and conflict in the region to centuries-old patterns of war and slave trading.

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He concludes:

> Migrants are essentially escaping from countries with dysfunctional social models. It may be well to reread that last sentence and ponder its implications. For example, it might make you a little more wary of the well-intentioned mantra of the need to have "respect for other cultures." The cultures—or norms and narratives—of poor societies, along with their institutions and organizations, stand suspected of being the primary cause of their poverty.

Unlike bad institutions or economic conditions, Collier asserts, bad culture is not just a characteristic of poor countries; it is embedded in their people. "Uncomfortable as it may be . . . migrants bring their culture with them," he writes. For example, he adds, "unsurprisingly, Nigerian immigrants to other societies tend to be untrusting and opportunistic."

But if you buy the argument that immigrants come from culturally inferior countries, it leads to some strange historical conclusions. For example, between 1850 and 1913, more than a fifth of the populations of Norway, Sweden, and the United Kingdom emigrated en masse, landing in countries with wages several times higher, such as Argentina and Canada. Yet it would be difficult to claim that the United Kingdom and Scandinavia possessed broken social models at the time or that immigrants from these places infected their adopted countries with dysfunction they brought from home.

Another core premise of the book is that diversity per se is bad. In Collier's view, Bangladeshi immigrants in London are dangerous not only due to their allegedly dysfunctional culture but also because they are "culturally distant" from most people in the United Kingdom. Collier pins his fear of diversity on one study by the political scientist Robert Putnam, which found that residents of racially mixed U.S. neighborhoods trusted one another less than their counterparts in more homogeneous neighborhoods, even after controlling for poverty levels, crime rates, and demographic factors. The statistics in Putnam's study pertain exclusively to race, not national origin.

Thankfully, Putnam chose not to interpret this finding as evidence in favor of keeping blacks and Hispanics out of white neighborhoods. Collier, however, offers this same data on race relations in the United States to justify limiting the entry of immigrants into wealthy countries. Although he no doubt opposes racial segregation, his conflation of race, culture, and nationality invites this analogy, and he offers no reason why promoting local homogeneity through the use of immigration barriers is any more defensible.

In fact, immigration has been widely shown to have many positive effects. For example, economists have found that crime is significantly lower in the English and Welsh neighborhoods in the United Kingdom with the largest immigrant inflows and that immigration raises local property values in Spain and the United States. But Collier makes no mention of such research.

Nor does he account for the evidence that undermines his assertion that "culturally distant" immigrants from poor countries fail to assimilate in rich countries. And such evidence is abundant. The Manhattan Institute, a conservative think tank, has compiled an "assimilation index" of immigrants in the United States that measures such factors as labor-force participation, earnings, English fluency, intermarriage, legal naturalization, and military service. After Canadians, it turns out that the highest-scoring groups come from the Philippines, Cuba, and Vietnam—hardly countries with social institutions mirroring those of the United States. Indeed, as U.S. immigration has accelerated, so has integration: the institute's researchers found that "immigrants of the past quarter-century have assimilated more rapidly than their counterparts of a century ago, even though they are more distinct from the native population upon arrival."

VALUE ADDED

If you ask entry-level economics students what they would expect a large influx of low-skilled immigrants to do to the economic prospects of natives, most will reason that the increase in the labor supply will reduce wages and increase unemployment, perhaps especially for poorer, less-educated locals. But professional economists have found something very different: study after study has shown that opening up labor markets to more people has not only increased the supply of labor but also raised the return on capital investments, accelerated economic growth, and thus increased the demand for labor—improving the lives of natives as well as those of the immigrants.

Collier deserves credit for embracing the consensus on this question. But the embrace is fleeting. His argument quickly leaves empirical evidence behind as he speculates about unprecedented bad economic effects that might happen in the future. He argues that although some rich countries do need more immigrants, others can absorb only a few and so should impose caps. The tipping point, he claims, hinges on a country's population density. It would be "selfish" for countries with lots of open land, such as Australia or Canada, to shut their doors, he writes, yet justifiable for high-density countries, such as Denmark and the United Kingdom, to do so. But it makes little sense to use overall population density as a measure of a country's ability to absorb new people, since those who immigrate to Australia or Canada these days disproportionately flock to Sydney or Vancouver, not vacant homesteads.

Collier's fears that immigration will someday doom dense countries are also undermined by evidence showing that even massive inflows of people constitute an economic boon. The most dramatic modern example is the desegregation of South Africa. With the fall of apartheid in 1994, black migrants who had been exiled to remote areas flooded to major cities, where they began competing with white workers for jobs. The scale of this change dwarfed Collier's worst nightmares of mass immigration to Europe. Yet the results are a staggering rejection of his simple analysis of supply and demand. As the economists Murray Leibbrandt and James Levinsohn have shown, between 1993 and 2008, the average income of black South Africans rose by 61 percent. And white South Africans suffered, well, nothing. Their average income also rose over the same period: by a staggering 275 percent.

Recent U.S. history is not so different. From 1960 to 2011, the number of immigrants in the United States rose from less than ten million to more than 40 million, doubling the foreign-born share of the population. The question of whether this enormous influx of labor has raised or lowered wages and employment has spawned much debate among economists. But the distance between the two sides is quite small; estimates of the cumulative effect of decades of immigration on natives' wages range from around negative three percent to positive one percent. No serious economists have found evidence of the large hypothetical effects that worry Collier.

Collier compounds this error with another one: he confuses labor markets with the overall economy. In market economies, he argues, the economic gains of immigration accrue to the immigrants, in the form of higher wages, "rather than to the indigenous population." But Collier forgets that the owners of capital in host countries would never pay such higher wages to immigrants unless those workers added even more value to their employers than what they cost. If one believes that immigrants generally do not displace native workers—as Collier rightly does—then one also has to accept that natives actually receive a greater economic gain from immigration than do the immigrants themselves. Collier gets this logic so wrong that he describes admitting immigrants as an act of "charity." But employers hire workers to make money, not to do good.

Nor are governments providing charity to immigrants, as Collier contends. Ignoring the large literature documenting the positive contribution of immigrants to public coffers, he cites a single study that offers an entirely theoretical model of how immigrants could strain the Scandinavian welfare state. But Collier's conclusions require empirical data. These exist—although not in the pages of *Exodus*—and they suggest the opposite of what Collier asserts. In a 2013 study of 27 countries, the Organization for Economic Cooperation and Development (OECD) found that immigrants contribute an average of $4,400 more per household to the government than they receive in benefits each year. For 20 of these countries, immigrants' net fiscal contribution was positive; in the United States, that figure was around $11,000 per immigrant household. These numbers should not come as a surprise, since immigrants tend to be younger than natives, and most of them move to work, not to qualify for benefits. Their age alone means that they will work longer (thus paying more in taxes) than natives and will remain healthy longer (thus receiving less in benefits).

At times, Collier seems to grasp for charges he can level at immigrants. He complains that immigrants compete for the "glittering prizes" of affluent societies, driving up the price of luxury apartments in London and capturing most of the spots in elite high schools in Sydney and New York. But these claims require readers to buy an odd pair of ideas: not only will immigrants become a grubbing underclass that drains public coffers, but they will also snatch up all the spots at the best colleges through their hard work and intelligence.

MOVING ON UP

The median wage of immigrants in the United States is more than four times that of comparable workers back home. Yet Collier describes governments' putting forcible limits on immigration, to the United States and elsewhere, as acts of "compassion." This is a strange type of compassion, involving armed agents turning away desperately poor immigrants and deporting them if they somehow slip in.

According to *Exodus*, however, immigrants gain little by leaving home. Collier supplies three arguments for why this is so—all of them misguided. The first is that new immigrants "drive down the earnings of existing immigrants." Although this may be true, all immigrants are still better off for having moved: economists' best estimate of how much new ones depress the wages of existing ones is on the order of five to ten percent, whereas typical immigrants who have moved from poor to rich countries raise their earnings by several hundred percent. If there is a point at which job competition among immigrants in their destination countries comes close to undermining the benefits of moving, the world is light-years away from it.

Collier's second argument is that "although international migration responds to global inequality, it does not significantly change it." Here, his logic is circular, since a key reason immigration has not reduced global inequality is that it is so tightly constrained. According to the economist Branko Milanovic, 60 percent of the variance in real incomes worldwide can be explained solely by one's country of residence. Yet immigration is a tiny phenomenon: 97 percent of all people live in the country they were born in. Collier's argument is akin to claiming that freeing a slave will not improve his earnings because while enslaved, he has earned little in the labor market.

Collier's third argument, about the plight of immigrants, deserves more consideration. He points out that immigrants in Australia and India are not, on average, much happier than the compatriots they left behind, despite having seen their incomes skyrocket. "The massive productivity gains from migration that so excite economists and that migrants capture appear not to translate into additional well-being," he writes, adding, "the psychological costs borne by migrants may well be enormous, wiping out the income gains that accrue to them." If future research confirms this point, Collier argues, "migration would not be an investment, it would be a mistake," and governments should act on that information by preventing such migration from happening in the first place.

This reasoning is bizarre. Using the same logic, one could make the case for barring mothers from working outside the home, noting, accurately, that women with children who work report more sadness and stress than those who do not work. To be blunt: polls showing that immigrants are no happier after leaving home do not justify taking away people's right to move freely.

Yet the survey evidence Collier cites does reveal a dark side to immigration. In many countries, especially in the Persian Gulf, immigrant workers enjoy few legal protections, have their passports seized by their employers, and are locked into a single company, making them easy targets for exploitation. Collier recognizes the risks that immigrants of precarious legal status face and makes a persuasive case for granting legal amnesty to undocumented workers in rich countries. That conclusion is correct and should be extended further: aiding the victims, not punishing them with quotas and deportations, is the right response to abuse in the labor market.

LEFT BEHIND

Having dismissed the enormous gains to immigrants as small and possibly illusory and immigration itself as a mistake, *Exodus* then asks whether immigration harms the people left behind. Collier notes that from an economic perspective, immigrants' remittances likely trump any downsides of their leaving. Indeed, the World Bank has estimated that in 2012, the developing world received over $400 billion in remittances; in a handful of smaller economies, such as Liberia and Nepal, such flows accounted for over 20 percent of GDP. "We can therefore safely conclude that migration is good for those left behind," Collier writes.

But once again, Collier is not satisfied to let historical experience guide policy. He speculates that increased emigration from poor countries could someday prove harmful and concludes that rich governments should cap immigration as an act of compassion. In making that argument, Collier first claims that retaining skilled and motivated workers is necessary to boost the economic prospects of those who do not emigrate, but his policy recommendation rests on a fundamentally different claim: that blocking immigration will lead to economic development in the countries immigrants leave. He offers no evidence to support this claim, because he cannot: there is no country, region, district, or city on earth where coercive policies to restrict departure have been shown to trigger economic growth.

Consider Haiti, which Collier offers as the quintessential case study of the downsides to emigration, since the country "has lost around 85 percent of its educated people." In fact, the true figure is closer to 75 percent; Collier inappropriately counts university-educated Haitians who left as children and were educated abroad. The bigger problem with this example, however, is his logical leap. It is obviously true that if Haiti is to have a twenty-first-century economy, it will need to convince skilled workers not to leave. But it is wrong to slip from that claim to a different one, for which there is no evidence: that if

skilled people born in Haiti were coerced into staying there against their will, because of immigration caps abroad, then the country's economy would modernize. Eighty percent of Haitians who earn more than $10 per day live in the United States, not Haiti. In other words, emigration is the main way to escape poverty in Haiti. Yet Collier would deny poor Haitians this opportunity on the baseless grounds that forcing them to remain in Haiti will cause the country to prosper.

Elsewhere in the book, Collier appears to reject the ethics of his own proposal. He writes that Afghanistan, Haiti, and Zimbabwe would benefit from coercive policies to forcibly prevent departure but admits that "of course these are neither practicable nor ethical." Yet he justifies forcible restrictions on immigration to rich countries from these same countries on the grounds that such limits will keep people from emigrating. He cannot have it both ways; the policy prescriptions in *Exodus* are explicitly designed to undermine the right to leave one's home country.

ANOTHER BRICK IN THE WALL

Collier's foregone policy conclusion is that countries need higher walls. The main question, then, is which select few to let in. Collier proposes four criteria: skills, employability, cultural distance, and vulnerability. With the exception of vulnerability, all pose problems. The first two criteria suggest that rich countries should skim the cream of the crop from poor countries' labor markets—an odd conclusion for a book that devotes a full chapter to the supposed deleterious effects of the emigration of skilled workers from poor countries. Collier fails to explain the incongruity between his analysis and his policy conclusions, leaving readers to assume that he has chosen to prioritize the preferences of policymakers in rich countries over the fate of workers in poor ones.

The third criterion, by which rich countries would weed out the immigrants who would be unlikely to assimilate, is particularly troubling. Collier writes that the rules determining which nationals to admit should be designed to offset the effects of cultural distance "to the extent possible without transgression into racism." But such policies have a long history of exactly such transgression. The U.S. Immigration Act of 1924 fixed quotas for immigration in part according to the representation of origin countries among the national origins of the U.S. population and was intended to limit the inflow of immigrants who were deemed less likely to assimilate, such as Asians and eastern Europeans, particularly Jews. The result was that over 85 percent of U.S. immigration slots were reserved almost exclusively for white northern Europeans.

Curiously, even though Collier admits that in many countries, far fewer people emigrate than ideally should, he never grapples with policies that would help would-be emigrants in these places. For every Haiti (with 10.2 percent of its native-born population living abroad), there is a Tanzania (with about 0.7 percent). There is no reason Tanzanians should be denied the enormous increases in income, health, and opportunities for their children that come from moving to a richer country. Yet *Exodus* never devotes a single line to policies that would help such groups emigrate.

To get a sense of just how big the gains that Collier brushes aside are, consider the following back-of-the-envelope calculation.

Assume for a moment that everything Collier says is correct. He argues that there is an optimal level of emigration from low-income countries and that it lies somewhere between Bangladesh's rate of around four percent, which he deems beneficial, and Haiti's level of around ten percent, which he deems harmful. Many low-income countries have emigration rates far below four percent. If those rates were raised to four percent, that would mean about 13 million new immigrants (using the World Bank's definition of low-income countries and its 2010 estimates of cross-country migration numbers). If all of them moved to OECD countries, the foreign-born population of the OECD countries would rise from 12 percent to 13 percent—the same level found in the United States and far below the 20 percent share in Canada and the 27 percent share in Australia.

Those people would move from countries with average annual incomes of about $600 to countries where average incomes are over $30,000, transforming their lives and adding hundreds of billions of dollars to the world economy every year. In other words, even if one concedes Collier's dubious moral and empirical claims about immigration, his own analysis suggests colossal potential gains from new immigration without substantial offsetting harm. But somehow, in his policy conclusions, Collier preoccupies himself exclusively with restricting immigration.

FACT AND FICTION

Soon, the young sandwich-makers incarcerated and then deported from Collier's doorstep will have arrived in Algeria and Bangladesh, if they have not already. Some of the effects of their removal have been proved by stacks of economic studies; others are hypothetical. What research shows is that the economic value of those men's labor will decline by 60 to 80 percent or more, reducing the size of the world economy; the job prospects of British workers will be essentially unaffected, given how little interest they have in low-wage service work; the British government will collect less tax revenue; Collier and his colleagues will pay slightly more for tea and cakes; and Algeria and Bangladesh will lose whatever money those men may have been sending home.

Beyond those well-documented effects, Collier posits other, wildly hypothetical effects: that the Oxonians strolling down Holywell Street will be able to gaze at one another with more trust and mutual regard, and that somehow people working in Algeria and Bangladesh will become more motivated to improve their lots and their countries. British national identity will also be protected, like an endangered species, for were England to become "an extension of Bangladesh," Collier writes at one point, "it would be a terrible loss to global cultures." Social science may one day prove all this speculation right, but not before other and better books arrive to lift the heavy burden of proof, serving up evidence in place of portentous insinuations and fearful "preventative policies."

Collier laments the fact that the immigration debate has been marked by "high emotion and little knowledge." That is true, yet *Exodus* exemplifies the problem. This book could have seriously engaged with the large literature on immigration and helped people without Collier's training and position think through the complexities of the issue. Instead, Collier has written a text mortally wounded by incoherence, error, and overconfident leaps to baseless conclusions.

From Shah to Supreme Leader

What the Iranian Revolution Revealed

Laura Secor

Days of God: The Revolution in Iran and Its Consequences
BY JAMES BUCHAN. Simon and Schuster, 2013, 432 pp. $27.99.

Revolutionary Iran
BY MICHAEL AXWORTHY. Oxford University Press, 2013, 528 pp. $34.95.

There is something irresistible about the story of Iran's last shah, Mohammad Reza Pahlavi. The pampered, foreign-educated son of a dour autocrat, Mohammad Reza ascended to the Peacock Throne in 1941, at age 21. He was weak and malleable, surrounded by sycophants and schemers, beholden to foreign powers that treated him with contempt. Nearly unseated by his popular prime minister, Mohammad Mosaddeq, in 1953, the shah retained his throne with American and clerical connivance. That crucible hardened him into something both brittle and shrewd. He fancied himself a nationalist beloved by his people, but in truth he scarcely knew them; he grew Iran's economy and its military, broke up feudal landholdings, and crushed dissent with his notorious intelligence service, known as SAVAK and adept in torture. "The boy," as he was known in his father's court, became a man: melancholic, grandiose, lonely, standing athwart titanic forces he could barely recognize let alone contain. No one was ever so blind-sided by the history he had made.

The story of the shah is compelling in the way of fiction: the tragic antihero friendless in his gilded palace, unable, for want of character and common experience, to see the shadow he himself has cast. But if the monarchy is the stuff of literature, the story of Iran's postrevolutionary Islamic Republic calls for sociology instead. Reading Iranian history as written by Westerners, it is impossible to miss this dramatic reversal of emphasis. Inevitably, accounts of prerevolutionary Iran foreground the shah, his court, and its foreign patrons. But the revolution forced Iranian society, with all its cleavages and complexities, its aspirations and refusals, into the light of historical explanation. For all the Western intimacy with the Pahlavi court, and for all the opacity of the Islamic Republic, Westerners see Iran more clearly now.

Two magisterial new books by British scholars of Iran make the best of this historical divide and the continuities that span it. James Buchan's *Days of God*, a survey of the Pahlavi years, with spectacular detail on the revolution itself, includes some deft portraiture and notes of literary grace. Buchan, who lived in Iran in the late 1970s, writes with an irreverence and confidence born of long familiarity, and the Iran of his history feels vibrantly present. Still, his history moves largely from the top down until 1979, when the revolution forces the old protagonists from the scene. Michael Axworthy's precise and judicious *Revolutionary Iran*

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carries the country's history forward as a contest among political visions and social forces. Axworthy's Iran is less lived-in and more abstract than Buchan's, but in another sense, more fully dimensional.

To read these two books together is to understand the revolution as something other than a historical rupture. It is to sense that when looking at Iran before and after the revolution, one is turning a kaleidoscope, reconstituting a new picture from the same elements. For although the Islamic Revolution upended Iran's political arrangements, it did not replace the polity. The tensions and energies that animate Iranian society today are not new; they have simply become more visible.

SHAH OF SHAHS

Mohammad Reza, as Buchan portrays him, was a stateless creature of an international aristocracy to which he never properly belonged, perched awkwardly atop a country that never properly belonged to him. His father founded the Pahlavi dynasty from nothing, having seized power as a low-level military officer of obscure origins. An austere, provincial man, the elder Pahlavi confected a crown prince with all the European trappings and manners he imagined a crown prince should have. By the time he took power, Mohammad Reza suffered from desolation at his core, which he tried to assuage with sexual dalliances, European luxuries, and an aviation hobby that terrified his passengers. As early as 1947, he expressed frank envy to the French scholar Henry Corbin, because at least Corbin had his philosophical work and "his life was not empty." The Iranian state seemed in those days an extension of Mohammad Reza's troubled psyche; it acted on his pretenses, his prejudices, his ambitions and anxieties.

Westerners knew Mohammad Reza well. They were visitors in his court, patrons and partners who took the measure of the royal mood. They were also technicians, advisers, businesspeople, and teachers. Between 1970 and 1979, the number of Americans living in Iran, many of them working in the defense industry, increased from fewer than 8,000 to close to 50,000. Foreigners shared the tense and vivid streets of the Iranian capital, which sloped from the city's affluent north to its squalid south, mountain runoff sluicing through the city's roadside gutters and deepening in murk as it neared the desert plain. But for the most part, according to Axworthy, Americans lived in American compounds, sent their children to American schools, and shopped at American commissaries. They took proximity for intimacy and never saw coming the lurch of history that would end with their violent expulsion.

Beyond the palace gates, Iran convulsed with social upheaval that threw its inequities into sharp relief. Hundreds of thousands of rural Iranians, displaced by land reform, swelled the country's cities, many of them settling in slums and shantytowns. Between 1930 and 1979, Tehran's population leapt from around 300,000 to about five million (today it is close to 14 million), poor youth from traditional families living cheek by jowl with the cosmopolitan sons and daughters of the modern middle class and with casually entitled foreigners. The structures of old Iran—the bazaar as the center of commerce, the low houses turned in on private courtyards, the neighborhood cleric as moral arbiter—heaved beneath the pressure of the emerging megacity, the global economy, and the shah's relentless drive toward a vision of modernity that had incubated abroad. Deep fault lines emerged in a society ill at ease with itself and aggrieved with the West.

The problems of modernity and authenticity preoccupied Iranian intellectuals. If agrarian society must fall to the machine, reasoned the writer Jalal Al-e Ahmad in his 1962 pamphlet *Westoxication*, at the very least, Iranians should own the machine. Iran's educated classes channeled Marx, Lenin, Jean-Paul Sartre, and Frantz Fanon to university campuses. Ali Shariati, perhaps the most influential Iranian intellectual of the prerevolutionary period, folded these ideas into a religious discourse that reimagined Shiism as a native revolutionary creed—one that promoted social justice in a society riven by inequality and that called for militancy in the face of oppression.

Ayatollah Ruhollah Khomeini, a charismatic cleric distinguished as much by his mystical cast of mind as by his ferocious opposition to the shah, was more reactionary. He first rose to prominence when he organized opposition to a 1963 law conferring on women the right to vote and to run for city councils. Not long after, he tapped into the rich vein of public indignation by speaking out ringingly against the shah's apparent capitulation to American whims. As early as 1943, he had envisioned an Islamic state governed by a learned cleric and with no legislation but the word of God. But this was hardly a revolutionary rallying point. Rather, after the revolution, Khomeini's acolytes imposed his theory of clerical rule on an otherwise liberal constitution. That compromise would prove fateful, a paradox built into the very foundation of the revolutionary state.

Buchan portrays Khomeini as a lifelong radical, an aggressively political man within a clergy that was largely quietistic. Khomeini exuded a cold-blooded ambition that the head of SAVAK once said made his hair stand on end. In his presence, writes Buchan, one felt "as if some figure of fathomless authority had appeared and with a single glare brought modernity . . . to an end." Forceful and uncompromising, Khomeini conceded nothing to courtesy, to diplomatic niceties, or, in the end, to the softer yearnings of his own people. "Within Creation, he seemed to be but imperfectly detained, like a passenger in an airport lounge in thick weather," Buchan muses. "In the West, having done with Scholasticism long ago, we cannot understand a man who could know so much and, at the same time, so little. His mystical writings pass over our heads and his political statements . . . beneath our notice."

BETWEEN SUBJECTION AND CITIZENSHIP

Axworthy's Khomeini cuts a strikingly different figure. According to Axworthy, as the first supreme leader of the Islamic Republic, Khomeini acted with a detached impartiality, often wincing at the application of violence. Axworthy contends that Khomeini sought to end the Iran-Iraq War in 1982, after Iran regained the territory it had earlier lost, and only reluctantly acceded to the Revolutionary Guards' judgment that it would be better to invade Iraq and pursue the ouster of Saddam Hussein. Axworthy believes that judgment was sound.

These contentions are controversial in light of other scholarship on the era, and Axworthy does not cinch the case for them. But his chapter on the Iran-Iraq War is a masterful showpiece in a book that is on balance edifying and fair-minded. Axworthy reconstructs the battlefield

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The emperor's new clothes: replacing portraits in the Niavaran Palace, Tehran, February 1979

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through excerpted narratives of Iranian soldiers. These young men turn out to be far more recognizable than the fevered imagery of the time might have led one to believe. "We should not need to displace the fact of their bravery into categories like fanaticism and martyrdom in order to comprehend it," concludes Axworthy. These young Iranian men were not so different from the British soldiers who fought in World War I, with "much the same patriotism and commitment to their comrades, and encouraged to volunteer by much the same wish for adventure. They were exploited in much the same way by their governments and generals, because governments and generals need naive young men and boys to fight for them."

Throughout the 1980s, the Islamic Republic forged itself in the white heat of conflict, both foreign and domestic. The Iran-Iraq War cost hundreds of thousands of lives before it ended in stalemate in 1988. At home, the revolutionaries who had toppled the shah found themselves divided over the very fundamentals of the new regime: whether it should embrace theocracy or republicanism, socialism or mercantilism, liberty or justice. As the radical clerics around Khomeini closed ranks, opponents of the new revolutionary order faced everything from firing squads to street combat, culminating in the execution of thousands of political prisoners in 1988. The opposition that the Islamic Republic did not decimate, it intimidated into silence. Prisons that had been built by the shah filled to many times their capacity, such that cellmates had to take turns sleeping because there was not enough room to lie on the floor. Although the new regime discontinued methods of torture deemed un-Islamic, it came up with new ones. By the time of Khomeini's death, in 1989, a stable order had emerged from a level of violence unprecedented in Iranian history.

That order, despite its authoritarianism and fierce policing of the public sphere, never fully ossified. The Islamic Republic retained a surprising degree of responsiveness. This owed partly to the democratic elements in the constitution, which allowed for an elected president, parliament, and local councils, subordinate though these were to clerical councils and the far-reaching powers of the supreme leader. It owed also to the complexity and multiplicity of the instruments of state. Air had a way of filtering through the latticework of factionalism. Constituencies attached themselves to political figures and currents within the system. Revolution conferred ownership on a people, even one as whipsawed between subjection and citizenship as Iran's.

A TENSE STABILITY

To travel in contemporary Iran is to know that it remains, as Buchan describes the late monarchy, "an uneasy country." The Islamic Republic has in many ways accelerated the very trends that pulled at the seams of the monarchy. Today's Iran is still more modern, still more urban, still more demanding of civil rights and freedoms than the Iran of the 1970s. The postrevolutionary regime has dramatically expanded access to education, partly as a consequence of sex segregation and forced veiling, which have made university life less alienating for the most traditional families, and partly, as Axworthy notes, because Iranian clerics esteem education as a universal good. The expansion of literacy, together with vast improvements in rural infrastructure and social services, has done much to promote social mobility in Iran. But Iran's expanding middle class exerts pressure on the state that nurtured it, and which has failed to make a stable space for it in an economy dependent on oil. The Islamic Republic has vacillated in its response to these and other pressures. The constitution itself sometimes seems to suggest two opposing answers to every question; passionately held contradictory ideas sustain the Iranian state in permanent tension. Tension has become a stability of sorts.

Iran's revolutionaries were young men in 1979. They matured with their Islamic Republic, and with that maturation came realignments that were all but inexplicable to anyone who presumed that ideological commitments had the constancy of character traits. During the 1990s, the most radical Islamic leftists of the previous decade remade themselves as liberal reformists, advocating free speech, civic engagement, and the rule of law. This agenda was enormously popular. In 1997, the reformists carried the country in the landslide election of President Muhammad Khatami. Once in power, the reformists relaxed censorship, encouraged the development of civic organizations, and reached out to the world by suggesting a "dialogue among civilizations." But they faced implacable opposition from the establishment's hard-line right. According to Axworthy, the hard-liners feared that Iran's hard-won independence would be swept away on a tide of Western cultural imports and bent to the will of Western diplomatic interlocutors. But this explanation passes too quickly over cruder motives, such as the self-interest of an elite fearful of the popular will and determined to protect its prerogatives.

Hard-liners used their dominant positions in the clerical councils, the judiciary, and the intelligence apparatus to veto reformist legislation, gag reformist newspapers, and disqualify reformist candidates for office. They unleashed a campaign of censorship, imprisonment, assassination, and intimidation against intellectuals, writers, student activists, and others. Khatami might have leveraged his popular support in a showdown with the hard-line establishment, but he was not that kind of man. Reform, moreover, was not that kind of project. It was an insiders' initiative, meant not to upend the system but to improve it. No one was less forgiving of Khatami's failures than the constituency that had elected him.

NEW FACES, OLD DIVISIONS

When Mahmoud Ahmadinejad succeeded Khatami in 2005, he seemed to herald a

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return to the Islamic Republic's early days. In truth, Ahmadinejad and his faction were the first, and still the only, new faces to emerge on Iran's political scene since that time. Ahmadinejad's young, populist conservatives had never before held high political office. They tapped into the resentment of the lower classes, which had borne the brunt of the war in the 1980s and made up the ranks of the Basij militia but felt their share of power and wealth to be incommensurate with their sacrifice. They called themselves "principle-ists," because they believed that the revolution's principles were increasingly diluted by political innovation and elite corruption. Ironically, as Axworthy points out, they revived the rhetoric of the most radical faction from the 1980s—the very faction that, as reformists, came to oppose Ahmadinejad.

Axworthy provides a gripping and illuminating narrative of Ahmadinejad's eight years in office, including the suspicious 2009 election that delivered the president a second term and gave rise to the largest protest movement in the Islamic Republic's history. The tensions that held Iran in balance seemed to strain to the breaking point. Caught between reform and confrontation, the opposition Green Movement opted for the former but was forced into the latter. Caught between constitutionalism and violence, the regime chose violence.

"The crisis was not just a confrontation between the regime and a section of the populace; it was also a crisis within the regime itself, and it is still not resolved," Axworthy writes. He might as well have written that it was a crisis within the populace itself. Under the monarchy, Iran's internal tensions—between modern and traditional ways of life, liberal and authoritarian political philosophies, cosmopolitanism and nativism, expansive and minimal interpretations of Islam—occupied a sort of negative space for Western observers. The shah's court was a conclave of idiosyncrasy and personal ambition compared with the Islamic Republic's rich web of connections to the society it governs—combatively, repressively, but dynamically nonetheless.

Axworthy's book went to press before the election of President Hassan Rouhani, a conservative cleric who has nonetheless promised to open up Iranian society and reconnect his country to the community of nations. Rouhani has transfixed the world by extending the hand of diplomacy to Western powers so long estranged. But his domestic mandate, to which outside observers have paid less attention, might ultimately prove determinative. Four long years of nonrecognition between the hard-line stalwart and a reform movement officially branded as "seditionist" seem to have hardened Iran's divisions into irresolvable hostility. Rouhani has a chance to sow peace among Iran's citizens, at the very least by providing legal outlets for criticism, dialogue, and dissent. For today, as in the past, national reconciliation remains the true test of Iran's rulers, who govern a society cleaved, not always in obvious ways, by ideology, class, and differing notions of identity. There, in the vibrant human space that extends through the Iranian interior, lies the new president's fundamental mandate and his greatest challenge.

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Command and Combust

America's Secret History of Atomic Accidents

Gregory D. Koblentz

Command and Control: Nuclear Weapons, the Damascus Accident, and the Illusion of Safety BY ERIC SCHLOSSER. Penguin Press, 2013, 632 pp. $36.00.

Between 1950 and 1980, the United States experienced a reported 32 "broken arrows," the military's term for accidents involving nuclear weapons. The last of these occurred in September 1980, at a U.S. Air Force base in Damascus, Arkansas. It started when a young technician performing routine maintenance on a Titan II missile housed in an underground silo dropped a socket wrench. The wrench punctured the missile's fuel tank. As the highly toxic and flammable fuel leaked from the missile, officers and airmen scrambled to diagnose the problem and fix it. Their efforts ultimately failed, and eight hours after the fuel tank ruptured, it exploded with tremendous force. The detonation of the missile's liquid fuel was powerful enough to throw the silo's 740-ton blast door more than 200 yards and send a fireball hundreds of feet into the night sky. The missile's nine-megaton thermonuclear warhead—the most powerful ever deployed by the United States—was found, relatively intact, in a ditch 200 yards away from the silo.

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The Damascus accident epitomizes the hidden risk of what the sociologist Charles Perrow has dubbed "normal accidents," or mishaps that become virtually inevitable once a system grows so complex that seemingly trivial miscues can cause chain reactions with catastrophic results. As the journalist Eric Schlosser explains in his new book, *Command and Control*, "The Titan II explosion at Damascus was a normal accident, set in motion by a trivial event (the dropped socket) and caused by a tightly coupled, interactive system." That system, he writes, was so overly complex that technicians in the control room could not determine what was happening inside the silo. And basic human negligence had only made things worse: "Warnings had been ignored, unnecessary risks taken, sloppy work done."

Command and Control is really two books in one. The first is a techno-thriller, narrating the Damascus accident in gripping detail and bringing alive the participants and the tough decisions they confronted in dramatic fashion. The second is a more analytic exploration of the challenge at the heart of nuclear command-and-control systems: how to ensure that nuclear weapons are both completely reliable and perfectly safe. Schlosser skillfully fits these two parts together to shine a bright light on the potentially catastrophic combination of human fallibility and complex systems. As in his two previous books, *Fast Food Nation* and *Reefer Madness*, Schlosser has exposed the hidden costs of practices that are widely accepted by the American public. Others have examined nuclear weapons though the lens of the normal-accidents theory, most notably the political scientist Scott Sagan in his influential 1993 book, *The Limits of Safety*. But Schlosser's gifts as a storyteller lend his book a visceral quality, such that every successive accident or close call feels more hair-raising than the last.

DOOMSDAY MACHINISTS

Since the dawn of the nuclear age, military planners, scientists, and civilian leaders have struggled with what the political scientist Peter Feaver has termed the "always/never dilemma": how to ensure that nuclear weapons always launch and detonate when ordered to do so, but never when they are not supposed to. In Schlosser's telling, throughout the Cold War, the military invariably opted for technologies and doctrines that maximized the readiness and reliability of U.S. nuclear forces to deliver a devastating blow against the Soviet Union.

The trend started under President Dwight Eisenhower, who supported the nuclearization of the military and the militarization of nuclear weapons as a cost-saving way to deter the Soviets. Under Eisenhower, custody of nuclear weapons shifted from the civilian Atomic Energy Commission to the military, and each service branch lobbied for new nuclear weapons to support its traditional missions. Even the authority to launch nuclear weapons under certain conditions was predelegated by the president to military commanders. As the number, type, and power of nuclear weapons increased, they became widely dispersed across the United States, at overseas military bases, and onboard ships and submarines.

Schlosser profiles one of the most powerful organizations driving this trend: the Strategic Air Command, which was created in 1946 as the air force's nuclear-strike arm. When General Curtis LeMay took over SAC in 1948, he inherited an organization that was grossly unprepared for its mission. To enable SAC to execute its elaborate war plan at a moment's notice under the most stressful conditions imaginable, he developed a checklist for every task and contingency, instituted a rigorous program of training and exercises, measured performance through routine and surprise inspections, and held officers and airmen accountable if their performance did not meet his standards. The command quickly developed a reputation for its discipline, proficiency, and zero tolerance for mistakes. "To err is human," newcomers were told, but "to forgive is not SAC policy."

Under LeMay's leadership, SAC's arsenal grew to include nearly 2,000 bombers, 800 tankers, and thousands of nuclear weapons. The hawkish LeMay, famous for orchestrating the firebombing of Japan, was and remains a controversial figure. As air force chief of staff, he advocated a first strike against Soviet missiles in Cuba during the Cuban missile crisis and, later, rapid escalation of U.S. military involvement in Vietnam. But it is undeniable that by the time LeMay left SAC, in 1957, he had transformed the organization from a hollow force into a formidable and impressive nuclear-war-fighting machine.

To maximize the United States' ability to survive a surprise attack and deliver a massive retaliatory blow, SAC kept a large portion of its bombers on ground alert—fully fueled, loaded with thermonuclear weapons, and ready for

launch within 15 minutes—and maintained a small number of nuclear-armed bombers on continuous airborne alert. It is no coincidence that the accident rate for U.S. nuclear weapons was highest between 1958 and 1968, when SAC's alert rate was at its peak. Schlosser recounts in horrifying detail a litany of accidents in which nuclear-armed bombers crashed or caught fire due to misplaced rubber cushions, loose nuts, broken vents, mechanical malfunctions, or human error.

In 1961, a B-52 on airborne alert broke apart in midair, dropping two Mark 39 hydrogen bombs near Goldsboro, North Carolina. As it hurtled toward the ground, one of the weapons rapidly passed through five of the six steps needed to arm it for an explosion. If the sixth safety mechanism had malfunctioned, the four-megaton bomb could have detonated on impact, showering the eastern seaboard with radioactive fallout. Even more disturbing, that sixth switch was later found to have had a history of malfunctions.

Near the end of the Eisenhower administration, the safety of nuclear weapons began to receive more concerted attention from weapons scientists and civilian leaders. As Schlosser recounts, the military's strong preference for reliability tended to trump other concerns. Even civilians such as Donald Quarles, the secretary of the air force, who took a personal interest in nuclear safety, believed that such considerations "should, of course, cause minimum interference with readiness and reliability." The uniformed brass were even less tolerant of such interference, and high-level civilian intervention was frequently required to ensure the adoption of measures that would improve security and reduce the risk of unauthorized use.

One of the factors that contributed to this prioritization of reliability over safety was the intense secrecy that shrouded all things nuclear. Military officials withheld details about nuclear accidents not only from Congress and the public but also from other parts of the nuclear weapons enterprise. As part of his research, Schlosser obtained a 245-page declassified Pentagon report on nuclear mishaps, which lists hundreds of minor accidents and technical glitches that the weapons scientists who were in charge of ensuring the safety of the U.S. nuclear arsenal were never informed of. Schlosser provides several examples of unsafe, insecure, or high-risk practices that the military halted only after they were exposed to outside scrutiny. With 484 footnotes and a 29-page bibliography, Schlosser's book ably brings the hidden history of U.S. nuclear command and control to a broader audience.

POSTWAR POSSIBILITIES

As alarming as these revelations are, the world Schlosser so vividly describes no longer exists. The Cold War ended more than two decades ago. As Schlosser himself acknowledges, steep reductions in strategic nuclear arms, the retirement of older and more dangerous weapons, and the near-total elimination of tactical nuclear weapons have greatly reduced the risks of a nuclear accident. Yet Schlosser is quick to point out that this change does not mean the risks have been eliminated. In August 2007, for example, a B-52 bomber flew from the Minot air base, in North Dakota, to Louisiana mistakenly loaded with six cruise missiles, each armed with a 150-kiloton nuclear warhead for a combined yield of about 60 Hiroshima-size bombs. Surprisingly, this incident warrants only a page in Schlosser's book, despite it being the first time since SAC's airborne alert was terminated in 1968 that a nuclear-armed bomber flew over the United States.

A report of the incident in the *Military Times* triggered an avalanche of investigations into the air force's nuclear safety and security measures. After then Secretary of Defense Robert Gates fired its secretary and its chief of staff, the air force embarked on a major reorganization of its nuclear operations. One of the most important changes was to create a high-level command dedicated to the nuclear mission, the Air Force Global Strike Command. Some of the independent inquiries pointed to the dissolution

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of SAC in 1992 and the erosion of its organizational culture as the root cause of the Minot incident. Yet this view risks romanticizing SAC. Although the discipline and attention to detail that the command instilled in its members was commendable, its emphasis on operational readiness at the expense of safety was not. And despite SAC's zero-tolerance approach, dangerous accidents occurred nonetheless. Schlosser's book is a powerful reminder that no combination of organizational design and culture can prevent accidents when systems are highly complex, tightly connected, and sensitive to unexpected deviations from standard operating procedures.

Perhaps the most important application of the lessons from Schlosser's book is not to the United States but to regional nuclear powers such as India and Pakistan, where Schlosser believes the biggest risk of nuclear confrontation now lies. With India and Pakistan capable of annihilating each other's capitals with a nuclear-armed missile in a matter of minutes, these countries face even stronger pressures on their command-and-control systems than the Cold War superpowers did. To make matters worse, Pakistan is currently introducing tactical nuclear weapons into its arsenal to counter India's conventional superiority, lowering the threshold for when nuclear weapons might be used during a conflict. And Pakistani nuclear planners must also grapple with internal security threats of a kind that neither the United States nor the Soviet Union ever had to face. As a result, Pakistan faces what Sagan calls the "vulnerability/invulnerability paradox": measures that allow its nuclear forces to withstand a first

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strike, such as mating warheads to mobile missiles and dispersing them, also make them more vulnerable to theft or takeover by terrorists.

India's nuclear command-and-control system faces a different challenge. According to Verghese Koithara, a retired Indian vice admiral, India's program suffers from too little military input. Nuclear doctrine remains in the hands of civilian scientists who are disconnected from the operational realities of handling and deploying nuclear weapons. As a result, the Indian nuclear command-and-control system is characterized by a "preference for networking over institutionalization, tight compartmentalization of activities, a dysfunctional approach to secrecy, highly inadequate external audit, and a marked lack of operational goal setting." This description does not inspire much confidence in the system responsible for ensuring the safety and security of India's roughly one hundred nuclear weapons.

DISASTER RELIEF

Schlosser concludes his book on a contradictory note. On the one hand, he pessimistically describes the world's nuclear weapons as "an accident waiting to happen, a potential act of mass murder. They are out there, waiting, soulless and mechanical, sustained by our denial—and they work." On the other hand, his book is filled with examples of when nuclear weapons haven't worked, even when subjected to abnormal environments and unanticipated stresses. According to Schlosser, "none of the roughly seventy thousand nuclear weapons built by the United States since 1945 has ever detonated inadvertently or without proper authorization." This safety record is even more impressive when one takes into account the 55,000 nuclear weapons produced by the other eight nuclear weapons states. Schlosser's account shows that serious accidents have occurred but also that they have never resulted in the ultimate catastrophe—a nuclear explosion.

As Perrow has pointed out, this apparent contradiction makes logical sense. A nuclear weapon must undergo a highly precise sequence of events before it can detonate, and any accident that disrupts a single step in this process will prevent an explosion. According to Perrow, "the immense complexity of the devices might have protected us from disaster even as it caused lesser accidents." But as Schlosser notes in his book, complacency about the safety of nuclear weapons risks running afoul of what the sociologist Donald MacKenzie has called "the Titanic effect": the safer a system is believed to be, the more catastrophic the accident to which it is vulnerable. The challenge, then, is to make the system safer while preserving the belief that it is dangerous.

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Art in the Time of Authoritarianism

Spain's Cultural Success Under Franco

Victor Pérez-Díaz

Franco's Crypt: Spanish Culture and Memory Since 1936
BY JEREMY TREGLOWN. Farrar, Straus and Giroux, 2013, 320 pp. $30.00.

Seventy-five years after its conclusion, the Spanish Civil War can sometimes seem like a river of blood that led inexorably to the sea of horrors that was World War II. But Spain's battle was also a devastating conflict in its own right, killing approximately 500,000 people. The war, which lasted from 1936 to 1939, pitted the Republicans, loyal to the existing government, against the Nationalists, a rightist rebel coalition led by General Francisco Franco. Franco's initial coup failed but left the country militarily and politically divided. The Nationalists eventually won, and Franco ruled Spain from 1939 until his death, in 1975.

The war, so often misunderstood as a mere prelude to World War II, is also frequently miscast as a simple story of good versus evil, a fight between democrats and fascists. In fact, neither side in the struggle could honestly claim the mantle of democracy. Franco, of course, made no such attempt: he was proudly authoritarian. As for the Republicans, although they paid lip service to democratic principles and tried to practice them, their side devolved into disorder and lawlessness during the war, and anarchists and communists came to dominate their ranks.

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Nor were the Republicans particularly virtuous from a moral standpoint. As the Nationalists were quick to point out, the Republicans assassinated almost 7,000 priests and nuns and killed roughly 2,500 prison inmates in the 1936 Paracuellos massacres, a series of organized mass murders during the battle for Madrid. Franco's forces, of course, committed their own share of atrocities and repression, both during and after the war. Both sides believed they had to be ruthless because most ordinary Spaniards were not that interested in fighting for either side and had to be coerced into doing so through fear and violence. In the first months of the conflict, 120,000 people volunteered to fight for the republic, and the Nationalists rallied some 100,000 volunteers; by the end of the war, the Republicans and the Nationalists had mobilized, largely through conscription, about 1.7 million and 1.2 million men, respectively. These figures suggest that the war involved not two Spains but three: two polarized blocs of true believers and a far larger body of people who just went along—or were forced to.

The war's carnage remains indelibly etched into Spanish memory. Tremendous amounts of ink have been spilled discussing and analyzing the war in the last 75 years. Indeed, some Spanish historians claim that the volume of historiography on the civil war comes close to that covering World War II. A small but growing part of this large bibliography studies the memory of the war and its lingering effects on Spanish culture and society. Many of these writings, similar to those on the war itself that have presented it as a straightforward morality tale, take a less-than-nuanced pro-Republican viewpoint, most notably in their portrayals of Francoist Spain as a cultural desert.

It is for precisely this reason that *Franco's Crypt*, the latest book by the British literary critic Jeremy Treglown, is so refreshing. In his focus on the surprising richness of Spanish culture since the war, Treglown pushes back against a knee-jerk pro-Republican perspective—not by apologizing for the Nationalists but simply by abstaining from projecting his own moral stance on the culture of the period. As he writes, "Franco is a bad memory, like a bad dream. But 'bad memory' also means forgetfulness and falsification. When Spain's campaigners for historical memory accuse their opponents and critics of *olvido*, amnesia, they have themselves often forgotten, or overlooked, or are simply ignorant of, the rich historical deposits in their own culture."

To explain how the Spanish have come to terms with the war and Franco's rule, Treglown narrates a series of personal encounters with people and places in contemporary Spain, weaving them together with his examinations of cultural artifacts, including public works, paintings, movies, and novels. His analysis is anything but simplistic. He shows how the day-to-day cultural reality of the Francoist period was much more complex and less planned from above than most portrayals suggest. This cultural richness resulted not, Treglown argues, from benevolence on the part of Franco or his entourage. Rather, it reflected the reality that for Franco, an opportunistic authoritarian eager to get along with the West, governing Spain meant allowing for limited pluralism and making concessions to a population ever more used to a modicum of wealth and freedom.

THE POLITICS OF MEMORY

Treglown begins his journey by introducing readers to the Association for the Recovery of Historical Memory, a group of Spaniards trying to right the wrongs of the war. Its members are sensitive souls who have nevertheless taken on a sometimes macabre task: searching for the remains of bodies to give them a proper burial. Many of those who were killed by the Nationalists during the war and its aftermath still lie in mass graves. In 2000, the association began a nationwide effort to disinter and rebury the bodies. Its task, not surprisingly, has been complicated by politics. When the Socialist Workers' Party took power in 2004, its leader, Prime Minister José Luis Rodríguez Zapatero, sought to pass the Law of Historical Memory, condemning the Franco regime and granting certain rights to the descendants of the victims. The law inevitably (and, Treglown argues, intentionally) drew the opposition of the conservative People's Party, thus making the party appear to be a defender of Francoism. The law was ultimately approved in October 2007.

Of course, when they were in power, Franco and his supporters also politicized the act of commemorating the war—a

The Valley of the Fallen: Franco's memorial to the dead, December 1956

GETTY IMAGES / TIME & LIFE PICTURES / DMITRI KESSEL

fact that becomes apparent in Treglown's portrait of the Valley of the Fallen, a memorial on the outskirts of Madrid commissioned by Franco and completed in 1959. The memorial includes a Catholic basilica, underscoring the extent to which Catholicism formed a crucial part of the collective imagination of the Nationalists. Franco had cast his military rebellion as a holy crusade, citing the Republicans' complicity in the assassinations of thousands of clergy members as proof of their godlessness, and he used his alliance with the church to help legitimize his rule.

The strategy worked during the early years of the Franco era. However, over the course of the following decades, Franco's Catholic allies underwent a profound change. Because their goal was to retain a hold on Spaniards' hearts and minds, the Spanish church had to take into account the intellectual and emotional attachments that many Spanish felt not only to the war's winners but also to the losing side. The church's outreach to Republican sympathizers was strengthened by broader shifts within European Catholicism during the 1950s and 1960s, as the Catholic Church began experimenting with Christian Democratic parties and made overtures to the left. The church also underwent a deep theological renewal during this same period, which led to the liberalizing Second Vatican Council in the early 1960s.

The end result was a new brand of ecclesiastics and lay Catholics who felt comfortable detaching themselves from

Franco's regime, or even fighting it head-on in a variety of forums, including student movements, intellectual circles, unions, political parties, and the media. During the 1950s and 1960s, a surge of anti-Franco civil-society associations accompanied vast demographic and economic transformations produced in part by waves of Spaniards going to other parts of Europe to work and study, tourists arriving from the rest of Europe, and increasing economic and cultural exchanges of other sorts between Spain and other countries. These developments transformed Spanish universities, factories, and towns—and in turn loosened the country's politics.

THE MIRROR UP TO NATURE

In the second half of *Franco's Crypt*, Treglown finds a parallel to this set of extraordinary economic and social changes, and the little-understood political opening that came with it, in the work of the Spanish artists, filmmakers, and novelists who sought to make sense of the civil war and life under Franco. Just as in the political sphere, where Franco's rule could not fully repress trends that ultimately led to the restoration of Spanish democracy, the dictator also had trouble snuffing out Spain's powerful cultural avant-garde. Even when they found themselves pitted against an authoritarian government, Franco-era artists continued to produce work of aesthetic, moral, and emotional complexity.

Referring to Spanish abstract artists such as the sculptor Eduardo Chillida and the painter and sculptor Antoni Tàpies, Treglown writes, "While [they] were affected . . . by the political-historical situation in which they grew up, it didn't hinder them"—a statement equally applicable to any number of the writers and filmmakers Treglown profiles. The most celebrated Spanish novelists and directors of the Franco era offered accounts of people's lives that avoided simple morality plays and partisan games. Most of them refused to take part in fratricidal political fights over the war's legacy. Instead, they bore witness to the decency, resilience, and cunning of ordinary people recovering from the devastation of war, enduring the postwar years, and later adapting as Spain began to enjoy relative prosperity. In a sense, the most influential Spanish art and culture of the Franco era embraced a nationalism of sorts without necessarily embracing the Nationalists.

Emblematic of this stance was the Nobel Prize–winning novelist Camilo José Cela. During the war, Cela had served in the Nationalist army, and he later worked as a censor for the regime. But in his novels, he eschewed the war's factionalism. As Treglown writes, Cela's celebrated 1969 novel *San Camilo, 1936* focuses on the first days of the civil war, interpreting the violence and upheaval through the stories of "ordinary people . . . including several who are killed but whose deaths make no headlines." Cela's novels did not ignore political events altogether; they just focused on their effects on the common people, each of whom, as Cela put it, carries "a moving little novel stuck to his heart." The dedication of *San Camilo* reads as one of the most damning judgments of the Spanish Civil War ever written and demonstrates the sort of unifying, inclusive, and yet chastened nationalism that defines many of the works Treglown describes: "To the conscripts of 1937, all of whom lost something: their life, their freedom, their dreams, their hope, their decency. And not to the adventurers from abroad, Fascists and Marxists, who had their fill of killing Spaniards like rabbits and whom no one had invited to take part in our funeral."

Cela's opposite number, in some ways, was Ramón Sender, another of the novelists analyzed in *Franco's Crypt*. Sender was a passionate Republican who saw his wife killed by Nationalist forces during the civil war and was later exiled, first to Mexico and later to the United States. Yet as Treglown highlights, Sender's memoir, *The War in Spain*, is "exceptionally alert to the feelings and views of people on the other side." Treglown cites Sender's best-known work, the 1953 *Requiem for a Spanish Peasant*, as another example of the novelist's "compulsion to cross political boundaries and delve into the emotional as well as moral difficulties they can create."

HOW SPAIN BECAME DEMOCRATIC

In a sense, both Cela and Sender helped establish the conditions for the politics and culture of reconciliation that came to characterize Spain's transition to democracy following Franco's death. Spain's transition cannot be explained just by paying attention to the behavior of political, social, and economic elites in response to Franco's death. Any account must consider the developments that took place during Franco's rule itself, including the profound cultural transformations of the period. For the protagonists of the era, the civil war and authoritarianism provided a lesson in reverse—a "how not to" lesson in

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The Council will select one individual each term (fall, spring, and summer) to work in the Council's New York City headquarters. The intern will work closely with a Program Director or Fellow in either the Studies or the Meetings Program and will be involved with program coordination, substantive and business writing, research, and budget management. The selected intern will be required to make a commitment of at least 12 hours per week, and will be paid $10 an hour.

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political life. It made them inclined to cooperate, to consider others' demands and criticisms, and to initiate a tradition of moderation that was crucial for the country's democratic transition.

This was especially true of the children of Francoism, who came of age as student protest politics swept Europe in the late 1950s and 1960s. This group largely hailed from middle-class families that had either supported the government or seen it as a lesser evil. Yet in time, many in this generation turned against the regime and came to see its discourse as a mix of conservative and capitalist platitudes, encouraged by the teachings of an anachronistic church. They thought Francoism gave rise to too many unscrupulous social climbers, rampant corruption, and a world of cultural opportunists.

Despite their disillusionment with Franco's rule, many in this generation managed to find positions in the lower echelons of the state-sanctioned academy or the public administration, particularly in the economic bureaucracy. From those positions, they helped foster a milieu sympathetic to art and culture. The end result was a society in which repressive policies coexisted with a degree of ambiguity about free expression and in which many cultural critics and political dissidents lived cautiously but quite publicly. In fact, none of the ministers of the first post-Franco socialist government, in the early 1980s, had spent a single night in a Franco government jail. The only exception was Miguel Boyer, who, as finance minister, convinced his fellow Socialists to eschew traditional leftist programs and instead adopt a variant of the conventional, moderate economic policies of the time.

But what such figures lacked in radical bona fides, they made up for in pragmatism. Indeed, the experience of fighting the system while securing a position within it left many Franco-era political figures in the ideal position to lead the country through a democratic transition. They knew how to prepare a left-leaning political and cultural world for an accommodation with a capitalist economy and liberal democratic politics. They were prepared to make the necessary compromises, such as allowing the monarchy to remain an element of Spain's government, enshrining private property in the constitution, and accepting the fact that educational freedom meant a role in the schools for the church and other private organizations.

For all its progress, today's Spain is struggling with a grave and prolonged economic crisis, strong separatist movements, and a pervasive lack of trust in the political class. But there seems to be a limit to the intensity of the divisions in Spanish society. Maybe that is a testament to the lasting effects of the Franco generation's pragmatism and its moderate, unifying, and almost tacit nationalism. In other words, the accommodating, cautious style that Treglown observes has helped keep the country together even in extremely dire straits.

Blind Oracle

A Response to "Never Saw It Coming"

Richard Katz

In his recent essay "Never Saw It Coming" (November/December 2013), Alan Greenspan makes two central arguments: first, that virtually no one foresaw the 2008 U.S. financial crisis and, second, that irrational "animal spirits" were the root cause. If true, these propositions would absolve policymakers such as Greenspan of blame. But neither holds water.

The truth is that many experts worried about the U.S. housing bubble and predicted a crash, even if they couldn't pin down its timing or severity. As early as 2002, Congress summoned Greenspan himself to discuss "the possible emergence of a bubble in home prices," a concern he repeatedly dismissed. A year later, the economists Robert Shiller, who won last year's Nobel Prize in Economics for his work on financial crises, and Karl Case voiced just that worry. Also in 2003, 50 of the top U.S. newspapers ran a combined 268 stories referencing a "housing bubble." By 2005, they had run an additional 1,977 such stories.

What turned the eventual bursting of that bubble into the worst financial crisis since the 1930s was not animal spirits but unregulated derivatives—complicated financial instruments whose value is "derived from" an underlying asset. Some derivatives, such as corn futures, can help economic growth, but that did not happen here. In the case of home mortgages, financiers bundled millions of toxic loans using the mortgage income as supposed backing. Then, they created a second layer of derivatives supposedly based on the value of the first set, and so on. In the end, the total package—built on such strange-sounding concoctions as "synthetic collateralized debt obligations" and "naked credit default swaps"—had a face value of $35 trillion, 14 times the value of the mortgages supposedly backing them. This explains why the 2008 financial crisis was so much larger than the housing crash that triggered it.

Greenspan was one of the chief advocates of deregulating finance, including derivatives. Testifying before Congress in 2005, he asserted that even if home prices declined, they "likely would not have substantial macroeconomic implications. Nationwide banking and widespread securitization of mortgages make it less likely that financial intermediation would be impaired than was the case in prior episodes of regional house price corrections."

But many others correctly predicted that this house of flimsy cards would actually amplify the effects of a decline in home prices. As early as 2002, the investor Warren Buffet argued that the more exotic derivatives were "financial weapons of mass destruction." And in 2005, Raghuram Rajan, then the International Monetary Fund's chief economist, warned of the dangers created by new "perverse incentives" for financial managers. Banks, he said, were "employing risky derivatives strategies to goose up returns." In the event of a downturn

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in the assets behind these derivatives, such as housing, "the interbank market could freeze up, and one could well have a full blown financial crisis."

Former U.S. Treasury Secretary Larry Summers publicly dismissed Rajan as a "Luddite." Seven years earlier, Summers had quashed an effort by Brooksley Born, then chair of the U.S. Commodity Futures Trading Commission, to regulate some financial derivatives. "I have 13 bankers in my office," Summers told her in a phone call at the time, "and they say if you go forward with this, you will cause the worst financial crisis since World War II."

RATIONAL FACTORS

By blaming the financial crisis on "animal sprits" and "irrational factors," Greenspan suggests that no one is at fault. The real problem, however, was that although most players had pursued their own interests rationally, they had, as Rajan put it, "perverse incentives."

Greenspan and other proponents of radical deregulation claimed to be liberating market forces. But markets cannot work properly unless healthy institutions nurture them. That includes making sure that each key player has independent interests so that each can balance the power of the others. In this environment, what is good for each player is generally good for the economy as a whole. By removing many existing checks and balances, radical deregulation ended up undermining the market.

Perhaps the most perverse incentives were those governing the behavior of CEOs of financial firms, for there was little to dissuade them from enriching themselves at the expense of their firms and shareholders. CEOs routinely took on the additional role of chair and filled their boards with fellow CEOs seeking equally generous compensation deals. If they took big risks that worked out, these executives were given enormous rewards; yet even when the gambles failed, they still won big. Stanley O'Neal, the former chair and CEO of Merrill Lynch, walked away with $165 million after ruining the company. And according to one Harvard study, Lehman Brothers' last chair and CEO, Richard Fuld, ended up with a net $222 million from the bankrupt firm.

Mortgage lenders, too, had skewed incentives, since they no longer kept the loans on their own books, instead passing them on to investment banks, which bundled and sold them as derivatives to investors. These lenders now had little stake in whether borrowers could pay back the loans. As a consequence, lenders approved huge numbers of mortgages that did not require the borrowers to document their ability to pay. Many financiers themselves reportedly dubbed these mortgages "liar loans"—which suggests that they, too, may have been committing securities fraud. Yet Greenspan refused to use the powers that Congress had given him in 1994 to require nonbank mortgage issuers to follow the same simple rules applied to banks: you can't lend to people without a down payment, without proof of ability to pay, and without a beating heart (there were several reported cases in which lenders approved mortgages for deceased individuals).

The credit-rating agencies, whose impartial judgments investors relied on, faced their own perverse incentives. After decades of being paid by investors, in the 1970s, they switched to earning fees from lenders. This gave the agencies a financial interest in assigning high ratings to trillions of dollars' worth of toxic assets.

At the same time, regulators weakened legal deterrence. After the collapse of Lehman Brothers in 2008, Timothy Geithner, then president of the Federal Reserve Bank of New York, told Andrew Cuomo, then New York's attorney general, that Cuomo's investigations into Wall Street malfeasance could destabilize the financial system. The result was a de facto policy of protecting financiers deemed "too big to jail." It is hard to think of any major player who has even been indicted, let alone convicted and jailed. What a contrast to the prison sentences for a host of corporate fraudsters, such as the executives at Enron and WorldCom, in the early years of this century. Geithner had reason to know better. As the U.S. Treasury's attaché in Tokyo during the early 1990s and then as a senior Treasury official, Geithner had participated in the Clinton administration's criticism that excessive leniency on the part of Japan's Ministry of Finance had prolonged that nation's banking crisis. Even today, the U.S. House of Representatives is allowing lobbyists for Citigroup to draft the words of laws aimed at weakening parts of the Dodd-Frank financial reform law relating to derivatives. Congress members deemed friendly get more campaign contributions from Wall Street.

As a result of all these changes, what was good for each powerful player was no longer good for the system as a whole. Greenspan failed to recognize this danger, not for lack of evidence but because he wore ideological blinders. Born later recalled Greenspan telling her, "You probably will always believe there should be laws against fraud, and I don't think there is any need for a law against fraud." He simply believed the market would correct itself. It was not until 2008 that Greenspan admitted in congressional testimony that he had "made a mistake in presuming that the self-interests of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms."

Regulators need not be soothsayers or micromanagers, but they must safeguard the market from conflicts of interest, perverse incentives, and collusion. With the proper checks in place, market players will have an interest in doing the right thing. Lenders who have to keep on their books even parts of the loans they make are more likely to make sure that the borrowers can repay those loans. CEOs compelled to return compensation if their firms suffer major losses would be more hesitant to make reckless bets with other people's money.

To be sure, booms and busts will come and go. But their severity can vary dramatically based on the policies in place to prevent them. With stronger regulations, neither the housing and derivatives bubbles nor the eventual crash would have been so bad. Shifting the blame from identifiable perverse incentives to vague talk of "animal spirits" leaves us more vulnerable to a repeat.

Reverse the Curse

How Can Oil Help the Poor?

Land Matters

Karol Boudreaux and Tiernan Mennen

Larry Diamond and Jack Mosbacher ("Petroleum to the People," September/October 2013) rightly observe that the coming oil boom in Africa is, paradoxically, a frightening prospect for the continent's poor and marginalized. If the so-called resource curse holds, this new surge of easy money will indeed "poison the prospects for development," fueling corruption, inflation, and authoritarian regimes. The authors' proposed solution, however, falls short. Diamond and Mosbacher suggest that governments could reverse the curse by distributing oil revenues directly to the people as taxable income. But doing so would not address the fundamental issue that gives rise to the resource curse in the first place: weak land rights.

Most developing countries still rely on legal frameworks that were originally established for colonial-era exploitation. These laws, many of which are still in place today, vest all natural resources—and often the associated land, too—in the state. This means that individuals or communities that own land do not own the minerals, petroleum, timber, water, or other resources attached to it. The state retains that privilege, and it profits from resource extraction by granting licenses and concessions to private firms. Locals thus have little say in contract negotiations and rarely see any of the profits. To further complicate matters, most property ownership, especially in Africa, is not legally recognized, even after generations of traditional use—making it easier for the government to remove people living in the way of extractive activities.

This setup contrasts markedly with the legal frameworks that govern landownership in those developed countries that have harnessed their natural resources to build strong economies, large middle classes, and democratic societies. In the United States, resource rights attach to individual landownership. In no case does the government automatically own what lies on or underneath privately owned land. The state instead gains revenue from taxing the incomes of landowners and of the companies that help them extract their land's resources.

The United States has extended the benefits of landownership to many indigenous communities, and the results have been impressive. In Alaska, some 110,000 shareholders of 12 for-profit native corporations now own entitlements to more than 40 million acres of land. Those ownership rights have encouraged the shareholders to carefully manage their resources, and in 2010, their collective revenue exceeded $8 billion, providing cash dividends that totaled nearly $170 million. That translates into significant tax revenue that the state and federal governments can use to provide services to others. And the businesses that the corporations operate have provided thousands of jobs and internships.

In some developed countries, such as Canada and Norway, the government still owns or controls a large share of the natural resources. But in those states, the resources tend to be located either offshore or in sparsely inhabited interiors. They also represent a complimentary source of government revenues.

The United States provides a better model for developing countries. Individual resource rights there underpinned the development of democratic institutions and a diversified economy. By expanding the the tax base, landownership gave citizens a stronger stake in local governance and gave the government the capital to provide needed services. Because both the risks and the benefits of resource extraction were tied to landownership, individuals and communities could weigh the tradeoffs of extraction. And the government assumed a more natural role as regulator.

Although the grand solution proposed by Diamond and Mosbacher would improve on the status quo in developing countries, it would at the same time undercut the principle that strong property rights are critical to sustainable economic growth. A cash-for-petroleum scheme would provide equal levels of income to all people, regardless of who carries the brunt of the burden. Yet the destruction and pollution of land disproportionately hurts the communities that inhabit it. In South Sudan, for example, the seasonal grazing lands of the Nuer and Shilluk tribes have been turned into oil fields. And in Nigeria, the communities that live in the Niger River delta have had to suffer the consequences of oil spills from offshore rigs. Yet under a cash-for-petroleum scheme, they

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The Council considers both undergraduate and graduate students with majors in International Relations, Political Science, Economics, or a related field for its internship program.

A regional specialization and language skills may also be required for some positions. In addition to meeting the intellectual requirements, applicants should have excellent skills in administration, writing, and research, and a command of word processing, spreadsheet applications, and the Internet.

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would not be entitled to the compensation they deserve.

Linking resources to land in these countries would prove difficult but not impossible. Any attempt to provide more cash to those adversely affected, however, would be virtually impossible without first establishing who has rights to what resources. The first step, then, is to legally recognize the long-standing claims of individuals and communities to the land they already live on. In such countries as Afghanistan and Indonesia, this would also mean recognizing customary or traditional landownership systems and enshrining these communal arrangements in law. To spur this change, Western development assistance must promote local landownership, linking trade agreements, aid budgets, and loans to the recognition and protection of land rights. Over the long term, governments should continue to encourage a careful transition from state ownership to individual and community resource ownership.

Empowering locals to manage resources, generate revenue, and contribute to the tax base would minimize the effects of the resource curse while avoiding the pitfalls of Diamond and Mosbacher's cash-for-petroleum scheme. Doing so would address the root cause of the curse, not merely its symptoms.

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Diamond and Mosbacher Reply

There is no magic bullet for avoiding the resource curse, and so we welcome Karol Boudreaux and Tiernan Mennen's response. Even our own proposal—a far-reaching oil-to-cash scheme, in which natural resource profits would be distributed to citizens as taxable income—would have to be complemented by radical efforts to increase the transparency of government budgets and revenues. And numerous other reforms are also worth considering. One former president of a mineral-rich developing country told us that he would like to require extractive industries to make payments directly to the people in the communities that inhabit the land they are extracting from. This would not strengthen citizenship the way direct taxation would, but it would get resource revenues directly to the people.

Certainly, Boudreaux and Mennen are correct that justice demands that the people who live on resource-rich land should enjoy both a political right to have a large say in whether the mineral wealth will be extracted at all and an economic right to a disproportionate share of the income from that wealth, given that they will bear more of the social and environmental costs of extraction.

But their proposal poses some practical and moral dilemmas. First, much of Africa's newly discovered oil, particularly in West Africa, lies offshore, and so much of the revenue will accrue to the government—and then to government officials—regardless of any changes in land rights. Second, given that where mineral wealth lies is an accident of

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nature, it is unclear who should be considered the owners of that wealth: the people who by chance live on top of it or the broadest segment of humanity that could reasonably lay a claim to it—that is, all of a country's citizens.

In addition to strengthening land rights, Boudreaux and Mennen want to give effect to these claims by granting ownership of the subsurface and other resources to the communal or individual landowners. This proposal would leave two problems, however. First, once the revenue flows to a community, there is no good way to ensure distributive justice within it. To be sure, the people of Nigeria's oil-rich but now environmentally devastated Delta region have seen tragically little benefit. But this is not because money has not flowed to them. In fact, they have received vast and disproportionate amounts of the revenue, as Nigeria's oil-producing states retain 13 percent of oil revenues off the top. The core problem is bad governance at every level. It is not only presidents and federal ministers who have stolen from the Nigerian people but also state governors and local officials. Recognizing communal rights to natural resources would not serve justice unless the revenue flowed directly to the people, which is hardly guaranteed.

Second, giving ownership of the subsurface and other resources to private landowners could trigger extensive land grabs in badly governed states, as the rich and powerful pushed ordinary people off their land in order to seize the wealth on and underneath it. This possibility underscores why the issue of land rights is so important, but it also suggests that distributive justice might be better achieved by establishing that natural resources belong not to the state or to any particular individuals but to all the people of the country.

We say "might" for a reason. Ultimately, what mineral-rich, poor countries most need now is an open, far-reaching policy debate. It is possible to know what has not worked in the past, but not to predict what will work under different circumstances in the future. We suspect that in most African countries, where land rights are flawed or nonexistent and tribal institutions have mingled in complicated ways with colonial legal systems, oil-to-cash programs would offer an efficient and achievable path to addressing the resource curse. But each society must weigh its own options. Policy innovation is sorely needed, and in that spirit, we welcome this latest contribution to the debate.

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Recent Books

Political and Legal

G. John Ikenberry

If Mayors Ruled the World: Dysfunctional Nations, Rising Cities
BY BENJAMIN R. BARBER. Yale University Press, 2013, 432 pp. $30.00.

Barber, author of the prescient 1996 book *Jihad vs. McWorld*, sees cities as the best hope for solving global problems and safeguarding democracy. In Barber's view, nation-states have shown that they are simply not up to the task of global governance. Cities, on the other hand, have demonstrated remarkable political vitality. Their politics tend to be pragmatic and oriented toward problem solving: trash needs to be picked up; streets must be plowed. Barber's most interesting thesis is that cities, which now house more than half of humanity, are more internationalist and inclined toward bottom-up solutions than states. Barber's proposal is to make cities the "building blocks" of a form of global governance enshrined in a "parliament of mayors." The book is organized around short portraits of activist mayors, such as New York City's Michael Bloomberg, London's Boris Johnson, Moscow's Yuri Luzhkov, and Delhi's Sheila Dikshit. The book is convincing in its claim, echoed in the words of Rio de Janeiro's mayor, Eduardo Paes, that the leaders of cities have "the political position to really change people's lives." Less convincing is the idea that cities can carry the burden of global problem solving, where the challenges include stabilizing financial markets, promoting economic growth and equality, and protecting rights and freedoms.

Just War and International Order: The Uncivil Condition in World Politics
BY NICHOLAS RENGGER. Cambridge University Press, 2013, 220 pp. $85.00 (paper, $29.99).

In this work of political theory, Rengger notes what he considers a disturbing shift in Western discourse on the use of force. Liberal internationalists and "just war" theorists see themselves as trying to prevent and circumscribe acts of violence and war. But Rengger argues that, ironically, these liberal political traditions are instead creating new legal and moral justifications for the use of force around the world. Liberal ideas of law and justice have led the Western powers to pursue new and more expansive collective ends. Although many liberals have opposed specific interventions, such as the Iraq war, Rengger sees their embrace of such ideas as "the responsibility to protect" as a sign that long-standing restraints on the use of force will soon begin to disappear. Rengger wants the world to think of international law and justice not as tools for a progressive agenda but as frameworks that allow people to pursue their own ends. But the question remains: Without ambitious efforts to solve collective global problems, how viable is individual freedom?

NATO Before the Korean War: April 1949–June 1950
BY LAWRENCE S. KAPLAN. Kent State University Press, 2013, 240 pp. $60.00.

In this detailed account of NATO's first year, Kaplan shows that the launch of the alliance is best understood not as a watershed moment for American internationalism but as just one part of the long path the United States had traveled from isolationism to engagement. Kaplan chronicles the Truman administration's navigation of the tricky politics of ratifying the treaty and bringing the alliance to life. The book's most interesting element is the story it tells about how American proponents of NATO were able to cast the treaty less as a military alliance and more as a tool of U.S. postwar internationalism, creating a partnership that would bolster European stability and allay British and French fears of a resurgent Germany. The alliance emerged not in a single moment of creation but through a long and tedious process of negotiations marked as much by improvisation as by design. Nonetheless, as Kaplan argues, the two sides ultimately discovered the terms of a grand bargain: the United States would commit itself to helping rebuild and protect Europe, and the Europeans would overcome their differences and forge a new Atlantic system.

Global Intellectual History
EDITED BY SAMUEL MOYN AND ANDREW SARTORI. Columbia University Press, 2013, 352 pp. $35.00.

Scholars have traditionally studied ideas and intellectual history within national, regional, or civilizational contexts. But as part of a broader "global history" movement, historians have begun to interpret the rise and spread of ideas as a global phenomenon. This useful collection includes scholars who study the paths of ideas such as Confucianism, republicanism, and market economics by examining what happened when intellectuals in one country grappled with the ideas of another. Others focus on the great forces that push and pull ideas around the globe, such as commerce and conquest. One of the more interesting chapters reveals that the particular European ideas about civilization and society that made their way to Japan during the late nineteenth century just happened to be ones that the Japanese authorities could use to legitimize their reorganization of the state. Lurking in the background of the book is a charged question: Is global intellectual history another way for the strong to dominate the weak, or is it a way for diverse peoples and societies to search together for knowledge?

Armed State Building: Confronting State Failure, 1898–2012
BY PAUL D. MILLER. Cornell University Press, 2013, 264 pp. $35.00.

In this excellent study, Miller brings to bear scholarly rigor and his recent experience as the U.S. National Security Council's director for Afghanistan and Pakistan to assess U.S. and UN efforts to rebuild failed states through armed intervention. Drawing on evidence from such missions in Germany after World War II and more recent attempts in Nicaragua, Liberia, Sierra Leone, Afghanistan, and elsewhere, Miller argues there is no master strategy that will work in all instances. In successful cases, such as the Allied occupation of Germany and the UN's postconflict reconstruction operations in Mozambique and Namibia, the key was correctly matching the strategy to the problem. The most important choices that would-be nation builders must make are whether to impose direct rule over a failed state and whether to assume full responsibility for its security. Miller argues that the ongoing failure in Afghanistan is a result of NATO and the United States' adopting the wrong strategy for rebuilding Afghan state security forces. Despite his firsthand experience of the struggle in Afghanistan, Miller delivers a surprisingly upbeat assessment of armed state building. His book displays an admirable clarity in its evidence and analysis, although it is worth wondering whether powerful Western states can reliably behave as carefully as Miller advises.

Economic, Social, and Environmental

Richard N. Cooper

A Case for Climate Engineering
BY DAVID KEITH. MIT Press, 2013, 112 pp. $14.95.

Many uncertainties surround the future effects of climate change. Keith, a physicist, argues that humankind would be wise to do some contingency planning, in case those effects prove to be more powerful than now predicted or come faster than expected. The earth has experienced many different climates, and human beings are highly adaptable. But we adapt more easily to slow processes than to rapid ones, so we should learn how to slow down global warming through climate engineering—just in case we need to. Keith focuses on techniques to reduce the amount of sunlight that reaches the earth's surface by reflecting some of it back into space, such as placing aerosols into the stratosphere. Keith does not recommend that anyone try this yet, nor does he suggest that it would be a good substitute for reducing emissions of greenhouse gases. But he wants scientists to learn how to do it effectively and efficiently while minimizing any unwanted side effects.

The Price of Rights: Regulating International Labor Migration
BY MARTIN RUHS. Princeton University Press, 2013, 272 pp. $35.00.

Migration across national boundaries has increased greatly in the last decade and has become a contentious political issue in many receiving countries. To what extent should countries encourage immigration? What rights should be conferred on immigrants, especially temporary ones? Ruhs emphasizes the uncomfortable tradeoffs built into every answer to those questions. The UN Human Rights Council and the International Labor Organization, along with many civil rights groups and labor unions, take the position that foreign-born workers should not be discriminated against in their new places of employment. Others, including the governments of developing countries and some economists, believe that more immigration, particularly from poor countries to rich ones, would improve the lots of the receiving countries and the immigrants alike. Ruhs points to the substantial tension that exists between those two positions: stronger rights will lead receiving countries to accept fewer immigrants, especially temporary ones. He urges receiving countries to prioritize the rights of immigrants, identifying which rights are inalienable and which ones should be considered more malleable given the need to stimulate more immigration.

Against the Consensus: Reflections on the Great Recession
BY JUSTIN YIFU LIN. Cambridge University Press, 2013, 273 pp. $29.99.

Lin, a former World Bank chief economist, examines the causes of the 2008 financial crisis. His analysis is kinder to China than other reviews of the crisis have been, and he places a good deal of blame for the disaster on financial deregulation in Europe and the United States. Lin argues that to end today's global economic stagnation and to reduce the risk of future financial crises, banks and households in Europe and in the United States must repair their balance sheets and Western governments must regain the flexibility they need to pursue sound fiscal policies. Economies around the world require long-term investments in infrastructure and education, and Lin urges international financial institutions to lend more for those purposes, financing such loans by borrowing in financial markets or directly from countries with excess foreign exchange reserves. Doing so would boost economic recovery and create jobs in rich countries while furthering development in poor ones. Lin also presents a rather sketchy proposal for reforming the international monetary system by introducing a new internationally agreed-on reserve asset and establishing relatively stable exchange rates.

Freedom From National Debt
BY FRANK N. NEWMAN. Two Harbors Press, 2013, 104 pp. $9.95.

Newman, a former senior official at the U.S. Treasury Department, offers a primer on the vital role of U.S. Treasury securities in the global economy. In the process, he exposes as mere blather much of the what passes for sound discussion of U.S. public debt and the federal government's debt ceiling, persuasively contradicting claims commonly made by deficit hawks. The U.S. government, whose securities are less risky than bank deposits, is not akin to an extremely large household, he argues, and its finances should not be evaluated as if it were. Near-term federal budget deficits are not a burden on future generations, as long as the borrowed funds are spent wisely and will result in more production. Foreign ownership of U.S. Treasuries does not pose much risk to the United States, and interest payments on U.S. public debt do not consume economic resources. This short book should be read by every journalist who covers economics and finance, every politician or policymaker who works on economic affairs, and anyone else concerned about the federal government's role in the U.S. economy and the country's financial system.

East Asian Development: Foundations and Strategies
BY DWIGHT H. PERKINS. Harvard University Press, 2013, 222 pp. $35.00.

During the past half century, the global economy's most impressive growth engines have largely resided in East and Southeast Asia. To explain the extraordinary performance of these Asian economies, Perkins draws on academic research and on his own decades-long experience as an adviser to developing countries. It comes as no surprise that the explanations vary over time and from economy to economy. Also unsurprising is the good deal of attention that Perkins pays to China, the largest of the economies examined (India and the rest of South Asia are not included). Perkins predicts that China's outsized economic growth will decline significantly in the years ahead, perhaps to an annual rate of five percent, which would still be high by world standards. He also helpfully places China in the context of other successful Asian countries, in which, Perkins argues, high growth has been aided by a strong emphasis on education. Asian countries' development of their nonagricultural labor forces has also played an important role, as has their steady engagement with the global economy.

Military, Scientific, and Technological

Lawrence D. Freedman

The Terrorist's Dilemma: Managing Violent Covert Organizations
BY JACOB N. SHAPIRO. Princeton University Press, 2013, 352 pp. $29.95.

Decoding Al-Qaeda's Strategy: The Deep Battle Against America
BY MICHAEL W. S. RYAN. Columbia University Press, 2013, 368 pp. $37.50.

If terrorists want to achieve their political ends, they need a strategy, as well as an organizational structure, that allows them to use their limited resources most effectively and maximize their impact. In this, they are no different from other political entities, except that their resources tend to be as meager as their ambitions are huge. Their organizational challenges are aggravated further by the need to remain covert.

In a unique study, Shapiro explores the management of such groups with considerable rigor, beginning with the nineteenth-century Russian progenitors of contemporary terrorist groups and ending with al Qaeda. Some of the groups he examines, such as the Palestinian organization Fatah and the Provisional Irish Republican Army, were substantial operations, and their size made it more difficult to retain cohesion among their distinct factions, especially when opportunities arose to move into more mainstream political activity. When Shapiro turns to smaller and supposedly more fanatical groups, it is strangely comforting to find their leaders struggling with dodgy expense claims and insubordinate hotheads and to see how bolder members feel weighed down by bureaucratic demands and slow decision-making. By analyzing the internal travails of such groups, Shapiro exposes some of their vulnerabilities: for example, the way their leaders, in trying to keep tabs on followers, inadvertently leave clues for intelligence agencies.

Ryan reinforces Shapiro's underlying point about the calculating nature of terrorist groups with a forensic history al Qaeda's strategic development. Ryan scrutinizes a number of important Salafi texts in which theorists allied with al Qaeda explain the radical nature of their objectives and methods. The most important observation is that they do not, as many might suppose, depend largely on inspiration from established currents in Islamist thinking; instead, they draw on some of the classic works on guerrilla warfare, including those by Clausewitz, Mao Zedong, and the North Vietnamese leader Vo Nguyen Giap. One important al Qaeda strategist, Abu Ubayd al-Qurashi, about whom little is known, appears to be extremely well read in Western military studies, including relatively recent works on "fourth-generation warfare," which is marked to a degree by the rise of violent nonstate groups.

Churchill's Bomb: How the United States Overtook Britain in the First Nuclear Arms Race
BY GRAHAM FARMELO. Basic Books, 2013, 576 pp. $29.99.

Winston Churchill's last major speech as British prime minister, delivered to Parliament on March 1, 1955, was one of his best. In vivid terms, Churchill made the case for nuclear deterrence, reflecting on the "sublime irony" that the world had reached a point "where safety will be the sturdy child of terror, and survival the twin brother of annihilation." In this terrific book, Farmelo tells the story of the United Kingdom's nuclear program, which began with pioneering work in Cambridge before World War II and ultimately merged with the United States' Manhattan Project. The book is built around a compelling portrait of Churchill that demonstrates the variability of his judgment. Farmelo also introduces readers to the remarkable collection of scientists who led the British endeavor and who helped shaped the country's nuclear policy, including Frederick Lindemann, Churchill's main scientific adviser, whom Farmelo portrays as an antidemocratic snob with flawed judgment. Farmelo demonstrates that although principles and evidence often shape the relationship between science and policy, personality and politics play just as large a role.

Out of the Mountains: The Coming Age of the Urban Guerrilla
BY DAVID KILCULLEN. Oxford University Press, 2013, 352 pp. $27.95.

Kilcullen has a rare ability to combine serious theory with the insight of an experienced practitioner. He argues that most future conflicts will occur in cities, thanks to the extraordinary growth in urban populations and the interconnectedness wrought by new technologies, which will create novel opportunities for crime and political violence. Kilcullen brings his narrative to life by using contemporary examples, including the recent revolts in Libya and Syria and the 2008 terrorist attacks in Mumbai. The density of contemporary cities makes it easier for gangsters and warlords to assert control and renders civilian populations highly vulnerable. Security forces can address such threats, but as Kilcullen notes, a lack of popular support can make intensive search-and-destroy measures counterproductive. Kilcullen's book would have benefited from more historical perspective. States have long coped with the particular challenges of urban security. Modern Paris was designed, in part, to help the authorities maintain order, and in Warsaw during World War II, anti-Nazi Polish resisters learned that states or armies can suppress a popular urban uprising so long as they care little about preserving life or property.

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Killing Without Heart: Limits on Robotic Warfare in an Age of Persistent Conflict
BY M. SHANE RIZA. Potomac Books, 2013, 256 pp. $29.95.

The United States' increased use of unmanned aerial vehicles to target individuals has already generated considerable moral and legal unease. Imagine, however, the dilemmas that will arise once machines not only are able to kill at a distance but also can decide whom to kill, without any opportunity for human deliberation or, possibly, hesitation. In this thoughtful meditation on technology and ethics, Riza, a fighter pilot and colonel in the U.S. Air Force, worries that robotics make it easier to go to war. But the concern that mechanical slaughter is replacing the work of discerning warriors is hardly new, and Riza exaggerates the role that robotics will play in future combat. Nonetheless, he performs a valuable service by raising the challenging issues of impunity and accountability.

The United States

Walter Russell Mead

Reign of Error: The Hoax of the Privatization Movement and the Danger to America's Public Schools
BY DIANE RAVITCH. Knopf, 2013, 416 pp. $27.95.

Radical: Fighting to Put Students First
BY MICHELLE RHEE. Harper, 2013, 304 pp. $27.99 (paper, $15.99).

Two recent books by leading figures in the fight for the future of American education illustrate the passions at play in one of the country's most important debates. Ravitch has emerged as the most consistent and searching critic of the contemporary education-reform movement, which favors more testing, more accountability for teachers, and more charter schools. The movement enjoys the support of an influential coalition of entrepreneurs, politicians of both parties, and wealthy foundations. Against these formidable opponents, Ravitch scores some important points: test scores are somewhat arbitrary, "teaching to the test" is not how great schools are built, segregation and poverty contribute to poor school performance more than many reformers admit, both the Bush and the Obama administrations gave the Department of Education far more power than it can wield wisely or well, and proponents of charter schools and school-voucher programs do not always have the facts on their side. As for school choice, which reformers believe will improve the system by making schools compete for students (and the funding that comes with them), Ravitch argues that education is one of the areas in which free-market thinking and market metaphors fail. But Ravitch's feisty defense of the pre-reform status quo will strike many readers as too undiscriminating. Can it really be true that in cities where governments have been hollowed out by decades of corruption and one-party rule, the public school systems don't need much reform? Is it not true that many public school teachers become cynical and despairing after years spent working in dysfunctional systems?

Rhee entered education through the Teach for America program and eventually rose to become an extremely controversial chancellor of the crisis-ridden Washington, D.C., public school system, where she took on the powerful teachers' union. In 2010, the district elected a new mayor who did not support Rhee, and Rhee left her post to found an advocacy group that promotes school reform and supports politicians who back it. Rhee believes that rewarding successful teachers and either retraining or firing low performers will improve the quality of education. This is her core disagreement with Ravitch, who argues that teaching is too complicated and too personal a profession to be easily assessed and graded and that, in the real world, subjective assessments are likely to be biased and putatively objective ones, such as standardized tests, are often inaccurate.

Conservative Internationalism: Armed Diplomacy Under Jefferson, Polk, Truman, and Reagan
BY HENRY R. NAU. Princeton University Press, 2013, 344 pp. $35.00.

Nau is interesting, provocative, and sometimes convincing when he looks for signs of conservative internationalism through the long sweep of U.S. history. His description of that school of thought alone makes this book worth reading. Unlike realists, Nau argues, conservative internationalists accept the promotion of freedom as a legitimate goal of U.S. foreign policy. Unlike liberal internationalists, they believe that American power, rather than international institutions, offers the greatest hope for progress. They also believe in an aggressive combination of force and diplomacy to advance the American agenda worldwide, but they are less confident than either liberals or neoconservatives that a democratic utopia is just around the corner. This is a valuable way of thinking about U.S. foreign policy for a post-Bush, post-Obama future. It will be interesting to see if any 2016 Republican presidential candidates look to Nau's ideas as a way to bridge the widening gaps within the GOP when it comes to foreign policy.

The Myth of America's Decline: Politics, Economics, and a Half Century of False Prophecies
BY JOSEF JOFFE. Liveright, 2013, 352 pp. $26.95.

From the Sputnik panic to the global chorus claiming that the 2008 financial crisis would spell the end of the U.S. model of capitalism, pessimists have been predicting American decline for 50 years. In this brave and bracing book, Joffe treats these repeated failed prophecies to the merciless debunking they deserve. Envious foreigners and nervous Americans alike have predicted the imminent demise of American power due to an allegedly failed educational system, the superior performance of foreign rivals, budget and trade deficits stemming back to the Kennedy era, imperial hubris, and assorted other maladies. Joffe makes a strong case that a mix of Chinese vulnerabilities and American strengths means it is unlikely that China will replace the United States anytime soon as the center of the global system. Yet, as Joffe notes, constant

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anxiety about the United States' prospects might be one of the cultural forces responsible for the country's persistent strength; rather than resting on their laurels, Americans continually and even neurotically poke at their social fabric, looking for tears that need mending.

The War of 1812: Writings From America's Second War of Independence
EDITED BY DONALD R. HICKEY. Library of America, 2013, 928 pp. $40.00.

The indispensable Library of America has produced a valuable collection of documents and contemporary accounts of the War of 1812. The war was ostensibly fought over British attempts to restrict U.S. trade and force sailors on American-flagged vessels into service in the British Royal Navy. It was, however, vehemently opposed by most U.S. trading and mercantile interests and was most strongly supported by farmers and other interior dwellers. One of the many merits of this volume is that, through speeches and accounts of official meetings, readers are able to see the war through the eyes of the defeated—and there was no group for whom the War of 1812 was a worse disaster than Native Americans. Ultimately deserted by their British allies, the Native American tribes who lived between the Appalachian Mountains and the Mississippi River suffered a series of defeats at the hands of American forces that left them defenseless before the accelerating tide of settlement along the frontier.

Western Europe

Andrew Moravcsik

In Spies We Trust: The Story of Western Intelligence
BY RHODRI JEFFREYS-JONES. Oxford University Press, 2013, 256 pp. $29.95.

Empire of Secrets: British Intelligence, the Cold War, and the Twilight of Empire
BY CALDER WALTON. Overlook Press, 2013, 448 pp. $35.00.

Spies and surveillance have dominated headlines all across Europe in recent months. These two books help illuminate how contemporary espionage took shape. Jeffreys-Jones focuses on Anglo-American intelligence cooperation, arguing that its finest hours were during World War II and in the early stages of the Cold War. By the 1960s, the British could no longer keep up with either U.S. technological prowess or the Americans' unilateral impulsiveness. The relationship fell into decline; today, it is no longer special.

To understand what the British were really up to in those years of decline, readers can turn to Walton's far more thoroughly documented study, which describes the role of the United Kingdom's intelligence agencies in defending and then liquidating the British Empire. This included intensive involvement in brutal counterinsurgency operations, colonial repression, and widespread torture, but also quite a bit of sensible, moderate advice that tended to be ignored by colonial administrations. The records of these events, suppressed by the British government for half a century, make for fascinating reading.

The Democratic Foundations of Policy Diffusion: How Health, Family, and Employment Laws Spread Across Countries
BY KATERINA LINOS. Oxford University Press, 2013, 250 pp. $99.00.

Linos argues that the adoption of particular health and family policies in one country can increase support for them in others. Technocrats draw on specific experiences elsewhere to fine-tune domestic policy proposals. More surprising, everyday voters—even in a country with an exceptionalist self-image, such as the United States—see the adoption of policies by other large countries as a signal that the proposals are feasible and fair. This would seem utterly implausible if Linos did not document it with public opinion data and historical case studies from Greece, Spain, and the United States. For scholars, the book poses as many questions as it answers. For policymakers, it suggests novel ways to build support for policy innovations.

Narrating Trauma: On the Impact of Collective Suffering
EDITED BY RON EYERMAN, JEFFREY C. ALEXANDER, AND ELIZABETH BUTLER BREESE. Paradigm, 2011, 336 pp. $113.00 (paper, $37.95).

In this book, a team of sociologists revisits some of the most horrifying cases of mass slaughter from the past century, including many episodes during World War II, the Cultural Revolution in China, the Greek Civil War and Cypriot partition, and the mass refugee crises in southern Africa. To a surprising extent, they find that politics and ideology, rather than the sheer moral horror of violence, have determined what subsequently registered as a painful and traumatic event, defined who was treated as a perpetrator or a victim, and dictated who deserved restitution. Political polarization leads Colombians to view kidnappings as individual private misfortunes rather than public problems. One-party rule led Poland to suppress the true story of the Katyn massacre of 1940, in which Soviet secret police forces killed more than 20,000 Polish nationals. The Holocaust sensitized the world to Jewish suffering yet desensitized many Israelis to Palestinian suffering. Germans view the Allied bombing of World War II as deserved retribution, whereas the Japanese view it as a complex and ambiguous national trauma. Readers might disagree with these conclusions, but the book makes a convincing case that the moral lessons of the last century remain ambiguous and contested.

The Art of Lobbying the EU: More Machiavelli in Brussels. 4th ed.
BY RINUS VAN SCHENDELEN. Amsterdam University Press, 2013, 390 pp. $55.00.

Academics and practitioners generally go their separate ways, barely paying attention to each other. Occasionally, however, a scholarly book emerges whose scope, clarity, and focus on a vital issue allow it to cross the theory-praxis divide.

This latest edition of van Schendelen's classic work synthesizes the most important lessons that political scientists, management scholars, and the best public affairs professionals have learned about how to lobby the European Union. Mastering the EU process is hard, as the five pages of abbreviations at the beginning of the book attest. Yet knowledge helps lobbyists pick which buttons to push when dealing with EU policymakers. Although the book is not an easy read, it makes even complex questions—such as whether lobbyists are a force for Europe's democratic legitimacy—concrete and accessible to the average reader. It is hard to imagine anyone succeeding in Brussels without knowing what is in this unique volume.

The Fall of the Celtic Tiger: Ireland and the Euro Debt Crisis
BY DONAL DONOVAN AND ANTOIN E. MURPHY. Oxford University Press, 2013, 256 pp. $65.00.

Although its subject matter and the text itself are a bit dry, this book is the best so far on the Irish financial crisis of 2008. The authors trace the well-known contours of the financial crisis that swept over Ireland, the government's response, and the debate that has followed. They explain how an investment boom triggered a housing bubble. When the bubble burst, it took the banking sector with it. Private actors were at best shortsighted and at worst criminal, and public authorities, notably the Central Bank of Ireland, failed to discharge their regulatory duties. The fact that during the boom, politicians failed to push against the irrational optimism of the financial sector reflects the cozy personal style of Irish politics. The media and economists failed to inform the public about the growing risks. The authors conclude that the government had no practical alternative to issuing a much-criticized comprehensive bank guarantee, which, combined with irresponsible government borrowing and spending during the boom years, quickly fueled public-sector deficits.

Western Hemisphere

Richard Feinberg

The Fate of Freedom Elsewhere: Human Rights and U.S. Cold War Policy Toward Argentina
BY WILLIAM MICHAEL SCHMIDLI. Cornell University Press, 2013, 272 pp. $39.95.

As U.S. President Jimmy Carter entered the White House in 1977, determined to restore purposeful idealism to U.S. foreign policy, a brutal military dictatorship in Argentina was systematically torturing and murdering thousands of suspected leftists. In his fast-paced, engrossing account, Schmidli chronicles the fierce internal struggles within the White House and the State Department, where political appointees dedicated to transforming Carter's idealism into concrete policies battled career diplomats accustomed to maintaining cordial relations with anticommunist regimes such as Argentina's. Schmidli concludes that, despite subsequent policy vacillations, the United States extracted some important concessions from the

Argentine junta, saving many lives. More broadly, the Carter team succeeded in institutionalizing human rights in U.S. foreign policy: after some early backsliding, the Reagan administration deemed democracy promotion the core of its Argentina policy, which Schmidli describes as an "unmistakable validation for U.S. human rights advocates' struggle." Drawing on declassified documents and personal interviews, Schmidli paints colorful portraits of key players in the policy debates. More interviews of Argentines would have rounded out the picture. But this very valuable study also underscores the vital roles of human rights activists and Congress in laying the foundations for Carter's diplomatic offensive.

The Structure of Cuban History: Meanings and Purpose of the Past
BY LOUIS A. PÉREZ, JR. University of North Carolina Press, 2013, 352 pp. $39.95.

Pérez, a masterful historian of Cuba, argues that whether Fidel Castro was motivated by heartfelt convictions or political opportunism, the Cuban leader undeniably understood the power of the past to drive contemporary politics. From the outset, Castro associated himself with the images and purposes of Cuba's national heroes and martyrs, casting himself as the standard-bearer of a hundred years of extraordinarily bloody struggles for national identity and dignity in the face of foreign imperialism—first Spanish, then American. Overtly hostile U.S. administrations inadvertently strengthened Castro's nationalist credentials. Inherent in Cubans' aspirations for sovereignty was an anticipation of improved material conditions; more controversial, however, was Castro's claim that the logical destiny of Cuban history was a radical social revolution. Today, deprived Cuban youth are less interested in historical slogans than in better living standards, portending a reinterpretation of the past. As Pérez concludes, "A history that had failed to fulfill the promise of its premise [risks] being discarded as irrelevant," perhaps giving rise to a "counterfactual history, with a host of what-ifs"—especially the question of what might have been had the United States not tried to subvert the Cuban Revolution, which Pérez refers to as "the noble gesture of 1959."

The Economic Development of Latin America Since Independence
BY LUIS BÉRTOLA AND JOSÉ ANTONIO OCAMPO. Oxford University Press, 2012, 352 pp. $125.00 (paper, $45.00).

This well-argued interpretive economic history is reasonably balanced in its assessment of the region's progress and shortcomings, even as it leans toward the neostructuralist school of thought and the approach associated with the UN Economic Commission for Latin America and the Caribbean, both of which favor state activism. The distinguished authors consider four major historical periods: the chaotic postcolonial era (1810–70), the first great wave of globalization and commodity exports (1870–1929), the era dominated by the kind of state-led industrialization that Bértola and Ocampo prefer (the 1930s through the 1970s), and the recent turn back toward market mechanisms, which they view with some skepticism. During

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the golden age of state-led growth, development strategies promoted national industries and domestic markets and the public sector's delivery of education and health services. But adjustments became necessary, the authors recognize, and the book identifies four main ingredients for promoting sustainable growth going forward: sound macroeconomic management to confront global vulnerabilities, energetic competitiveness and technology policies, strong governance institutions (although the optimal mix of state and market varies across countries), and equity agendas to encourage more just distributions of wealth.

The World Turned Upside Down: The Complex Partnership Between China and Latin America
BY ALFREDO TORO HARDY. World Scientific Publishing, 2013, 268 pp. $98.00.

A senior Venezuelan diplomat-scholar, Toro Hardy depicts a rapidly declining United States and Europe and an emerging Chinese powerhouse, voicing an increasingly common perspective on global trends. Extensively referencing commentators such as Joseph Stiglitz, Niall Ferguson, and Kishore Mahbubani, Toro Hardy gleefully depicts U.S. society as trapped in a self-destructive orgy, as myopic corporations and deadlocked politicians lose all sense of the national interest, while the Chinese Community Party brilliantly masters technological innovation and gains global leadership. A more multicultural, multipolar world will present exciting opportunities for Latin America, but only if the region draws the right lessons from its checkered past, conserves earnings from high commodity prices in sovereign wealth funds, further diversifies its exports to include modern goods and services (pop music, software development, product design, and so on), and develops its human capital and physical infrastructure. Most interesting, Toro Hardy urges Latin American diplomats to unite as a block and negotiate a grand bargain with China in order to integrate their economies into Chinese industrial value chains and to obtain more access to Chinese capital and technology.

Worldly Philosopher: The Odyssey of Albert O. Hirschman
BY JEREMY ADELMAN. Princeton University Press, 2013, 760 pp. $39.95.

This is a wonderful book about a superb political economist. Adelman invested many years in this admiring biography, which allows readers to fully appreciate the diversity of Albert Hirschman's many contributions to economic scholarship; it also does not fail to offer occasional criticisms. Hirschman never won a Nobel Prize in Economics, but his writing did lead to the emergence of political economy as a central field within the social sciences in the United States. Hirschman's 1970 book, *Exit, Voice, and Loyalty*, generated an immense positive response on its appearance, although primarily from political scientists, rather than economists. Hirschman possessed a unique ability to shift from the particular to the general and projected an implicit optimism about humanity's prospects. He did not enjoy teaching—to put it mildly. But he was able to profoundly

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influence two generations of students who have greatly benefited from reading his works, which have proved especially useful for those who study development issues in Latin America, a region to which Hirschman paid particular attention.

ALBERT FISHLOW

Latin American Populism in the Twenty-first Century
EDITED BY CARLOS DE LA TORRE AND CYNTHIA J. ARNSON. Johns Hopkins University Press and Woodrow Wilson Center Press, 2013, 416 pp. $30.00.

During the twentieth century, a majority of the countries in Latin America developed market economies and representative democracies. Yet in some of these countries, the promises of a liberal society did not match the magnitude of citizens' demands, provoking calls for democracies that were more representative and for states that were more active in the production and distribution of goods and services. Latin American leaders including Hugo Chávez of Venezuela, Evo Morales of Bolivia, Rafael Correa of Ecuador, the Kirchners of Argentina, and even Álvaro Uribe of Colombia all rose to power partly through promises to be more effective and just in the mediation between citizen demands and state resources. Chávez shared so generously with his supporters that Venezuela's petroleum revenues proved insufficient to cover the runaway costs. Morales, for his part, has also shared with his supporters, but he has managed to maintain budget discipline, taking advantage of high commodity export prices. De la Torre and Arnson's volume addresses these varieties of populism, concluding with a wide-ranging essay by the editors that analyzes the continuing significance of this durable political phenomenon in Latin America.

ARTURO CRUZ, JR.

Eastern Europe and Former Soviet Republics

Robert Legvold

Russia, the West, and Military Intervention
BY ROY ALLISON. Oxford University Press, 2013, 320 pp. $85.00.

No issue has more vexed recent U.S.-Russian relations than the tension over military interventions, such as those launched or backed by Washington in Kosovo, Iraq, and Libya and the one carried out by Russia in Georgia. Analysts have paid too little attention to the roots of this tension, which lie in the conflicting normative and legal standards each side has used to justify its actions. It takes a scholar as meticulous and thorough as Allison to properly chronicle the remarkably complex debate between proponents of traditional norms of state sovereignty and advocates for new norms of humanitarian interventionism. In this clash, the Russians—like the Chinese, the Indians, and many others—align themselves with the conservative, pro-sovereignty side of the argument, a position that owes as much to self-interest as to principle. Yet the Russians have struggled to be consistent. Although doing so is not his overt purpose, Allison demonstrates how if U.S. and western European analysts

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ignore or discount this dimension of Russian thinking, their explanations of Russian behavior in controversies over intervention (including in the Syrian civil war) will be shallow.

Hard Diplomacy and Soft Coercion: Russia's Influence Abroad
BY JAMES SHERR. Chatham House, 2013, 152 pp. $25.95.

In the debate over just how alienated Russian foreign policy has become from the interests of the United States and Europe, count Sherr among those arguing that the sides are worlds apart. His case, however, is neither strident nor crude. On the contrary, Sherr subtly traces the historical roots and complex character of Russian power. His starting point is the political scientist Joseph Nye's notion of "soft power." But in his examination of Russia's relations with states that were once within the Soviet Union's borders or that were part of the extended Soviet empire, Sherr reveals the Russian approach to instruments of influence—trade, energy, the Russian Orthodox Church, and Russian cultural exports—as more brutal than dulcet. He interprets the fundamental impulse behind Russian policy as a desire to create an international environment that protects the Russian regime's preferred domestic order, but he views the steps Russia takes to further that stark agenda as intricate and artful. As for the policy's success, Sherr's judgment lingers between mixed and suspended. As for the policy's permanence, he allows for the possibility of change—perhaps, ultimately, out of necessity.

Danubia: A Personal History of Habsburg Europe
BY SIMON WINDER. Farrar, Straus and Giroux, 2014, 576 pp. $30.00.

Making five centuries of Habsburg history fun seems like a tall order, but Winder pulls it off. He entertains because he is entertained. His sprawling history of a dynastic empire that began in the early twelfth century and finally unraveled in 1918 is a personal travelogue; over many journeys, he foraged in both the famous and the obscure historical sites of central and southern Europe, detailing here what they represented in their day. With unrelenting wit—sometimes smirking but also self-mocking—he traces the Habsburgs' fortunes: their ascendance to the throne of the Holy Roman Empire in the fifteenth century; the division of the family into Austrian and Spanish houses in the sixteenth century; and the Austro-Hungarian Empire's central role in all of modern Europe's dramas, from the French Revolution to World War I. What gives the text verve is Winder's ability to interweave the eccentric details of the Habsburgs themselves with an absorbing cultural history, driven by his exuberant passion for the lives and music of great composers and textured by his skillful physical descriptions of forgotten corners of the realm.

Ethnonationalist Conflict in Postcommunist States: Varieties of Governance in Bulgaria, Macedonia, and Kosovo
BY MARIA KOINOVA. University of Pennsylvania Press, 2013, 320 pp. $69.95.

Within the substantial group of scholars focused on ethnic conflict, Koinova has carved out a niche between those who concentrate on civil wars and intrastate conflict and those more concerned with countries in which multiethnic relations have remained peaceful. She is interested in why ethnonationalist conflicts vary in the level of violence they generate, why violence at whatever level persists, and when and why things change for the better or the worse. To get at the answers, she explores three cases, similar in their characteristics but different in their outcomes: Bulgaria (where majority-minority conflict has been free of violence), Kosovo (where it has not), and Macedonia (somewhere in between). Elaborate but lucid theorizing informs her explanations, at the heart of which are what she calls "critical junctures"—the historical moments (such as the aftermath of Soviet communism) when majority-minority relationships form in a way that encourages either accommodation or resistance. The conditions that develop in those brief periods tend to harden, improving or deteriorating only as the result of external shocks or incremental change.

Guilt, Responsibility, and Denial: The Past at Stake in Post-Milosevic Serbia
BY ERIC GORDY. University of Pennsylvania Press, 2013, 288 pp. $65.00.

For all the attention paid to the carnage of the Yugoslav wars and the trials of those responsible for the violence, scholars have only just begun to assess the legacies of those leaders and their impact on their successors and the societies they left behind. Gordy zeroes in on how Serbs have (or have not) come to terms with the war crimes and crimes against humanity committed by their leaders and prosecuted before the International Criminal Tribunal for the former Yugoslavia. Judging the Serbian public mind is not easy. Gordy, by going beyond merely examining the legal dramas and public opinion polls, discovered that most Serbs see the issues of guilt and responsibility in wavering shades, not stark colors. The Serbian people, he concludes, have come a good distance. But denialism lingers, for which he assigns considerable blame to the non-Serbian prosecutors at the tribunal, who have failed to clearly convey to the Serbs the full, convincing weight of the evidence against their former leaders. Gordy delivers his judgment of all the parties with sensitivity and compassion.

The Readers of Novyi Mir*: Coming to Terms With the Stalinist Past*
BY DENIS KOZLOV. Harvard University Press, 2013, 442 pp. $55.00.

In repressive societies, literature often carries a weight that it does not in free countries. The principal venue in the post-Stalinist Soviet Union for reflections—narrow at first and then inexorably widening—on the Soviet Union's history was the venerated literary journal *Novyi Mir* (New World). The journal shot to prominence in 1953 with its publication of an essay on sincerity in literature, written by the critic Vladimir Pomerantsev. Western literary critics accustomed to scarcely a ripple of attention might find it hard to believe, but the piece stirred a storm of controversy in newspapers, universities, and even factories. More than 700 letters flooded

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the journal's offices, some of them longer than 30 handwritten pages. Other provocations followed, each pushing deeper into the dehumanized reality of the Soviet experience and each generating agitated responses. With the opening of the archives of the journal and of its bureaucratic keepers, Kozlov gained access to tens of thousands of unpublished letters from readers as well as the records of editorial meetings and accounts of the authorities scrambling to respond to the latest controversies. This fine history reveals the society-changing power of what Kozlov calls "the relationship between texts and readers."

Middle East

John Waterbury

The Syria Dilemma
EDITED BY NADER HASHEMI AND DANNY POSTEL. MIT Press, 2013, 272 pp. $14.95.

Syria 2018
BY THE NYU CENTER FOR GLOBAL AFFAIRS. NYU Center for Global Affairs, 2013, 41 pp. Free online.

These studies bring together leading experts on Syrian affairs and conflict resolution. Both studies confirm that the Syrian civil war presents stakeholders with many options, all of them bad. The first book was assembled at the beginning of 2013, and the second, midyear. Since then, with the exception of the U.S.-Russian agreement that paved the way for Syria to give up its chemical weapons arsenal, none of the basic elements in the Syrian conflict have changed—except that the casualties and refugee flows have increased significantly.

The contributors to Hashemi and Postel's volume reflect on whether and how outside powers should intervene in Syria. If there is a common thread that runs through the essays, it is that "the responsibility to protect" applies in Syria and should guide any intervention by the United States or other players. With varying levels of enthusiasm, the contributors suggest establishing "no-kill zones" (Anne-Marie Slaughter), providing massive humanitarian relief (Kenneth Roth), and even engaging in "sequential decapitation" of the Assad regime (Tom Farer). Christopher Hill invokes the agreement that ended the war in Bosnia as a possible model for how to resolve the Syrian conflict, while Fareed Zakaria points to the 2003 U.S. invasion of Iraq as a cautionary tale about the risks of military intervention.

The Center for Global Affairs' report imagines possible scenarios for how the conflict might play out between now and 2018. Participants include Josh Landis, Bassam Haddad, Steven Heydemann, Robert Malley, and other experts. They envision three possibilities: a regionalized conflict, a contained civil war, and a negotiated settlement. In the first, the conflict spills over Syria's borders, igniting civil wars in Iraq and Lebanon and threatening King Abdullah's hold on power in Jordan. In the second, outside attempts to contain the conflict ultimately produce further chaos inside the country, especially in northern Syria. The authors find the third scenario, a negotiated settlement, "implausible" and therefore conclude that the least worst option is containment, which would lead to the internal fracturing of Syria but might produce a less violent stalemate. It is notable that none of the three scenarios accounts for two developments that would have a major impact on the conflict. One is a possible attack by either the United States or Israel on Iranian nuclear facilities. The other is a negotiated U.S.-Iranian "grand bargain," or at least a more stable détente between Washington and Tehran.

Unthinkable: Iran, the Bomb, and American Strategy
BY KENNETH M. POLLACK. Simon and Schuster, 2013, 560 pp. $30.00.

This book will be read carefully in Tehran, Washington, and Tel Aviv. Pollack lays out the strategic factors the United States must take into account when deciding how to deal with Iran's nuclear program, covering nearly all contingencies, including military action. He argues forcefully that, should negotiations fail, Washington should opt for containment instead of military action. His case is lucid and compelling; he reminds readers that a U.S. air campaign that failed to set back Iran's nuclear development for more than several years would probably lead to a U.S. ground invasion that would make the Iraq war look relatively simple. More provocatively, Pollack advocates combining containment with efforts at regime change, arguing that Iran does not moderate when the pressure is off but rather when it is high. He dismisses the idea that so long as Iran's supreme leader believes the United States seeks to end the Islamic Republic, he and his supporters will have little incentive to reach agreement with Washington on the nuclear issue. Iran, Pollack argues, is aggressive but rational. It would not use nuclear weapons unprovoked. It would not share them with third parties such as Hezbollah. It would only use them to defend itself.

Roots of the Arab Spring: Contested Authority and Political Change in the Middle East
BY DAFNA HOCHMAN RAND. University of Pennsylvania Press, 2013, 176 pp. $47.50.

Should Western governments have seen the Arab Spring coming? Rand, who is currently serving on the U.S. National Security Council, carried out the research for this revealing book in Bahrain, Morocco, and Tunisia well before the region was rocked by popular revolts in 2011. She believes the West should have sensed that something was coming, since systemic changes had already been roiling Arab societies for some time. Her explanation acknowledges but does not stress the role of structural factors, such as youth unemployment, in producing the 2011 uprisings. Rather, she focuses on the economic liberalization campaigns that Arab governments launched in the 1990s and early years of this century, in part to placate internal opposition and respond to pressure from the West to reform. But the regimes soon began to reverse those reforms, which they believed had encouraged unwanted dissent. The reversals were meant to stifle opposition but served only to encourage more of it. Through top-down, antidemocratic constitutional and legal maneuvers, Arab regimes sent a message that bargaining for change was futile and so, too, was the quest for incremental reform. For many dissidents, that meant the only hope for change was the fall of the regimes.

Fountainhead of Jihad: The Haqqani Nexus, 1973–2012
BY VAHID BROWN AND DON RASSLER. Oxford University Press, 2013, 320 pp. $35.00.

The Haqqani tribal network is based in North Waziristan, a region that straddles the border highlands between Afghanistan and Pakistan, a position that allows the Haqqanis to control vital supply lines. The Haqqani patriarch, Jalaluddin Haqqani, and his son Sirajuddin Haqqani guide their organization with a combination of fierce resistance to central authorities and a less-than-strict practice of Islam. Above all, they want to preserve control of their homeland, which has served as a safe haven for al Qaeda and as a supply route through which Pakistan's intelligence service ships materiel to the Taliban and others in Afghanistan. Brown and Rassler argue that the Haqqanis have played a greater role in the region's anti-American jihad than has al Qaeda—despite the fact that Washington assisted the Haqqanis' resistance to the Soviet occupation of Afghanistan during the 1980s. They speculate that after the U.S. withdrawal from Afghanistan, al Qaeda and the Haqqanis might refocus on India, Kashmir, and the Central Asian states. Brown and Rassler have assembled unique and impressive evidence for their arguments, shining a light into some hitherto dark corners.

Hezbollah: The Global Footprint of Lebanon's Party of God
BY MATTHEW LEVITT. Georgetown University Press, 2013, 426 pp. $32.95.

In this book, Levitt, a former deputy assistant secretary in the U.S. Treasury Department, focuses on Hezbollah's operations outside Lebanon in near-excruciating detail. He presents an avalanche of evidence that Hezbollah is a global terrorist organization and demonstrates that its links to Iran are strong and organic. Levitt relies on declassified intelligence, court documents, and other sources in the public domain to delve into familiar (albeit horrifying) crimes often linked to Hezbollah, including the deadly 1994 bombing of a Jewish community center in Buenos Aires and the 1996 attack in Khobar, Saudi Arabia, that killed 19 U.S. military personnel. But Levitt does not offer much analysis of these events and makes little effort to situate them in a broader consideration of Hezbollah's tactics and strategy. The main takeaway from his book is that Hezbollah's overarching objective is to destroy Israel and drive the United States from any effective presence in the Middle East, and that its foreign operations also serve the purpose of revenge—above all for the assassination of the group's strategic mastermind, Imad Mugniyah, in February 2008.

Asia and Pacific

Andrew J. Nathan

An Uncertain Glory: India and Its Contradictions
BY JEAN DRÈZE AND AMARTYA SEN. Princeton University Press, 2013, 448 pp. $29.95.

India has experienced two decades of rapid economic growth, yet half of Indian households lack indoor toilets, nearly 40 percent of the country's adults are illiterate, immunization rates there are among the lowest in the world, and 43 percent of its children are underweight. The benefits of growth have flowed to the top 20 percent of the population, while the profoundly poor—who represent 28 to 80 percent of the population, depending on where the line is drawn—have gained little. The authors, two distinguished economists, use unfavorable comparisons with Bangladesh, China, and the countries of sub-Saharan Africa, among other places, to shame India's politicians, corrupt bureaucrats, media, and self-interested economic elites, whom they blame collectively for the country's pattern of "biased growth." Against those who want to address poverty through further market reforms, Drèze and Sen argue that India needs more (albeit better-run) public services and redistributive social programs. But given the scope and severity of the problems they describe, it seems like a leap of faith to argue, as they do, that the system can right itself by means of "public reason" and greater political pressure from the poor.

The China Story (www.thechinastory.org) Australian Centre on China in the World. Free online.

Among a growing number of websites and e-mail newsletters providing insight on China, the China Story stands out for the richness of its coverage of Chinese culture and history. The site is guided by the veteran Sinologist Geremie Barmé and informed by what he calls "New Sinology," which emphasizes the continuity of China's contemporary problems and debates with those of the country's past. The material is infused with Barmé's taste for the unconventional, affection for the Chinese language, and alternately playful and acerbic writing style. The site's sketches of leading Chinese thinkers illustrate the vitality of Chinese intellectual life despite the state's efforts to control it. The site also provides access to the China Story Yearbook series, which covers politics, law, foreign policy, the blogosphere, and other subjects, and to the online journal *China Heritage Quarterly*, which carries articles about the presence of the past in Chinese architecture, culture, and literature.

Forgotten Ally: China's World War II, 1937–1945
BY RANA MITTER. Houghton Mifflin Harcourt, 2013, 464 pp. $30.00.

Mitter applies historical empathy to yield fresh insights into the situations of all the actors in the horrific conflict that the Chinese call the War of Resistance Against Japan, which lasted from 1937 to 1945. He pays particular attention to China's leaders, explaining Chiang Kai-shek's decision to breach the dikes of the Yellow River, an act that killed half a million of his countrymen; Mao Zedong's preference for a protracted guerrilla strategy against the Japanese; and Wang Jingwei's decision to collaborate with the Japanese occupiers. But he also recounts the frustrations of Japanese infantrymen that led them to behave so viciously in occupied Chinese cities. The only person Mitter fully condemns is U.S. General Joseph "Vinegar Joe" Stilwell, often portrayed as a hero in earlier accounts but whom Mitter charges with blinkered egoism in his clashes with Chiang. The narrative also tells the stories of soldiers, refugees, missionaries, and journalists, creating an exceptionally full narrative of a fateful period whose legacies still shape China; these include a broader sense of national identity, modern techniques of mass mobilization and propaganda, a large role for the state in providing for the needs of the people, and a culture of violence.

Media Commercialization and Authoritarian Rule in China
BY DANIELA STOCKMANN. Cambridge University Press, 2012, 352 pp. $95.00.

Chinese media have changed since the gray days of Maoism. There are now nearly 2,000 newspapers, 10,000 periodicals, and hundreds of radio and TV stations with a wide variety of styles and features. All but a few have to support themselves with advertising and subscriptions, spurring fierce competition for readers and listeners. But contrary to the conventional wisdom, Stockmann argues that media commercialization has strengthened, rather than weakened, the Communist Party's rule. Today's media cover fashion, sports, business, and a host of other subjects in a wide range of styles, which enables them to attract more readers and listeners. Audiences place greater trust in outlets they select for themselves than they did in the more tightly controlled, less diverse media of the past. Meanwhile, the Communist Party still has the power to shape the message whenever it feels the need to, including by firing reporters who get too far out of line. Stockmann finds that the Propaganda Department more often uses its authority to tamp down, rather than ramp up, nationalist sentiment against the United States and Japan, lest popular anger turn against the party itself. By reporting more aggressively, the media give the leadership better information about what the public thinks than they did in the past, which helps the government address problems that might otherwise lead to unrest.

We Didn't Start the Fire: My Struggle for Democracy in Cambodia
BY SAM RAINSY WITH DAVID WHITEHOUSE. Silkworm Books, 2013, 198 pp. $25.00.

Sam Rainsy's Cambodia National Rescue Party won a surprising 47 percent of the vote in the country's National Assembly elections last summer, capping a series of contests during the past 20 years in which the party, under various names, won a growing vote share despite electoral manipulation and violence meted out by the ruling Cambodian People's Party of Prime Minister Hun Sen. To explain his commitment to confronting Cambodia's entrenched elite in the face of legal persecution and assassination attempts, Sam Rainsy has written an autobiography that reaches back to his childhood, his father's exile and assassination, his work in Paris as a financial manager, and his interest in the Moral Re-Armament movement and Buddhism. The book is also a manifesto pitched to foreign governments and nongovernmental organizations, asking them to stop propping up the Hun Sen regime with development aid. In it, Sam Rainsy explains how he would combat corruption, land grabbing, nepotism, patronage, and other ills if he came to power.

Wealth and Power: China's Long March to the Twenty-first Century
BY ORVILLE SCHELL AND JOHN DELURY. Random House, 2013, 496 pp. $30.00.

Each year, scores of books appear purporting to explain where China has been, where it is now, and where it is going. Rare, however, is a book such as this one, which offers genuinely new insights into this vast and complicated country. Schell and Delury argue that for most of China's recent history, the country has been consumed with the search for wealth and power: the desire to "see China return to greatness and honor." They explore the debates and often fierce political battles that surround this quest through a series of fascinating portraits of Chinese thinkers and leaders. The cast of characters is wide-ranging. Some of those profiled, such as Mao Zedong, are familiar; others, such as the Qing dynasty scholar Wei Yuan, will be new to most readers. One of the book's greatest strengths is its authors' lack of ideological bias in selecting their subjects: few would think to place the much-reviled nineteenth-century empress dowager Cixi alongside the 2010 Nobel Peace Prize winner Liu Xiaobo. The portraits are beautifully written and bring to life not only their subjects but also the mood and intellectual debates of the times in which they lived.

ELIZABETH C. ECONOMY

Africa

Nicolas van de Walle

To the Ends of the Earth: Pentecostalism and the Transformation of World Christianity
BY ALLEN HEATON ANDERSON. Oxford University Press, 2013, 336 pp. $24.95.

The various currents that make up Pentecostalism represent the fastest-growing Christian denomination in Africa. In this sympathetic survey, Anderson, a former Pentecostal minister, argues that Pentecostalism in Africa must be understood more as an indigenous religion than as a Western one. Pentecostal missionaries introduced the faith into the "global South," including Africa, during the early twentieth century, but the churches soon began to develop autonomously. Unlike churches belonging to traditional Christian sects, Pentecostal churches were decentralized, nonhierarchical, and independent of colonial authorities, making them more likely to take on native leadership, adapt to local cultural norms, and connect with the nationalist sentiments of newly urbanized and socially mobile Africans. In addition, the relentless proselytizing required by Pentecostal theology ensured that there would be plenty of converts and led to steady growth during the entire twentieth century. Today, more than 100 million Africans belong to Pentecostal churches, making Anderson's book essential reading for anyone interested in the sociology of contemporary Africa.

Integrating Africa: Decolonization's Legacies, Sovereignty, and the African Union
BY MARTIN WELZ. Routledge, 2012, 243 pp. $135.00 (paper, $44.95).

Region-Building in Southern Africa: Progress, Problems, and Prospects
EDITED BY CHRIS SAUNDERS, GWINYAYI A. DZINESA, AND DAWN NAGAR. Zed Books, 2012, 368 pp. $39.95.

Analysts frequently note the lack of economic integration and political cooperation among the 54 states of Africa—an ironic state of affairs, perhaps, given the large number of intergovernmental organizations that exist on the continent. Welz examines the foreign policy of eight countries in the region to understand why the member states of the Africa Union, the region's primary institution of regional integration, have not devoted more energy to realizing the organization's lofty aims. He mostly blames domestic politics, especially the personalization of power by heads of state, which tends to undermine commitments that countries make to greater international cooperation. The book also makes an interesting observation: countries still governed by parties that participated in anticolonial struggles are more reticent to give up sovereignty. Welz concludes that the passage of time and the continued democratization of the region are prerequisites for more meaningful regional cooperation.

Experts see southern Africa as the subregion on the continent that is the most economically integrated and the Southern African Development Community as the continent's most effective intergovernmental organization. Saunders and his colleagues have brought together a group of well-informed analysts whose essays largely buttress Welz's argument that independence is still too recent for most governments to easily agree to cede authority to the international technocrats of an organization such as the SADC. But unlike Welz, most of the book's contributors tend to emphasize the difficulty of forging cooperation when the capacity of the states involved remains low and the economic and political interests of the various countries diverge significantly. Perhaps the core difficulty is the imbalance between rich states—especially South Africa—and other, less affluent members, who worry that South Africa will reap most of the benefits of regional cooperation. For its part, South Africa seems unwilling to exert the kind of leadership and policy generosity that would allay such fears.

Political Parties in Africa: Ethnicity and Party Formation
BY SEBASTIAN ELISCHER. Cambridge University Press, 2013, 336 pp. $95.00 (paper, $30.99).

Many assume that ethnic identity plays the main role in holding African political parties together. Yet as Elischer shows in this careful analysis of ten African countries, the picture is more complicated. In some countries, such as Kenya, parties are indeed organized largely along ethnic lines—mostly, Elischer argues, because no single ethnic group dominates and a number of ethnic groups each account for more than ten percent of the citizenry and can thus aspire to electoral success on the basis of ethnic loyalty. But Elischer shows that in other countries, especially ones in which there is a large core ethnic group, political parties make fewer appeals based on ethnicity, instead defining themselves through economic and social policies or by rallying around a charismatic politician. Elischer's book is empirically sound and well argued; it is the best analysis of this subject to date.

Success in Africa: CEO Insights From a Continent on the Rise
BY JONATHAN BERMAN.
Bibliomotion, 2013, 224 pp. $26.95.

This breezy, upbeat appraisal of the merits of Africa's private sector and its boundless potential to spearhead growth would have been unthinkable a decade ago. The prose sometimes descends into generic M.B.A.-speak, but Berman produces real insight by giving voice to African entrepreneurs themselves, through lengthy quotations. His interlocutors represent a new class of risk-taking businesspeople who benefit from the region's newly investor-friendly business climate. Berman does not offer analyses of particular sectors—he barely mentions manufacturing or commodities such as oil and gold—and he makes few meaningful distinctions among the region's 54 countries. Instead, he chronicles individual companies that have enjoyed success by entering expanding markets, capitalizing on local knowledge, and demonstrating resilience. This might sound like an obvious recipe for success. But why, then, did so few experts anticipate the current boom?

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Editor Gideon Rose on This Collection

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