

US Economy Up By Only 2.6% In The Fourth Quarter

WASHINGTON – The White House communications and policy teams are not in luck. Not too long ago they told the President to use Yemen as a good example of how America is successfully conducting a muscular campaign against terrorists. The trouble is that literally a few days later, out of nowhere, here comes a Shiite insurrection in Yemen led by the Houthis that swept away the (legitimate?) government, supposedly the main anchor of America's anti al Qaeda very successful campaign.

Bragging a bit too much

What is remarkable here (and truly regrettable) is that the US Government, this time just as many other times in the past, seems completely surprised by this development. Clearly nobody saw this Houthi uprising coming (this group is also known as Ansar Allah, "Partisans of God"); otherwise the White House national security and communications staff would not have suggested that the President would use Yemen –now once again in chaos– as a good example of smart US anti-terror policies that are actually working.

More bragging on the economy

Shifting to the domestic economy scene, just days ago (January 20) the President was really bragging about the economy during his combative State of the Union Speech to Congress. Indeed, recent figures on lower unemployment (now 5.6%) and a surprisingly strong third quarter (with GDP up 5%) seemed to indicate that the US was finally out of the swamps of uncertain growth, with possible relapses into stagnation or worse.

And so Obama bragged, and took credit. *"Tonight, we turn the page,"* the president said to Congress. *"The shadow of crisis*

has passed," he added. *"The state of the union is strong."* Well, hard to argue with success.

Not true

Except that it is not really so. Just released figures for the 4th quarter of 2014 indicate a rate of economic growth of 2.6%. Not bad, but hardly stellar, and half of the impressive 5% registered in the third quarter. Translation: the third quarter was a blip. We did not keep the momentum.

Besides, if we dig deeper, we see that part of the upward swing in the third quarter was due to much larger government spending (mostly military sales that will not be repeated) that came all at once due to the ending of the federal fiscal year, (September 30), and to extraordinarily large auto sales facilitated by extremely easy financing given by America's dealers to practically all buyers.

Easy car loans

In fact, this wave of almost zero interest car loans is so large that it has prompted a debate on whether this is in effect a *"sub prime auto loans crisis"* in the making, since many borrowers will be unable to pay their car loans. Beyond car sales, most of the GDP growth in the third and fourth quarters was due to much higher consumer spending.

And this means credit card spending, because real incomes have not grown. Yes, once again Americans spend money they do not have. This is not the kind of "healthy growth" we really want.

So, all in all, even though these unimpressive 4th quarter numbers are still subject to upward revisions, overall the US economy is not doing great. With an average 2.4% growth for 2014, it is doing OK. However, looking ahead it is hard to keep even this modest consumer-driven rate of growth, because the average American will be unable to go much deeper into debt in order to buy "more stuff".

The worst recovery

It has been said before, but it is worth repeating. Overall, this is the worst recovery in terms of GDP growth that we have had in decades. And this is so despite the historically unprecedented period of monetary easing, with interest rates at zero and years of QE, or “Quantitative Easing”. In other words, the “stimulus medicine” administered by the US Federal Reserve in massive amounts has not done that much to boost productive investments and new output.

Few high paying jobs

Of course, we should celebrate any new job created. But the truth is that, despite an unemployment rate now down to 5.6%, most of the new jobs created during this recovery are low paying. Far too many of the new positions are part-time.

Various surveys indicate that there are millions of Americans who would like to have a full-time job, but cannot get one. Worse yet, wages are frozen, median income has not grown. *Meanwhile, the level of labor participation, that is how many adult Americans are actually employed, has gone down from almost 66% to less than 63%. And this means that millions of unemployed Americans have simply dropped out and stopped looking for jobs they could not get. The unemployment rate looks good because these people are no longer counted.*

Look, if we consider the dismal conditions of other advanced economies in most of Europe and Japan, by comparison the US is doing great. But we are doing poorly in comparison to our post war performance.

This is no triumphant come back

In this context of consistent but unimpressive growth, the triumphant tone of Obama’s January 20 State of the Union Speech looks really out of place. Yes, the recession is over. And this is good. But there is nothing miraculous about it.

All recessions end.

However, we did not come out of it with a roar. Obama's point that the good numbers are a demonstration that his policies worked is yet another exaggeration.

Advice To Europe: Deregulate And Cut The Red Tape

WASHINGTON – Well known Wall Street financier Steven Rattner stated the obvious about Europe's lack of competitiveness and what to do about it in a [NYT](#) op-ed (*Europe's Anti-Business Stance*, January 29, 2015). Europe's problem, he says, is not about making the right choice between "stimulus" and "austerity".

Not competitive Europe

The problem is that Europe is no longer competitive. The real problem is in stratified laws, ruled and customs that make it very difficult for enterprises to thrive. *"Archaic restrictions on hiring and firing workers –writes Rattner– flawed energy policies and kilometers of red tape that can make even starting a business difficult –just to name a few– have combined to damage the Continent's ability to compete in increasingly global markets".*

Centrist advice

So, there you have it. Red tape, rigid labor markets, and more. This is the problem. And, in case you are

wondering, this is coming from a practitioner who worked for Barack Obama at the time of the General Motors bailout. In other words Rattner represents a centrist point of view, not some kind of far right, ultra free market extremism.

Yes, as he says, a stratification of bad policies, to which we should add the exaggerated power of trade unions, have created an anti-business and therefore anti-growth economic environment. This is the problem; and this is what needs to be addressed and resolved, if Europe wants to get out of this trend leading to economic decline.

QE is the wrong remedy

Given all this, continues Rattner, the recent European Central Bank (ECB) decision to start its own Quantitative Easing (QE) policy *“amounts to reaching into a medicine cabinet when the patient needs open-heart surgery”*.

Got that? The patient –Europe– needs the equivalent of open heart surgery, and instead the ECB is ladling more easy money, as if this were the appropriate cure for profoundly non-competitive economies.

Change policies

Indeed, what is the point of QE in Europe now? With real interest rate at zero across Europe, how much lower can they get? Europe’s problem is not that obtaining financing is too expensive, the problem is that there very few investments in activities that will create wealth and employment.

“Europe needs to become more competitive in global markets”, continues Rattner. *“That can be achieved only by a variety of policy changes, such as keeping top tax rates at sensible levels and regulatory reforms that would give companies more freedom to manage their businesses as they see fit, including, when necessary, closing plants and reducing head counts”*.

Unheard of

Can you believe that? Companies need freedom to operate, including the freedom to hire and fire employees. And taxes should be reasonable.

Unheard of.

And yet this almost banal advice comes from Steven Rattner, a centrist who used to work for the Obama administration, not exactly a nest of right-wing reactionaries.

However, the very fact that what Rattner, a reasonable practitioner, suggest has little chance of being enacted in France and Italy, let alone Greece shows the profound disconnect between what many Europeans believe to be sensible economic policies and what it takes in the real world to generate growth, wealth and jobs.

Socialism is alive and well

The sad conclusion is that, while the communist parties have lost their appeal in Europe, destructive socialist ideas are alive and well. To the extent that silly egalitarianism dominates, while profit-making activities are demonized, there is no way for Europe to come back.

For sure the ECB “medicine” is not going to solve deep-seated problems that are not even acknowledged by most policy-makers.

China Facing Population Decline

WASHINGTON – It looks totally implausible, but China is facing the real danger of a declining population. Yes, with 1,355 billion people, China is the most populous country on earth. But the demographic trends indicate decline. With an average of 1.55 children per woman, China is well below “replacement level”. This means that slowly the population will decline, because the number of children born will not outpace the number of people who die every year.

Relaxing the one child policy

While the fertility of Chinese women is not as low as what we observe in most of Europe, Korea or Japan, (with lows of only 1.23 children per woman in South Korea), it is bad enough to have prompted the Chinese Government to relax the one child policy that has been strictly enforced for over 30 years. (Sadly, the policy includes forced abortions).

Few Chinese couples want a second child

But it turns out that very few couples that could be eligible to have a second child exercise this option. (Only 5% in Shanghai). Hard to say exactly why. In some instances it is about the cost of a larger family. In others it is about the difficulties that working women would experience trying to balance employment and motherhood.

This being the current scenario, unless Chinese women have a lot more children, China’s enormous population will start declining, while the average Chinese in a few decades will be quite old. This will have negative economic repercussions, because there will be fewer young workers and an increasing population of elderly retirees.

This is how the Chinese publication Caixin describes the so far unsuccessful efforts undertaken by Shanghai's officials to encourage couples to have a second child:

“Shanghai Official Urges More Couples to Have Second Child”

January 28, 2015

“(Beijing) – A Shanghai health official has urged qualified couples to have a second baby because only a few had taken advantage of changes the government made a year ago to ease its one-child policy.

Only 5 percent of women eligible to have a second child have applied to do so, Fan Hua, an official in Shanghai's health and family planning commission, said on January 25.

The high cost of raising a child and women's career pursuits were to blame for the lack of interest in having children, Fan said. The average age for a Shanghai woman to get pregnant is 28, Fan said, and many dropped the idea of having a second child as their careers took off in their early 30s.

A survey by the Shanghai Academy of Social Sciences and Shanghai Women's Federation in 2011 found that half of the surveyed 2,000 parents who had a child under 12 years old said they would not have a second baby.”

“Qualified couples should have a second child because two children provided a family with the proper stability and social development, Fan said.

The ruling Communist Party started easing the one-child policy in 2013, more than three decades after it was implemented. The changes allowed couples in which either parent was an only child to have a second baby. Local governments across the country started implementing the changes last year.

Shanghai's call for couples to take advantage of the changes shows the city government is worried about its population,

said Huang Wenzheng, a biostatistics expert at Johns Hopkins University. Shanghai has the lowest fertility rate of any large city in the country, he said.”

“The eastern city has an aging and shrinking population. Shanghai had 3.87 million people over age 60 at the end of 2013, more than one-quarter of its population. Some 105,200 babies were born that year in the city, which recorded 116,500 deaths. [bold added]

All couples should be encouraged to have a second child, Huang said, but Shanghai would have to wait for the central government to announce a policy allowing that.

About 1 million couples around the country applied to have second children by the end of 2014, Mao Qun’an, a spokesman for the National Health and Family Planning Commission, said on January 12.

The government had predicted the figure would be 2 million every year. Mao said the shortfall may be due to couples taking time to apply, and he said more may seek permission this year.

Huang said government data showed that application figures were declining every month, and reversing the trend is impossible”. [bold added]

China’s Plans To Improve Air Quality Fall Short

WASHINGTON – After decades of denials, at least the Chinese authorities now recognize that they have a huge environmental

problem that in some regions and large cities has reached catastrophic proportions. 30 years of wild industrial growth, with practically zero environmental safeguards, have created a nightmare. No doubt the Chinese economy has grown, incredibly so.

No safeguards

But the rapid rate of growth was at least in part accelerated by no spending on pollution control. The outcome of this unchecked race to increase output is a semi-devastated country. Chinese cities, especially in the North East, have extremely poor air quality. The amounts of pollutants in the air routinely exceed what the World Health Organization considers to be the maximum allowable.

Well, at last the Chinese Government has taken notice. And it has launched programs aimed at curbing emissions. This is good. However, according to Chinese experts, the publicly announced goals cannot be met within the time frame announced by the government. Translation: *“This is a much bigger problem than we want to acknowledge.”*

Here is how the Chinese publication Caixin describes the issue in a piece titled *“Researchers Cast Doubt on State Council Goals to Cut Air Pollution”*, published on October 21, 2014:

“(Beijing) – Just after China celebrated its week-long National Day holiday at the start of October, heavy haze again hit the capital. City authorities released the yellow warning after smog shrouded the capital city starting on October 8. The next day, the alarm was raised to orange, the second most serious warning.

Heavy haze covered the city for at least 75 hours, official figures show, the most serious air pollution in the second half this year so far.

It has been more than a year since the State Council, the

country's cabinet, approved a plan to fight air pollution in September last year. The plan, which contains measures in 10 major areas, was seen as the country's strongest-ever effort to fight air pollution. It set targets to improve air quality in major regions around the country within five years.

The plan says that by 2017, the overall level of PM2.5, small particles in the air that can cause lung disease, should be cut by 10 percent. In the Beijing, Tianjin and Hebei Province region that is hit the hardest by pollution, the level should fall by 25 percent. The annual PM2.5 density in Beijing is to be under 60 micrograms per cubic meter.

Official figures show that the capital's average PM2.5 density in 2013 was 89.5 micrograms per cubic meter.

The 2013 plan declared an ambitious war against the country's worsening air quality. However, recent research says that China is likely to fail to meet most of its targets by 2017."

Goals Unmet

"On September 25, Tsinghua University and the Clean Air Alliance of China, an air quality research group, published an evaluation of the policies proposed in the 2013 plan.

He Kebin, the director of the School of Environment at Tsinghua University and the leader of the research, said that "if the measures are fully implemented, it would effectively improve the air quality in the Beijing, Tianjin and Hebei region."

But He and his team concluded that even if all the measures are put into practice, PM2.5 levels would fall by 25.6 percent in Beijing, 18.7 percent in Tianjin and 14.7 percent in Hebei by 2017. That means that both the province surrounding Beijing and the eastern port city will fall short of the government's targets. [bold added]

Even in Beijing, which is expected to meet its target, the annual average PM2.5 density will only decrease to 65.8 micrograms per cubic meter.

He said his team is confident in their conclusions. According to He, the research used a methodology called community multi-scale air quality that was developed by the U.S. Environmental Protection Agency. The methodology focuses on studies on the troposphere, the Earth's lowest level of atmosphere; acid levels; visibility; particulate matter; and other pollutants.

To test the accuracy of the method, He's team calculated the air quality data for 2013 based on the model and the results were very close to the actual figures for that year".

Local Enthusiasm

"The researchers suggested ways to improve air pollution reduction efforts. The report stated that current policies have effectively controlled emission of sulfur dioxide, but have ignored the pollution from nitrogen oxides, volatile organic compounds (VOCs) and ammonia.

To meet the 2017 targets, the region of Beijing, Tianjin and Hebei should pay more attention to controlling nitrogen oxides and VOCs in order to prevent the formation of particulate matter such as PM2.5, the report said.

He's team proposed 10 measures to reduce coal use in various industries and cut chemical industry emissions and pollution from the agricultural industry.

Earlier this year, He and his team released preliminary research results and got the attention of many local officials. According to He, some local officials who are eagerly to meet the central government's order on pollution cuts have resorted to stricter measures to improve air quality.

Provincial officials from Hebei visited the research team at Tsinghua University to get advice on pollution control, He said.

They wanted) to make sure that they can meet the 2017 targets," said He, adding the officials asked for help to work out a more effective pollution plan.

But He's measures could pose implementation challenges for local authorities.

For instance, VOCs are a major source of secondary aerosols that create particulate matter, and their control is an important part of cutting air pollution. Strict policies to restrict emissions from the coking industry, coating material production and other areas would see VOC emissions fall by as much as 40 percent in Tianjin and Hebei.

However, the current industry policies will only see levels reduced by about 5 percent.

Meanwhile, the widespread use of fertilizer in agriculture and the growing livestock breeding industry are the main sources of ammonia pollution around Chinese cities. The colorless gas with a pungent smell comes from poultry waste and auto engines, and is an important factor for forming the particulate matter.

Despite government orders to curb dangerous emissions from coal-burning power plants, steel factories, construction-site dust, cars and other well-known sources of air pollution, ammonia has been left off the official list of targeted pollutants, even though it is an increasingly serious component of smog.

China has been spewing more ammonia than any other country for the past two decades, but studies on output of the chemical have been inadequate. Researchers believe most of the country's ammonia pollution comes from farms where nitrogen

fertilizer is spread on fields, or from the animal waste that piles up at poultry and livestock facilities. [bold added]

He's team called for increasing the concentration of the livestock breeding industry in order to better control ammonia emissions, but in reality that will be hard to achieve, He said".

Syriza Victory Is Not A Solution For Greece

WASHINGTON – As expected, Alexis Tsipras and his Leftist Syriza party won the Greek elections for a new parliament. After having struck a coalition agreement with the much smaller Independent Greeks (Anel) party, Syriza has a clear majority. Tsipras is now the new Prime Minister.

Voters choose

Fine. Voters get to choose their leaders. What is not at all clear is what will come next. Syriza campaign was all about rejecting the EU-imposed austerity packages that Greece was forced to accept in exchange for a gigantic \$ 270 billion (240 billion Euro) bailout package put together by the EU, the European Central Bank, and the International Monetary Fund, (the "troika").

Not without cause, Tsipras and his allies complained loudly that austerity alone will not give Greece a chance to regain its strength and chart a course back to economic growth.

Austerity alone will not do

All right. Austerity alone is bad medicine. But then what is

the right mix? This is not at all clear. For the moment we can expect that the new Greek leadership will try to renegotiate the terms of the bailout packages in order to get more flexibility and therefore more breathing room.

And they may get this from Brussels. Or at least some of it. But the real test for a leftist, populist political force is to concoct a credible, sustainable economic growth plan. And I doubt that Syriza has even the slightest idea of how to do this.

Which way to economic growth ?

If this or any other Greek government could convince German Chancellor Angela Merkel, the ECB, the EU and the IMF that less austerity would allow Athens to launch a successful economic growth strategy, they would all support a renegotiation. After all, if the Greek economy starts growing again, the chances of Greece actually paying back its debt improve.

No real changes

The problem is that the Greeks most likely will pocket concessions from their creditors and then prove unable to change the country's economic fundamentals.

Unfortunately in Greece there is a bad combination of strong trade unions that usually push for protecting the status quo, entrenched special interests, crony capitalism, corruption and lack of venture capital that will support new enterprises. In good times, this means economic stagnation. In bad times (and these are horrible times) this means decline.

If the Greeks now believe that by changing government they have voted themselves out of debt and into prosperity, they will soon realize that it is not so.

No More Start-Ups In America

WASHINGTON – There is an almost unquestioned belief that America is the land of entrepreneurs. This is “start-up” country. Anybody with a good idea, if armed with enthusiasm and persistence, is likely to get results. The assumption is that America loves young people going into business. The system helps. It is easy to get started. Relatively easy to get funding. Plenty of venture capitalists willing to buy into a promising venture.

Young entrepreneurs

And we have many good examples, from Bill Gates (Microsoft), to Mark Zuckerberg (Facebook), that demonstrate how brilliant innovators can go from zero to building enormous business empires, becoming fabulously rich in a relatively short period of time.

Well, while these are real examples, there are not as many as there used to be. The broader picture is far less inspiring. Indeed, survey after survey indicate that in America the number of new businesses has been declining. The established American firms are old. The number of newly hatched companies is very small. The number of people employed by them is negligible.

No more start-ups

As Holman Jenkins put it in the [WSJ](#) (“*Secular Stagnation*” and *the Cheap Burger*, January 24-25 2015), “*Our new business formations are the lowest in 35 years, more like Europe than the US. According to Gallup, companies are dying faster than new ones are being born*”.

Got that? the lowest in 35 years.

Yes, we still have Silicon Valley (Thank God!) and other high-tech centers in Texas, Massachusetts and elsewhere. America is still the world leader in information technology, and one of the best in biotechnology.

But the famed, irrepressible entrepreneurial spirit that led people in their twenties (in some cases) to drop out of school in order to get started on their (sometimes) revolutionary projects as soon as possible is not what it used to be.

What is happening?

The data supporting this conclusion of fewer and fewer start-ups is out there, and it is not challenged.

What is not clear is why this is happening.

Less enthusiasm for technology? Fewer young people drawn to business? Too risky to set up your own company? Better career opportunities if one chooses to work for an established big company? Lack of financing?

Who knows really.

However, we can say that gradually the old pro-business ecosystem that enabled and supported entrepreneurship has been damaged.

Too many obstacles

Indeed, over time, running a business in America has become more onerous and more complicated. Taxes are high. Indeed, America has the highest corporate tax rate in the developed world. (Sure enough, large companies manage to pay much less; but only because of sophisticated tax avoidance arrangements that require small armies of accountants and tax lawyers).

Onerous compliance

Besides, a thicket of rules and regulations (from safety standards, to environmental impact, to corporate governance, book-keeping, and mandatory disclosures) requires companies to dedicate a lot of resources to administrative matters, just to make sure that they comply and do not get into trouble with regulators.

And then there are permits and licences that must be obtained to have the legal authorization to do almost anything. And finally now the Affordable Care Act (Obamacare) creates new and costly medical insurance burdens for some employers.

There can be other reasons. But it is intuitively obvious that if you make it more complicated to start and operate a new business, you will end up having fewer people trying to set one up.

America's advantage

America's true economic advantage used to be in the optimistic dynamism of its people. This used to be the "can do" country. Yes, this used to be the land in which "creative destruction" took place every day.

It takes a certain mind set to challenge the status quo with new technologies, new systems, and new modalities. It is obvious that the new destroys the old, including the companies that run it, and all the jobs they created.

But this is the only way to move ahead. Successful new companies create new sectors and new jobs.

Remove barriers

If all of a sudden we become timid, because trying the new looks too complicated or too risky, as a country we are done. In this new, fiercely competitive global economy, the future belongs to the fearless innovators.

I do not believe that public policy can breed innovators. But for sure policy-makers should not create unnecessary bureaucratic obstacles for anybody who would like to try to be one.

The ECB Launched Its Own QE – But Growth Expectations Will Not Be Met

WASHINGTON – Here we go. European Central Bank (ECB) President Mario Draghi launched his own version of QE, or “Quantitative Easing”. The goal of a rather large bond buying program (about 60 billion Euro or \$ 68 billion a month) is to lower interest rates, spur more lending and energize the semi-comatose Eurozone economies, (Germany and a few others being the exception).

Good luck!

Well, good luck! Draghi himself in many different occasions urged European Governments to take bold action by reforming bloated welfare states and labor markets, while reducing regulations that suffocate business.

Yes, believe it or not, ultimately one needs new money-making enterprises to grow the economy and add jobs. That is the real deal.

Monetary manipulation alone will not get you very far unless policy changes create a more propitious “business climate”. But Draghi for some reasons felt compelled to act now, even though he knows very well that real economic policy

changes will not follow his new monetary manoeuvres.

Monetary easing instead of reforms

Indeed, Europe has not moved and will not move on this needed pro-growth agenda. Given this most unpromising background, it takes an act of faith to believe that even lower interest rates –now already quite low– will trigger a healthy cycle of higher growth within the Eurozone. Does Draghi really believe that his QE will do the trick?

Devalued Euro is good for exporters

Sure enough, this move aimed at increasing liquidity has had the immediate effect to further devalue an already devalued Euro. This is of course good news for all the European companies that export outside the Eurozone. As their goods and services are now cheaper, they are more competitive; and therefore they are likely to get more business.

This is no cure

But the notion that devaluation is a good cure-all for any economic malaise is false. The damage is usually bigger than the gain. Look at Japan. “Abenomics” did more or less the same thing the ECB is beginning now. As a result, the yen took a dive. And, of course, with a lower yen Japanese exporters are doing much better. But everybody else is doing worse, since the cost of imported goods went up.

Right now, Europe benefits from cheap oil. Even when paying with a devalued Euro for oil priced in dollars, the Europeans still benefit from the global oil prices collapse. And this is good news. But everything else will be more expensive.

Easy borrowing will discourage reforms

Furthermore, the unintended negative effect of even lower interest rates is that eternally profligate European Governments now know that they will be able to go deeper into

debt at a lower cost. Ironically, while Draghi urges EU Governments to get busy with a credible reform agenda, his policies cause even lower interest rates, and this will make it easier for Rome, Paris or Madrid to get into even more debt. Which is to say that QE will allow this deplorable trend of more spending and more debt to go on a little longer.

Low yields on 10 year bonds

Look, with already depressed interest rates due to monetary easing prior to the launching of Draghi's QE, we had the absurdity of French 10 year bonds with a 0.70% yield, while Italian 10 year bonds were at 1.56%. Which is to say that French and Italian bonds must be a super safe investment.

Italy must have solid finances

While the US Federal Reserve is also guilty of the same crime of having created and maintained artificially low interest rates, the US 10 year bond has a higher yield of 1.8%. Until very recently it was above 2%. And this is in America, still the world's largest economy, with a rate of growth of about 3%. But from this interest rates picture we get that French 10 year bonds are so much safer that investors grab them even with less than 1% interest. And Italy's finances must also be in better shape than America's. What do you know, with an economy at a stand still, sky-high unemployment and debt now at 130% of GDP, Italian bonds are super safe, and this is reflected in the 1.56% yield.

Monetary manipulation produces distortions

When Central Banks create these types of market distortions through monetary manipulation, so that there is no longer any honest valuation and "price discovery" in something as basic as government bonds, it is hard to believe that things will get better in the real economy on account of another big helping of manipulation, via QE.

Feel-good medicine

ECB President Draghi is simply adding more “feel good medicine” to a Eurozone public debt market in which bond prices are no longer a reflection of real risk. This is really dangerous.

And now the ECB will make a bad situation even worse. Because of even lower interest rates caused by QE, Eurozone governments will mistakenly believe that their financial wiggle room really improved. Feeling no real pressure to get their economic and fiscal house in order, they will yet again postpone any serious pro-market, pro-business reform effort. No serious reform, no chance to have any appreciable new growth.

No welfare state reform

In the meantime, with so many restless segments of society demanding pensions, entitlements, and other benefits, European politicians elected to safeguard clearly unaffordable welfare states will continue to spend money they do not have, counting on the ECB to buy their bonds, so that they will be able to keep borrowing at ridiculously low interest.

I understand that President Mario Draghi is doing the best he can in extremely unfavorable circumstances. But anybody believing that this ECB-managed QE is the real deal that –all by itself– will trigger a new era of growth within the Eurozone is a fool. The Eurozone needs good economic fundamentals, and QE is not one of them.

Pakistan Points To Saudi Money Funding Militant Groups

WASHINGTON – It is an open secret that Saudi Arabia and other Gulf countries have been funding religious schools and militant religious groups in Pakistan. It is however unusual for Pakistani officials to make any specific references to this flow of money to armed groups that end up destabilizing this seriously challenged country and its unhappy neighbor Afghanistan. That said, the fact that this issue has been brought up in an open forum, is worth noting.

Whatever Saudi private individuals and groups are doing, it should be stopped. Financing radical groups leads only to chaos. Here is how a January 22, 2015 editorial in Dawn, a leading Pakistani newspaper, commented on the issue:

“Foreign Funding of Militancy”

“IN order to effectively put militant groups out of business, it is essential to dry up their finances. Religiously-motivated militants do raise funds through local sources and criminal rackets, but foreign funding – particularly from Muslim states in the Middle East – is also a major source of cash. While the Gulf states are often cited as sources of militant funding, especially from private donors, it is extremely rare for government officials in Pakistan to openly identify any one of them. Hence, when Inter-Provincial Coordination Minister Riaz Pirzada named names at an event in Islamabad on Tuesday, eyebrows were certainly raised. The minister, though he claims he was quoted out of context, told a conclave that “Saudi money” had destabilised this country.”

“In fact, it has been largely established that Pakistan has been a conduit for funds destined for religiously inspired fighters for over three decades. In 1979, two monumental

events took place in this region that forever altered the geopolitical calculus: the Islamic Revolution in Iran and the Soviet invasion of Afghanistan. Thereafter, funds flowed in freely from the United States, Saudi Arabia and others for the 'mujahideen' battling the Soviets across the border, while many Arab states – fearful of a revolutionary and explicitly Shia Iran – started to fund groups that could resist Tehran's ideological influence in Muslim countries. Ever since, a jumble of jihadi and sectarian groups (of varying persuasions) has thrived in Pakistan, as the country became a proxy battlefield for Iran and Saudi Arabia, as well as a front line of the last major battle of the Cold War. Since then, militancy has morphed out of control to such an extent that it now threatens the internal stability of this country; neutralising the myriad jihadi outfits has then become Pakistan's number one security challenge."

"While documentary evidence is often hard to come by, Gulf money has been linked to the promotion of militancy in many instances. There have been reports of Gulf funding for extremists in the Syrian conflict, while the WikiLeaks disclosures of 2009 also attributed comments to Hillary Clinton linking Saudi funds to militant groups. Another cable claimed donors in Saudi Arabia and the UAE were pumping millions into south Punjab, with much of these funds ending up in the hands of jihadis. Even Interior Minister Nisar Ali Khan admitted recently in a written reply to a question in the Senate that madressahs were receiving funding from "Muslim countries". In principle, there is nothing wrong with seminaries or charities receiving foreign funds. But when this cash is used to fund terrorism and extremism, things become problematic. The best way to proceed is for the intelligence apparatus to monitor the flow of funds. If the authorities have reasonable evidence that funds from the Gulf or elsewhere are being funnelled to militants, the issue needs to be taken up with the countries concerned."

The End Of China's Boom

WASHINGTON – The China story has changed, quite a bit. Yesterday it was about relentless growth. Today it is about the slow down. In fact, it is worse. Today it is becoming the story about “what went wrong”. Today's story is about massive industrial overcapacity, newly built cities with no people, and environmental disasters. All this is coming out while China's growth numbers, while still incredibly high, are less impressive. From 10% we got down to 7.4%.

Industrial machine

For many years we were used to the gigantic Chinese industrial machine powering on, gobbling more and more export markets. We were used to old Chinese cities made over at incredible speed. We saw pictures of brand new airports, new highways, super fast trains, and glittering shopping malls.

At the same time, literally hundreds of millions of Chinese had graduated to the middle class. They owned cars, apartments and started traveling abroad, while the very rich sent their kids to expensive, elite Western universities.

America down, China up

After the disastrous 2009 US recession, the contrast appeared even more stark. America was in decline, General Motors was bankrupt; while China gained even more ground. The biggest trading nation also became the world's number 2 economy, leaving Japan behind.

The secret of success

Of course, at the time, everybody wanted to know the secret. Many believed that the special ingredient was superior leadership. The Chinese Communist Party had successfully morphed into a super qualified technocratic elite that could steer China in the right direction, crafting smart growth policies that were able to create a unique and super optimized blend of state-run and private corporations.

Not so

Well, guess what, it was not so. Not by a long shot. And we are beginning to see the truth. China did extremely well exploiting its cheap labor advantage. China did manage to become the workshop of the world simply because its workers received wages that were a fraction of what Western workers normally got.

Cheap labor

This basic cheap labor factor made China the primary destination of outsourced manufacturing. Granted, the Chinese were also quite skilled in creating the supply and logistics chains that factories and foreign customers depend on. Indeed, beyond the new factories, the Chinese also built the railways, the highways and the ports that made it possible to move enormous quantities of goods reliably and efficiently. This is no small accomplishment. (If you look at India, well, no comparison. India could theoretically exploit a cheap labor advantage. But forget about efficient logistics. India is a gigantic mess).

With all this manufacturing base and infrastructure coming to life, it made perfect sense for thousands of Western companies to move all or most of their manufacturing to China.

Because of this, while big chunks of America's middle class disappeared, along with the shuttered factories, China put to work millions of people.

The end of the export boom

But this export-led boom is over. Not that we Westerners will stop buying made in China products. We simply will not buy them at the same rate. Most markets are saturated. Leaving aside any speculation about the resurgence of manufacturing in America or Europe, it is simply impossible to grow export markets by 10% a year, every year –for ever. China will remain a major exporter. But GDP growth cannot depend on growing exports the way it used to.

Construction boom is over

Add to this the end of the fantastic construction boom. Well, much of it was bad speculation financed by (now bad) debt. Much of it was driven by local governments trying to “look good” by showing nice growth numbers. The problem is that these local leaders got into heavy debt in order to finance easy development to be achieved through construction projects.

And the net result of this collective insanity is a monstrous property glut. In the so-called second or third tier Chinese cities, (from 500,000 to a few million people), one can see entire blocks of empty high-rise buildings. Very simply, the Chinese created an enormous, debt-financed property bubble.

Worse yet, the unprecedented construction frenzy fueled the creation of massive over capacity in all industrial sectors that support construction: steel, cement, glass, copper. Add to this the oversized growth of all the industries that supply the housing market: major domestic appliances, furniture, bathroom fixtures, you name it. Too much capacity in all these sectors.

The stimulus led to waste

And then you must add to this mix unwise policy choices. In order to avoid the ill winds of the 2008-2009 recession created in America, China launched a massive stimulus program.

Well, guess what: a large amount of that money was wasted on bad projects that added to the overcapacity mentioned above, while saddling the financial system with a huge number of bad loans.

Environmental disasters

And I forgot to mention that during the go-go years of massive industrial expansion, the Chinese couldn't care less about environmental safeguards. As a result, at the end of this incredible 30 year run, tens of millions in China live in cities where the air is not safe and most of the water is polluted. Not to mention soil contaminated by toxic and poisonous substances. How do you fix that?

Growth still high

Well, let's fast forward to the present. China just announced that in 2014 its economy grew "only" 7.4%. Of course this is still a fantastic rate. (Europe is lucky to have 1%. America seems like a giant within the West because it moved up to about 3%). But China is trending down.

Of course, there could be a good way forward. Having exhausted its major comparative advantage –cheap labor– China should move upmarket. It should become an "innovation society".

Innovation society?

But, you see, innovation usually requires plenty of innovators, original thinkers. People willing to think outside the box. People who go against the grain. People who are willing to experiment, and try new things.

The Chinese are very good at making products following the specifications provided by the Western companies that actually design them. But this has little to do with innovation. Innovation requires a different set of skills. And China is not the ideal breeding ground for their development.

The fact is that China, with all its incredibly rapid modernization, is still a hierarchical country run by a small unelected elite that is extremely aware that it needs to control society in order to stay in power.

This *de facto* “top down” control in which discipline and uniformity are not just encouraged but often imposed does not strike me as the ideal, decentralized, multi-polar eco-system that will breed many future innovators.

You see, innovators thrive in free societies.

Keystone Pipeline Would Improve US Energy Security

WASHINGTON – Is The US State Department (read President Barack Obama) going to finally authorize the Canada to the US Keystone oil pipeline, to be built by TransCanada? The political signs are not at all good. And why would Obama say “no” to a pipeline that will carry additional Canadian oil to the refineries in Texas?

Politics, not energy policy

Sadly, this will have nothing to do with the merits of the issue. This is all about politics and the demonization of carbon based energy. The accepted narrative in the environmentalist camp (these are all Democrats, and they voted for Obama) is that Canada’s heavy oil extracted from oil sands, (the greens prefer the pejorative but technically correct expression “tar sands”), is the worst of the worst

when it comes to high polluting crude.

Heavy oil requires a lot of energy to be extracted, and fuels made from it contain more greenhouse gases. Therefore, according to the greens, the US Government should not allow more of this toxic stuff to get to America.

Ideological objections

Of course, it is true that Canada's heavy oil pollutes more. But not that much more. And, in any event, we already use heavy oil from Venezuela and other countries, including Canada. Besides, if you look at total world consumption, (about 90 million barrels a day), using more of this Canadian oil, (the pipeline will carry less than one million), will not make much of a difference.

Obama will not go against his constituency

And yet, since this oil has been stigmatized as super bad by the environmentalist, President Obama is in a bind. If he approves the pipeline, as he should, he will face fierce protests from within the Democratic Party. However, if he does not he will pay no special political price. The Republicans do not get along with this President anyway. By giving them an additional reasons for disliking him, Obama will not change an already poisoned Washington political climate.

This being the political context, would the US be better off having this TransCanada Keystone pipeline, even at a time of oil super abundance and falling prices? Do we really "need" to get more oil from Canada?

The answer is "yes".

US is still a major oil importer

Notwithstanding the oil glut and falling prices, America is still a major oil importer. This will not change in the near future. America must import almost half the oil Americans

consume every day. Therefore, from an energy security stand point, it makes sense to get more crude from Canada, a trusted and geographically close ally, this way reducing our imports from OPEC or other countries.

Of course, the pipeline opponents claim that this decision on Keystone has nothing to do with energy security, because the additional Canadian oil that will be refined in Texas will be turned into gasoline for export markets.

May be so. But getting additional supplies from a friendly neighbor is still an advantage for America. Most certainly, in case of future supply disruptions, gasoline made in Texas using Canadian crude will be sold in America.

Add to supplies from North America

In other words, it is smart for the United States –a net oil importer– to add to the total imports from North America, as opposed to getting oil from the Persian Gulf.

Besides, this new Keystone pipeline will also carry some of the US oil from North Dakota.

And finally, let us keep in mind that a lot of heavy oil from Canada is already coming into the United States, via rail cars. This transportation system (that does not require Government approval) is less efficient, more dangerous, (as a few spectacular accidents have demonstrated), and more expensive.

Additional flexibility

Building the Keystone pipeline will allow more of the same Canadian oil to come to America –but at a lower cost. There will be an additional advantage in creating more energy flexibility for the US, while diminishing reliance on oil from OPEC. This is mostly about increasing supply (from a trusted ally) in a more cost-effective, more efficient way. For all

these reasons, this pipeline should have been approved long ago.

Political decision

But this has not happened, and it may not happen, because these days pretty basic energy policy decisions are hostage to ideology. Once you have demonized a piece of energy infrastructure by claiming that the crude it will carry would trigger planetary disasters, it is hard to retreat and say that after all this oil will not cause any real damage.

It is really sad to acknowledge that this is the way we make important energy policy decisions in America. But this is unfortunately the case.