

# No Economic Growth Without Clear Property Rights

WASHINGTON – The almost unanimous mission statement of key International Financial Institutions (IFIs) devoted to development, along with national development agencies and their many private and public sector partners is that they are all united in a major effort “*to fight poverty*”, or at least “*reduce poverty*” around the world. Well, may be so. But if this is indeed their goal, they are not focusing on one of the most important issues –may be the most important– that prevents poor countries to get out of poverty.

## **Not what you think**

And it is not what you think. The issue is not insufficient health care services, poor education facilities, or gender inequality. Nor is it insufficient resources devoted to international aid. It is something completely different –and perhaps surprising for both analysts and practitioners.

***The issue is property rights, in fact lack of properly defined, universally recognized and enforceable property rights.***

Such property rights are clearly defined and codified in modern capitalistic economies. But in most emerging countries their legal status is uncertain, very messy and confused. This creates huge impediments in buying and selling property.

Indeed it is hard and in most cases outright impossible to sell what you do not legally own. Furthermore, all these assets with no legal standing cannot be used as collateral when requesting commercial loans.

**The problem is not poverty**

Simply stated, in poor countries the main impediment to economic growth and therefore higher standards of living, is not lack of wealth, as in crushing poverty.

The problem is instead that most emerging markets lack the recognized legal frameworks and regulatory arrangements regarding property and its legal status that are common place in most modern countries.

According to economist Hernando de Soto, (*The Mystery of Capital*, published in 2000), the key to understanding under performing economies and therefore continuing poverty is not lack of wealth as an objective impediment.

The problem is that the existing real estate and industrial/commercial ventures assets –and the not insignificant wealth they contain– in most cases are not legally owned by those who control them. Therefore they cannot be mobilized and leveraged by their “owners” in order to spark new investments and thus additional growth. They are therefore “dead assets”. And for this reason they cannot be mobilized to obtain financing that would promote significant new economic development.

### **A big deal**

Is this lack of modern property laws and regulations shared by most developing countries really a big deal? Yes, it is.

Let me expand on this. In the U.S. in Europe and elsewhere there are clear laws that provide a legal framework for real estate ownership and related transactions. These laws regulating property rights (with universal applicability within a country) created accessible inventories of all real estate assets. They prescribe how deeds held by property owners should be formulated, what a title to a property is and how it is legally obtained. They also clearly indicate which public agencies are the official repositories of all deeds and titles. As a result, all the real estate existing within any

country's borders is properly accounted for, while all transactions (buying, and selling and more) related to it are a matter of public record.

### **A uniform legal system regulates property rights**

The point here is that in developed countries all records of who owns what are compiled according to one standard formula, this way creating one system that captures all assets and all transactions involving them. These standardized records in turn become accessible public documents that clearly define the nature and boundaries of a property and allow anybody to reliably trace its lawful owners.

### **Legally owned property can be mobilized**

But this is only half the story. The truly important consequence of this uniform legal treatment of property is that, by virtue of having such a system in place, real estate becomes a "live asset" that can be easily bought and sold and rented at market prices.

***Most critically, property becomes an asset that can be used as guarantee and collateral for commercial loans and mortgages. Lenders can determine the market value of these assets on the basis of publicly available information regarding their size, locations and other attributes.***

Furthermore, owners of large businesses can sell parts of their assets and receive fresh capital by creating corporations that own the assets and therefore can legally issue shares. This way, new shareholders can "own" a fraction of the assets controlled by the corporation without any need to subdivide the assets controlled by it.

### **None of this in emerging countries**

In emerging countries, almost none of this exists. There are some rules regulating property; but they are not uniform and

not universally enforceable. They are murky and usually recognized only in a specific locality within the country. Outsiders do not know them and do not understand them.

All this means that property cannot be easily and reliably bought and sold on the basis of market prices. Hard to buy from someone who has no clear legal title on the asset in question. The buyer has no guarantee that henceforth he will indeed be recognized as the lawful owner.

Given all this, most loans that require real estate as collateral, as well as other transactions based on the ability to offer solid guarantees to lenders or business partners, are off-limits to most property “owners”, for the simple reason that most people do not “legally” own what they have.

### **Squatters have no rights**

Let me explain. The “owners” do occupy and use property, a building for instance. May be they built it themselves. But they have no legal title to the land on which the building sits, or to the building itself. In most instances they are squatters who built something illegally. Therefore, since they did all this outside any prescribed law, they cannot use the wealth they do have and control –however modest this may be– as collateral that would be accepted by banks in order to get a loan. De Soto correctly calls these assets “dead capital’.

### **This is critical**

Now, how important is all this? very important. Indeed, we all know that commercial credit is the yeast of all modern capitalist economies. It is really hard to think of economic growth without the lubricant and fertilizing power of commercial loans.

***But almost all loans that require collateral are beyond the reach of most would-be borrowers in emerging countries. This has the effect of a huge wet blanket on economic growth. How***

***can a small entrepreneur borrow from a bank to finance its expanding business if he/she cannot offer any collateral? Very simple: they cannot.***

### **Informal sector does not help**

Of course, other means to obtain credit may be available within the informal economic sector, (think “loan sharks”), but they are generally extremely onerous in terms of short repayment terms and exorbitant interest rates. Therefore these instruments are in most cases unappealing.

It is clear that these types of “loans” can hardly become the main engine of economic growth serving the purpose of funding promising new enterprises, as is the case in most advanced economies where commercial loans are routinely provided by established banks.

### **How much “dead capital”?**

And how much “dead capital”, (meaning capital that does exist but cannot be leveraged), are we talking about? Well, according to de Soto’s book cited above, an enormous amount:

*“By our calculations, [de Soto and his team worked in several countries in order to conduct their research] the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least \$ 9.3 trillion”.*

*“This is a number worth pondering: \$ 9.3 trillion is about twice as much as the total circulating U.S. money supply...It is more than twenty times the total direct foreign investment into all Third World and former communist countries in the ten years after 1989, forty-six times as the World Bank loans of the past three decades, and ninety-three times as much as all development assistance from all advanced countries to the Third World in the same period”.*

(NOTE: Data cited in de Soto's book goes up to the year 2000. Since then the picture may have shifted somewhat. But there has been no dramatic transformation, because in most developing countries property is still held mostly without proper legal title. Therefore, it still cannot be used as collateral for commercial loans and/or any other form of financing).

***These are truly amazingly large figures. Yes, poor countries are poor. But not as poor as we would generally think. The problem is that whatever wealth most individuals hold in these countries, it cannot be used as a legally recognized asset; and therefore it cannot be leveraged. This is a major impediment to growth.***

### **Working hard is not enough**

It should be stressed that this impediment originating from lack of legal status of so much property has nothing to do with how much or how hard people work in these countries. In poor countries many people do work hard, and they do acquire assets.

The problem is all about the failure to create a modern property laws system that would allow citizens in developing countries to gain legal title to what they own, this way transforming large amounts of "dead capital" into "live capital".

### **Priority one**

In the light of de Soto's remarkable findings, a legal/regulatory/administrative effort leading to clear and enforceable property rights should be priority one for both governments and donors who want to enhance economic growth in developing countries.

You want to eliminate poverty? Well, begin with breathing real life into (now anemic) commercial lending backed by real

estate as collateral.

And this starts with creating a rational and transparent property rights legislation and system that will allow business people to **a)** gain title to what they own, and **b)** be able to borrow in order to grow their enterprises, offering their now “*live assets*” as acceptable collateral.

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## **In Japan Corporate Losses Are Not Revealed**

**WASHINGTON** – The WSJ commented in an editorial, (*Japan's Sharp Turn*, March 31, 2016), that the Foxconn (Taiwanese electronics giant) acquisition of the beleaguered Japanese consumer electronics icon Sharp may represent a turning point for Japan.

### **No help from the state**

Sharp was in deep financial trouble. But the company decided not to seek help from the state backed Innovation Corporation of Japan, so that it could arrange a merger with another Japanese electronics manufacturer, this was probably getting to an honorable settlement, while hiding its awful conditions. Sharp decided instead to seek a foreign buyer.

This however created problems. When Foxconn gave a second look at Sharp's books, huge additional (and previously undisclosed) losses were exposed. Foxconn demanded and obtained a deep discount on the original price in order to go ahead with the purchase.

## **A turning point?**

The WSJ argues that Sharp did something that most Japanese companies would not do. It went abroad with the hope that a foreign buyer would be able to inject not just capital but a different corporate culture and managerial style that would revitalize the electronics company. The editorial argues that this may be a turning point for insular Japan whose under performing economy is in part the outcome of its secretive and opaque way of conducting business.

## **Do not tell the truth**

I would not be so sure. Indeed, reading between the lines of this WSJ editorial we get a positively unflattering, in fact alarming picture of Japanese big business. This is a world in which essentially the truth is never told.

As the editorial itself puts it, the Japanese economy is an elaborate system of cross-shareholding structures designed to prevent real outside control on corporate activities. This system in which all the big companies have investments in other corporations created a web of shared interests. The net outcome is that no one has any real incentive in revealing other companies embarrassing secrets. *"I cover you, because I know that will you cover me"*

## **Discretion?**

This "discretion" may be a wonderful recipe for the survival of the Japanese corporate elites. But it is also a perfect tool for hiding poor management and worse. For example, there was a huge scandal involving Toshiba last year when it was revealed that the company had engaged in a major \$ 2 billion accounting fraud that had gone on for quite a long time, undetected. With adequate corporate governance control systems in place, along with internationally recognized disclosure standards, keeping this massive fraud secret for so long would have been impossible.



The WSJ argues that Sharp's decision to let everything out in the open, exposing its own bad management and huge losses before being taken over by a foreign firm, shows courage and therefore a major transformation in Japan's corporate culture. This means that from now on there will be more openness, more transparency, while more foreign investors will be welcomed.

### **Sharp is the exception**

I wish this were true. I really do. But I suspect that Sharp is an exception, may be a big one; but not the beginning of a new trend. Sadly, Japan is an ossified society run mostly by old people afraid of change. Corporate leaders know one another very well, and instinctively cover for one another.

I do praise the courage of Sharp's managers who in fact took a bold new direction. But they were also desperate. Others who may not be in such dire straits probably see nothing wrong in cooking the books and hiding their tracks with the help of complicit boards all composed of other corporate managers who also have something to hide.

### **This is the root of Japan's decline**

if you want to know what is at the root of Japan's economic decline, it is right here: a risk averse corporate culture in which lying is actually considered good manners, because the truth may be too embarrassing. This approach may be good for smoother social relations. But it is a lousy way to run a profit based capitalistic economy.

Real capitalism needs true numbers. Hard to get those in Japan.

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# “And The Fair Land”: Freedom Is America’s True Blessing

WASHINGTON – *Thanksgiving 2015* –

The Wall Street Journal has been publishing the same “Thanksgiving” Editorial since 1961. It is titled “And The Fair Land”. it depicts America as a land of opportunity and resourcefulness. But also a land of self-doubt, fears, and internal conflict.

However, the hope expressed in this enduring essay is that we Americans shall reflect on the fact that this land was built by confident people. And they were, and we are, the spiritual heirs of the Pilgrims who came to America, so long ago, carrying with them only a hope for a better life.

They celebrated the first Thanksgiving in 1623, beginning a tradition that was later on institutionalized, and that we still honor today.

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## ***And The Fair Land***

*“Any one whose labors take him into the far reaches of the country, as ours lately have done, is bound to mark how the years have made the land grow fruitful.*

*This is indeed a big country, a rich country, in a way no array of figures can measure and so in a way past belief of those who have not seen it. Even those who journey through its Northeastern complex, into the Southern lands, across the central plains and to its Western slopes can only glimpse a measure of the bounty of America.*

*And a traveler cannot but be struck on his journey by the thought that this country, one day, can be even greater.*

*America, though many know it not, is one of the great underdeveloped countries of the world; what it reaches for exceeds by far what it has grasped.*

*So the visitor returns thankful for much of what he has seen, and, in spite of everything, an optimist about what his country might be. Yet the visitor, if he is to make an honest report, must also note the air of unease that hangs everywhere.*

*For the traveler, as travelers have been always, is as much questioned as questioning. And for all the abundance he sees, he finds the questions put to him ask where men may repair for succor from the troubles that beset them.*

*His countrymen cannot forget the savage face of war. Too often they have been asked to fight in strange and distant places, for no clear purpose they could see and for no accomplishment they can measure. Their spirits are not quieted by the thought that the good and pleasant bounty that surrounds them can be destroyed in an instant by a single bomb. Yet they find no escape, for their survival and comfort now depend on unpredictable strangers in far-off corners of the globe.*

*How can they turn from melancholy when at home they see young arrayed against old, black against white, neighbor against neighbor, so that they stand in peril of social discord. Or not despair when they see that the cities and countryside are in need of repair, yet find themselves threatened by scarcities of the resources that sustain their way of life. Or when, in the face of these challenges, they turn for leadership to men in high places—only to find those men as frail as any others.*

*So sometimes the traveler is asked whence will come their succor. What is to preserve their abundance, or even their civility? How can they pass on to their children a nation as strong and free as the one they inherited from their*

forefathers? How is their country to endure these cruel storms that beset it from without and from within?

Of course the stranger cannot quiet their spirits. For it is true that everywhere men turn their eyes today much of the world has a truly wild and savage hue. No man, if he be truthful, can say that the specter of war is banished. Nor can he say that when men or communities are put upon their own resources they are sure of solace; nor be sure that men of diverse kinds and diverse views can live peaceably together in a time of troubles.

**But we can all remind ourselves that the richness of this country was not born in the resources of the earth, though they be plentiful, but in the men that took its measure. For that reminder is everywhere—in the cities, towns, farms, roads, factories, homes, hospitals, schools that spread everywhere over that wilderness.**

**We can remind ourselves that for all our social discord we yet remain the longest enduring society of free men governing themselves without benefit of kings or dictators. Being so, we are the marvel and the mystery of the world, for that enduring liberty is no less a blessing than the abundance of the earth.**

**And we might remind ourselves also, that if those men setting out from Delftshaven had been daunted by the troubles they saw around them, then we could not this autumn be thankful for a fair land.”** [emphasis added]

—The Wall Street Journal

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# Obama's Nairobi Speech In Praise of Enterprise Not Well Reported – A Pity

WASHINGTON – US President Barack Obama traveled to Nairobi, Kenya to address a US-sponsored international forum on entrepreneurship. He said a lot about the value of enterprise in modern societies.

## The key point

And yet this is what most international media quoted from his speech: *“Entrepreneurship offers a positive alternative to the ideologies of violence and division that can all too often fill the void when young people don't see a future for themselves.”*

## That's it?

Let me understand this. According to world media, of all the things that Obama said, the most quotable sentence is that Africans (and others) should foster entrepreneurship because it provides a good antidote to *“ideologies of violence and division”*? That's it? This is the value of enterprise? An antidote to political extremism?

This is how you narrow down what the leader of America, the most successful capitalistic economy in history –an economy, mind you, founded on free enterprise– has got to say about the value of entrepreneurship?

## There is a lot more in Obama's speech

Obama said a lot more in his speech, a lot more. He talked about the power of innovative ideas, creativity, risk taking, meeting challenges. He talked about ways in which America plans to support private sector entrepreneurship around the

world. He talked about the role of women.

But none of this has been reported at any length. This is a missed opportunity. A speech extolling the value of enterprise in emerging countries, precisely because it has been delivered by an American President, illuminates why the capitalistic industrial democracy model that we would like other countries to embrace, is better.

### **The enabling environment**

Sure enough, enterprise is not everything. You need a real *"enabling environment"*. You need good laws that defend private property and investors rights. You need an independent judiciary, simple regulations, and a true commitment to fight corruption.

And there is more. You need infrastructure (power generation and distribution, railways, good highways, ports, and what not). Of course you need all this. And Obama talked about this in his Nairobi speech.

### **Enterprise is key**

And yet, the truth is that, if a society is unable to produce a robust group of future oriented entrepreneurs willing to take risks, you can have all these "building blocks" without making any real economic progress.

Look, it is very difficult to "breed" entrepreneurs. But one way to encourage more people to take a chance by starting a business is to make it clear to them that risk taking can have great rewards. You can make money. You introduce a new product or service. You can offer employment to others. You contribute to the overall progress of your society. And this is what Obama said in his Nairobi speech.

### **Incentives**

And this is why it is a great pity that most media chose to

focus only on what Obama said about enterprises as antidotes to political violence. The US President said a lot more.

He said that enterprise is the engine of growth and innovation. He said that it is the best way to have faster economic growth. He said that America encourages women entrepreneurs in emerging countries. He talked about broad-based initiatives that will link US investors and technology leaders with young entrepreneurs world-wide. All this may not be revolutionary. But it is important.

Too bad that Obama's message extolling free enterprise was not properly reported, and therefore it was lost.

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## **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.

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## **Yes, There Are Young American**

# Innovators

**WASHINGTON** – While the marvelous “*American Innovation Machine*” is not moving ahead as fast as it used to, luckily for us it is still alive. Reading Forbes magazine, the chronicler of American capitalism and enterprise, I recently saw a very interesting piece.

## **Self-made billionaire**

It is a short but compelling profile of the youngest female self-made billionaire. (*Bloody Amazing*, July 21, 2014). Elizabeth Holmes is only 30; but her company, Theranos, has been valued at \$ 9 billion, and she own 50% of the stock.

So, there you go: 30 years old and worth \$ 4.5 billion. “*Only in America*”, as we used to say.

## **New blood testing technology**

And what did Elizabeth Holmes come up with? Something really remarkable. She developed a disruptive technology that allows medical facilities to easily conduct blood tests using only drops of blood drawn from patients. Theranos blood testing technologies are now available at 21 Walgreen’s clinics.

What this means is that tests that normally require relatively large amounts of blood, plus complex machinery and facilities with lots of personnel, now can be conducted by drawing minimal amounts of blood from patients. The whole non invasive procedure can be completed at easy to reach facilities located within drug stores.

This means lower costs and less complexity for all: patients, lab technicians and doctors who ultimately use the test results to have a diagnosis on the patient’s conditions.

## **Innovation and its reward**

There you go: Elizabeth Holmes conceived and developed a novel way to deliver at a lower cost, with minimal disruption, routine medical services used by millions, every day. Great idea.

And this is good news for America. It would appear that the US economic eco-system, notwithstanding its shortness of breath, and in spite of all the stupid, cumbersome regulations and our byzantine tax system, can still provide enough encouragement for people like Elizabeth Holmes to think something new and try to make it happen.

Her newly created substantial personal wealth is the reward for her creativity, and for her courage in pursuing her goals.

### **More like her**

I really hope that there are many others out there, just like her. Undaunted young entrepreneurs, men and women, willing to think outside the box, and with enough guts to develop and bring to market their amazing new technologies.

It is because of people like Elizabeth Holmes and her peers that America managed to become prosperous, while generating new devices that benefit our quality of life.

### **Attracting talented people**

Despite the current stagnation, let's hope that we can keep the "*American Innovation Machine*" running. This is by far the best thing we have got. And it is the main reason why talented people from all over the world still want to come to America.

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# Ukrainian Prime Minister Yatsenyuk Both Defiant And Conciliatory In A Speech At The Atlantic Council

By Paolo von Schirach

March 12, 2014

**WASHINGTON** – The Western world seems to be united in its support for the embattled (and truly broke) Ukraine. Regarding the unprovoked Russian invasion of the Crimean peninsula, The G 7 issued a statement indicating that territorial changes in the Ukraine arrived at without following the proper constitutional process will not be recognized: *“Any such referendum [on the secession of the Crimea] will have no legal effect”*. The EU, on its part, also condemned the Russian military occupation and Moscow’s moves aimed at the annexation of the Crimea.

## **Obama’s support**

President Obama added his open support when he received at the White House Arseniy Yatsenyuk, the Ukrainian Prime Minister, on March 12, just days prior to the planned referendum on joining Russia to be held on March 16 in the Crimea now under Russian military occupation (in violation of the Ukrainian constitution). So, the message to Putin is clear: *“We, Europe and America, stand firmly with the new government in Kiev. What Russia has done is unacceptable. Moscow has to order its troops to go back to their barracks”*.

## **Prime Minister Yatsenyuk at the Atlantic Council**

The young (39 years old) and affable Prime Minister Yatsenyuk,

speaking at a packed event hosted by the Atlantic Council, a prestigious, non partizan Washington foreign policy think tank, talked confidently about all the support his country has received.

And yet, the general tone in the West, and even in the words articulated by the Prime Minister, is not bellicose. Yatsenyuk opened his remarks at the Atlantic Council referring to the Russians as past and future “partners”. He repeatedly indicated that this unprecedented crisis created by the invasion should be resolved through dialogue and diplomacy. He pointed out that the Ukrainian government is eager to work on new laws and regulations that will further enhance the autonomy of the (mostly Russian speaking) Crimea. He pledged that there is and there will be no discrimination in the Ukraine against the large Russian minority.

### **Autonomy to the Crimea**

In other words, he *almost* said (anyway this is what I read between the lines) that the Ukraine is willing to give the Crimea *virtual* (even though not legal) independence. (Any formal secession could be arrived at only by following a prescribed constitutional process).

Yatsenyuk did everything he could in his remarks at the Atlantic Council to reassure the Russian government in Moscow, the Russians in the Crimea and in the rest of the Ukraine that they have nothing to fear. The government in Kiev does not and will not discriminate against anybody.

Which is to say that if indeed the Russians have intervened militarily because of a genuine concern about the welfare of the Russians in the Crimea, *there is really no issue*. The Ukrainians are committed to protecting all citizens equally, regardless of ethnicity.

### **The Russians can get reassurances**

If the Russians have indeed acted in good faith, out of fear about the fate of their brethren in the Ukraine, then they should seize this opportunity and start a dialogue with Kiev aimed at spelling out how the Russians in the Crimea and elsewhere in the Ukraine will be protected by the new government.

If this were indeed the real issue, then it could be addressed and solved, since the Ukrainians, according to the Prime Minister, are willing to concede (almost) *everything* when it comes to additional autonomy to the Crimea. Yatsenyuk pointed out that this would not require a major effort, as there was no violence or discrimination against ethnic Russians in the Crimea prior to the Russian military occupation.

### **The alleged persecution of Russians is just an excuse**

The problem is that Putin used the alleged persecution of ethnic Russians in the Ukraine as a convenient excuse. I doubt that he believes any of what he said publicly to justify Russia's military intervention. The fact is that for his purposes of power consolidation and reaffirmation at home, seizing the Crimea after having lost (politically) the Ukraine seemed the clever thing to do. This notion of "saving" oppressed Russians unjustly separated from the Motherland has a certain ring among Russian nationalists, and so this was a politically astute move. In Russia and among most Russians, Putin now looks very good.

But Putin is now in a bind abroad. The West is against all this. There is no way that an open land grab that violates key principles of international law, along with a multilateral treaty that guarantees Ukrainian sovereignty co-signed by Russia, can be ignored. Berlin, London and Washington simply cannot continue business as usual with Moscow.

### **What will the West do?**

That said, it is unclear to me, despite the declared support



for the Ukraine, what exactly does the West plan to do. Are we ready to go to the next level: ***namely serious economic sanctions against Russia?*** We certainly could, starting with the seizure of bank accounts and properties owned by the Russian oligarchs (most of them friends of Putin) who have stashed their loot in London and Geneva and who bought luxury homes in Paris or the Riviera.

### **Sanctions, anybody?**

We could really hit Russia where it hurts. And let's remember that Russia does not have a lot of staying power. It has a relatively weak economy that is almost totally dependent on the revenue provided by selling oil and gas abroad.

Of course, there are also clear European vulnerabilities. The Russians know that Europe depends on Russia's gas. Therefore, if Europe freezes economic relations with Russia, and gas stops flowing west, what will happen in Germany or Poland? How will they keep the lights on without Russian gas? No easy answer for this, as there is no immediate alternative to Russian gas. This energy dependence makes it very unlikely that Germany, Sweden or Bulgaria are prepared to enforce really tough economic sanctions against Russia.

In the US the picture is only marginally better. (By the way, we have all the gas we need here at home). President Obama, notwithstanding his recent show of support, has no special interest in prolonging a foreign crisis that most Americans do not even begin to understand, just a few months before the November congressional elections in which his party already stands to lose a lot of seats.

### **Putin's calculations**

All in all, my sense is that the Russian "Crimea Gamble" included the calculation that there would be no Western united front against Russia. If this is so, Putin may really believe that he will get away with this unprecedented land grab.

I would love to be wrong on this, but I suspect that Putin's assessment is correct. There will be a split within the West. If Putin is right, in the end he will prevail. He is a bully willing to take risks. The "peace-loving" Europeans are not in the same league.

### **Western verbal support**

For the moment, everybody is saying the right things. But when it comes to "**action**" I suspect the music will change –a lot. The poor Ukrainians will realize that they are pretty much on their own on the Crimea.

They will get (some) money from the EU, the US and the IMF to stabilize the economy, and more help down the line for structural fiscal and institutional reforms. But nobody is going to engage in serious, prolonged actions –let alone military actions– against Russia, in order to restore law and order in the Crimea.

Without real (as opposed to verbal) support, the Kiev government will have to settle. It is obvious that the Ukraine cannot afford to be in a state of permanent crisis with Russia. There are just too many intertwined interests, too many relationships. Eventually some face-saving formula regarding the final status of the Crimea will be devised.

The world will nod and we shall all move on.

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# **Financial Aid To The Ukraine? Great Idea But Huge Costs**

**By Paolo von Schirach**

March 10, 2014

**WASHINGTON** – A few days ago, I argued [in a related piece](#) that it is hard to believe how Ukraine can be considered by either Russia or the West as a coveted prize in this emerging new version of an East-West confrontation. The country is vast, (almost the size of Texas), and it is home of a fairly large population, (somewhere around 45 million). Other than that, however, Ukraine is a real mess. It is poorly organized, very corrupt and essentially broke. Indeed, just to get things back together, we are talking about [a \\$35 billion bill](#). I assume that includes all the unpaid natural gas bills that Ukraine owes Russia's Gazprom.

## Save the Ukraine?

And yet, notwithstanding this economic train wreck, now the talk is about the (semi-broke) West bravely stepping up to the plate in order to “save” Ukraine. Indeed, if I understand correctly the still hazy plans articulated by US Secretary of State John Kerry and some European policy-makers, we are in for a lot more than just an emergency financial rescue operation.

***We are talking about a long-term commitment to turn the Ukraine around.***

We are talking a major, multi-year assistance package, (including money, tools, technical expertise), aimed at helping the new leaders of the courageous Maidan demonstrators in planning and then implementing major reforms. The goal is nothing less than a reborn Ukraine that would prove to the world (and of course to its Russian neighbors) that a messed up, post-Soviet Republic can become a viable, modern country by adopting best practices when it comes to ensuring basic freedoms via good governance and the adoption of sound economic management. In a nutshell: if we are serious about this, we are talking years and years of sustained work,

and tens of billions of dollars.

## **This is going to be expensive**

Turning the Ukraine around is of course a great idea. The problem is that, even assuming good will and not too much negative Russian interference, (you can count on Moscow's attempts at sabotaging pro-Western policies), this is going to be difficult and very, very costly.

Therefore, Western leaders should make this very clear. For instance, I am not sure that US voters, worried about unemployment, stagnant wages and massive student loans debt burdening millions of young workers are that keen on pouring billions of dollars into the Ukraine mess.

## **Let's try**

That said, I do hope that America and Europe, with the support of the IMF and others, will try this. If the Ukraine succeeds, if it becomes like Poland, a former Communist country that successfully embraced Western values, this would strengthen Europe and America. Furthermore, it would show the world that our model works. Yes, a well-functioning democracy is the foundation for sustainable prosperity.

## **Nation building? Again?**

Look, I realize that here in the US any undertaking that even remotely resembles "*nation building*" evokes the truly bad experiences of Afghanistan and Iraq. And for very good reasons. Lacking judgment and even elementary common sense, the Bush administration and to a lesser extent the Obama administration poured tax payers' money into costly and generally ill-advised development assistance projects aimed at these two countries. The US "Grand Strategy" at the time of the Bush administration was to crush dangerous tyrants and

autocrats, have free elections so that the people would finally have a say, and then help the new, democratically elected policy-makers rebuild their countries following the tried and tested Western model. And so, thanks to America, there would be genuine freedoms, market economies, no more corruption, gender equality –and a lot more. Yes, people would vote, children would get immunizations, girls would go to school. A New World.

Nice and noble ideas. But it could not be done. Not because the aims were bad, but because there was a gigantic disconnect between the lofty goals on one side and the relatively small resources allocated, plus the (almost insane) belief that much could be done in a relatively short period of time on the other.

## **It could not be done**

Simply put, you cannot have gigantic social and economic transformations –premised on new values being genuinely embraced by millions– in a matter of a few years. At the time of the US military occupation in 2001, Afghanistan was a semi-destroyed country with almost no viable economic activities. Thanks to the Taliban, it lived virtually in the Middle Ages. It was disconnected from the rest of world.

The very fact that some people in Washington embraced the notion of a turbo-charged modernization program as a viable proposition is baffling. And that approach, mind you, was developed before the rebirth of the Taliban-led insurgency made everything a lot more difficult.

## **Ukraine is different**

Well, if we fast forward to today's Ukraine with the still fresh memories of the Afghan and Iraqi failures in our minds, the idea of starting all over along the same path looks

really unpalatable. And for very good reasons.

The huge difference, though, is that the Ukraine, while in truly bad shape, is a semi-modern country. It has educated people and some of the building blocks to make things work. Therefore we can assume that our chances of success would be a lot higher. And, again, let's keep in mind that helping to build a viable society in a vast country at Europe's immediate periphery in the long-term would help peace and stability in the Continent.

## **Uncertain mission, but worth pursuing**

That said, if America and Europe are serious about this undertaking, we are talking about tens of billions of dollars over a number of years. Beyond the immediate financial crunch, the Ukraine will need investments and help to modernize its industries, its infrastructure, its governance, its education systems, and what not. And, let's not forget that this noble attempt may fail. If the country will not abandon its deeply rooted culture of corruption nothing much can be done.

Still, even keeping in mind the lessons of Afghanistan and Iraq, and the uncertainties embedded in any undertaking of this magnitude, the Ukraine is a far better place. And the stakes for the West are arguably much higher.

Vladimir Putin's dream is to bring major pieces of the old Soviet Union back into the fold. But he has nothing good to offer. Beyond oil and gas, Russia is not a leader in anything. Whereas Europe and America can offer a new path to democracy and prosperity (via investments, technology transfers and trade) to the Ukrainian people.

And ultimately it is in our own self-interest to demonstrate that our values and our systems really work. This

is the best lesson that we can offer to all the people who suffer under autocratic regimes, in Russia and elsewhere:

*Democracy is the right choice, and it is really good for you.*

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# Hollande's Poor Efforts At Attracting Foreign Investors To France

By Paolo von Schirach

February 18, 2014

**WASHINGTON** – *“France is not afraid to open itself up to the world. We realize that the mobility of investment is part of making a country successful”*. This is what French president Francois Hollande recently said to an audience of high-caliber international corporations assembled in Paris to listen to his sales pitch. Well, if this quote indeed captures the substance of Hollande's message, the picture is depressing, if not outright scary. You do not lure foreign investors by saying: *“We are not afraid of you, really”*.

## **Low taxes**

Sure there is more. Hollande talked about tax advantages for investors and new measures aimed at making it is easier to set up shop in France. Well, thank God for that. But, guess what: any government worth anything, from Georgia to Vietnam, is already doing all this. Foreign investors expect a “one stop shop” investment promotion agency that will make it easy for them to get established. They expect quick registration of their business. They expect a competitive taxation regime.

They expect labor legislation and norms that will make it easy to hire workers and dismiss them, if necessary.

### **This is a great country**

What would make investors pay attention is a pitch that would focus on what a great place to do business France really is. "We have a highly educated, English-speaking, sophisticated work force. We have some of the best research universities in the world. They nurture the best scientists, engineers and business managers. We have excellent vocational training facilities that will provide the best workers. We have state of the art telecommunications and infrastructure. Make France your hub, the center of your value chain and supply chain, and you will prosper because we offer you proximity to your markets and to your key suppliers. And, best of all, we can guarantee the best quality of life. Here you have safety, affordable housing and first class education for your children, and of course, superior culture, beautiful nature and entertainment."

### **You are better than anybody else**

Now, assuming all this were true, this would be a real sales pitch. You get investors to pay attention only by stressing how great you are, and not by telling them that, in truth, you are not afraid of them and that "France is going to become simple". No, Mr. President. First you make France simple and extremely attractive; and then you advertise it as a great place to do business.

### **Only those who have needed high-value commodities do not need to promote themselves**

The only countries that do not need to make a special effort to lure foreign investors are those that can produce scarce and valuable commodities desperately needed by international markets. They can rest assured that investors will come to them, no matter what. But if what you offer is a mostly a good



location, it has to be really great. Or, at the very least, it has to be a lot better than what your neighbors or other potential competitors around the world can provide.

**First you create a true investor-friendly environment, and then you advertise it**

Getting rid of legal, immigration and administrative obstacles that discourage investors is a good start. But it is only a very modest start. The truth is that France is a sick country that grows only a little, while it contemplates the erosion of its past competitiveness. If president Hollande really believes that by saying “We are not afraid of you” investors will come in droves, he needs better advisers.

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# **Chinese Experts Say That China Needs A Lot More Natural Gas – Not Renewables**

**By Paolo von Schirach**

February 17, 2014

**WASHINGTON** – In the often schizoid US national debate on energy issues the “good and enlightened people”, (those who would like us to stop using carbon based fuels immediately), frequently point out that China is way ahead of America. China, we are told, is investing massively in renewable energy, most notably solar. You see, the real point is that the wise Chinese technocratic leaders, capable as they are to serenely contemplate “the big picture”, figured

out long ago that their vast nation needs to get out of carbon. The conclusion is that the Chinese are wise and smart. We are not.

### **Bad carbon based energy**

Largely because of the evil works of the oil and gas lobby, we keep focusing on the outmoded, wrong formulas –fracking being the latest. Indeed, by developing this (sinister?) source of natural gas contained in shale formations we continue our perverse dependence on carbon, while we pollute our precious water supplies and create untold dislocations across rural America.

### **What is really happening in China**

Well, the real picture is quite different. China's state TV, CCTV, reports that in order to curb stratospheric levels of pollution, officials in the Hebei Province, (a large area surrounding Beijing and now officially the most polluted province in China), had to resort to the actual closing down or destruction of 8,347 industrial plants producing cement and glass, among other heavy polluters.

An expert from an official research agency, interviewed by CCTV, indicated that reducing horrible levels of smog will be very, very tough.

*For one thing, he stated, if the province wants to move to renewable energy, making anything there is going to be much more expensive. This will be very tough for business, he pointed out. Furthermore, the general public will be hit by higher utility bills. So, there you have it. Renewable energy costs a lot more and makes it harder for industry to stay competitive.*

### **China needs natural gas**

And so, what is the way out? Well, the expert said that China

needs to increase its supplies of “natural gas” and “nuclear power”.

*Got that? “Natural gas” and “nuclear power”. Not a word uttered by this presumably enlightened Chinese expert about solar and wind. And why not? Not because they are bad. It is because, to date, they are still too expensive.*

So, here in America our incredible natural gas bonanza is demonized by the “good experts” as more of the same bad stuff, while they invoke the healing power of renewables supposedly pushed forward by the smart Chinese technocrats. But it turns out that in China the experts say that they would love to have access to a lot more natural gas, so that they could reduce their reliance of dirty coal.

### **Renewable energy has a future**

The day of renewable energy no doubt will come. But we are not there yet. The American do gooders should look at China’s environmental disasters and the lack –today– of cost-effective renewable energy solutions. After that, they should look back at America and consider how lucky we are. Thanks to fracking and horizontal drilling –American home-grown technologies– we are now the largest producer of natural gas in the world.

Because of this abundance of domestic, cheap and relatively clean energy we can retire old, high polluting, coal-fired plants without any adverse economic effects.

What do you know: our natural gas is very cheap and it is much cleaner than coal.

And, yes, as a result of this shift from coal to gas for power generation we have cut our greenhouse gases emissions. China is indeed investing heavily in solar energy. But, thanks to a huge number of high polluting coal-fired plants that cannot be shut down, as there is no economically viable alternative, millions of wise Chinese live in cities that are virtual gas

chambers.

Certainly, we in America have a long way to go in our quest for affordable, clean energy; but –thanks to our natural gas revolution– we are much farther along.