A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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THE FUTURE OF CORPORATE BRITAIN

A talk given by Patience Wheatcroft, Editor in Chief of the Wall Street Journal – Europe, to members of the Economic Research Council on Thursday 16th September 2010

Some people might hear the title The Future of Corporate Britain and think that is a pretty depressing prospect. I don't believe it is. I think actually that corporate Britain is in rather better health than some parts of the media and probably those less inclined towards supporting business than we at the WSJ are, would have us believe. I want to continue to see corporate Britain thrive for that way lies increased prosperity, or should I say less austerity for all. Cuts in government expenditure alone will not do the trick; we need growth. Finding out where that growth is going to come from is a big issue. And I do have qualms about the prospects for Britain's businesses providing that. Those qualms go beyond a top rate of tax which is already beginning to drive talent out of this country. This evening I'd like to point out some of the potential problems I see and talk of a few potential suggestions for what might be done; not many, but I hope Dr Cable might be listening.

Red Braces, Gucci Sneakers and Greed

First, let's take a look at the current state of British business. Well, we haven't killed manufacturing as so many headlines would have us believe, but we are getting uncomfortably close to doing so. Contrary to popular myth, manufacturing in Britain remains larger than financial services. At the last count, according to the Office for National Statistics, financial services accounted for 8.5 % of GDP; manufacturing for 11. The trend, however, would see that relationship soon reversed and the financial crisis hasn't changed that. On the contrary, the banks' new-found restraints in lending practices is likely to exacerbate the trend and, whatever the banks say, I am sure you are hearing from your contacts – as I am hearing from mine – that the terms on which they will lend to business now are much tougher and they are very reluctant to do so. It's fine for the government to say we want more foolish lending, which is what they appear to be saying. After what's been going on, I don't think that's a good idea, and of course we want the banks to have higher capital requirements – there

is no way that it makes sense for them not to have that sort of safety net – but we need them to lend and somehow they have to be persuaded to. You can't legislate for it, but their shareholders can start pressing, and of course their shareholders are also shareholders in the rest of corporate Britain, so the pressure needs to mount, we need the banks to do more than they are doing.

Go back to 1970, manufacturing accounted for more than 30% of the economy; financial services were too small to feature. By 1980 they had crept up to reach 2.2% against manufacturing's 25%. Even by 1990 financial services was barely a fifth of the scale of manufacturing – it's quite hard to believe now – 4.6% against 22%. But then the effects of big bang – that 1986 upheaval in the City's antiquated structure – began to really have an impact. Gordon Gecko lookalikes were everywhere. It was red braces, Gucci sneakers and greed.

Now, I am not opposed to bankers – I've been one, but my husband, who thought it was bad enough being married to a journalist, being married to a banker over the last couple of years – well, three years ago now – is pretty appalling. And I think in 18 months on the Board of Barclays, I have probably experienced about a hundred years of banking. It was a steep learning curve and actually way more time consuming than being a non-exec was supposed to be – we had an awful lot of meetings, and we had quite a few run-ins with the government too. You wouldn't be surprised to hear that the government had one view about whether or not we should take Gordon's money, and the Barclays Board had a very different view – I think we were vindicated.

Anyhow, bankers do some good. I fully believe that and we do need bankers.

Does it matter where growth comes from though, should we applaud the financial services industry and settle for an economy based on that? I think the last couple of years have well and truly answered that. We have realised with a jolt that ours is not a Goldilocks economy – neither too hot nor too cold – that was what Gordon Brown liked to think he had created. But it wasn't a Goldilocks economy at all, it was a fairy story.

At this point, and for no justifiable reason really other than that it is one of my favourite statistics, I will remind you of the very best line in George Osborne's emergency budget earlier this year, announcing that he was abolishing the golden rule set by the Chancellor Gordon Brown as a means of limiting borrowing. Osborne revealed that the Brown legacy, the golden rule target, would be missed by £485 billion. I do think it is worth

reciting that on every available occasion. Ponder it and weep. We were fooled. The golden rule was no rule at all as we all know now.

We Need to Bolster our Manufacturing Productivity (Again)

But back to the now widely accepted need for a balanced economy, for financial services and manufacturing and services. In the last thirty years more than four million jobs have gone from manufacturing. The positive side of that, and there is one, is that there has been a huge surge in productivity. We produce more now than we did then. As Paul Krugman, the Nobel Prize-winning economist, has memorably remarked, productivity isn't everything but in the long run it is very nearly everything. We are more productive than we were. The most up-to-date figures from the ONS cover 2008 though I make no comment on ONS productivity, but 2008 seems quite a long time ago. Anyhow, they showed that UK productivity was above that of Japan, very slightly below that of Germany and Canada, and well below that of Italy, France and the US. Somehow I don't feel comfortable being below the productivity of Italy where what they seem to be very good at producing is scandal, bureaucracy and tax fraud, but, no, their factories are very productive, you've only got to look at what goes on in Turin. But we've clearly got a long way to go.

And yet the ONS tells us that the UK has experienced faster productivity growth than all the other G7 countries since 1991 as measured by GDP per worker. Between 1991 and 2008 UK GDP per worker has grown by 39% with the G7 average being only 29%. That's not really a cause for applause; it is just an indication of how bad we were before. In the wake of Mrs Thatcher's reforms productivity leapt; we closed down all those useless pits; employers felt emboldened to close factories that were no longer efficient and we saw a surge in productivity. Then we got flabby again. Then along came technology; we embraced it, we went for outsourcing and we began to motor. We've got to keep that going and to go back to the banks and their investment, unless we do get that investment going into industry again, we are going to lose our place. We need to bolster our productivity and that means our competitiveness, again.

It's not happening. Companies with money are spending it on acquisitions rather than investing it. There is a lot of cash sitting around in some corporate coffers; it's not going into the investment that we would like to see. And we know that acquisitions don't create value apart from for those who sell and of course for the bankers who, surprisingly,

always think acquisitions are a good idea – unless they are being paid not to.

Britain is Strong in Services (Who Knows Why?)

That is not to say that manufacturing is the only way ahead. The UK is strong in services. I am told by my friends at PWC that you can never have too many accountants. Lawyers too. We've got a burgeoning tourism industry although it doesn't create a huge amount of employment for our native workers if you notice the voices you hear in restaurants and in hotels now. We excel in software development, a category classed as services rather than manufacturing, although my own industry, which is more and more dependent on technology, is firmly put as manufacturing. Some of you might think it more appropriate that newspapers should be classified with the creative industries and not for flattering reasons – but that's my competitiveness of course.

The creative industries are another area where Britain has grabbed an edge. Who knows why, but we breed brilliant animators. Perhaps it's time spent doodling in the classroom when they should be paying attention to chemistry and physics. It's London Fashion Week next week; we do brilliantly in fashion. We do well in media. Our film industry is not the biggest in the world but it is successful and in music too we play above our weight. We don't just need manufacturing. We do though still have some great manufacturing companies. A hundred of Europe's top 500, some are up there with the best – Rolls Royce, an absolute world beater; BAE Systems; GlaxoSmithKline. Financial services though do feature large in the FTSE 100 – HSBC, Barclays, Lloyds, and there are some names in that index now that I suspect some of you wouldn't associate with corporate Britain at all. Anybody really familiar with Kazakhyms? The name is a bit of a giveaway of course. The company is big in natural resources in east central Asia. Or Essar? – now a pillar of the FTSE 100 – an Indian focused energy group. Are you familiar with Fresnillo? It sounds like a new variety of ice cream. In fact it's the biggest silver producer in the world and it hails from Mexico.

The FTSE 100 is no longer a gauge of British business but of international business. There is Intertek. Intertek joined the FTSE last year but it traces its history back to Thomas Edison, famous for developing the electric light bulb. Testing is what Intertek does and it does it on a huge scale – 26,000 people in a thousand locations in a hundred countries. It's the result of one British company – Inchcape – deciding that testing was a

growth area and gathering up testing companies wherever it could. Inchcape may have had its failings, not least from the car industry, but in testing it was really on to a good thing. It accumulated all these companies and then hived them off into a separate entity and floated it. It is sophisticated business making full use of the best technology and it's a world leader, a truly global business, headquarters in London – what Britain needs.

But we are Weak in Educating a Skilled Work-Force (Even from University)

As we compete with the fast-motoring economies of the east, we have to be quick and we have to be clever, and I don't have to tell you that, whatever the A-level results say, people who are leaving our schools and even our universities are too often not clever enough, or if they are clever they are badly educated. I am glad to see Michael Gove making a start at tackling this problem. The lack of a properly skilled workforce is a real threat to corporate Britain. The Chief Executive of one leading pharmaceutical company told me that he really is on the point of having to move his research facilities out of the UK because he simply cannot get enough of the highly qualified scientists he needs. That is what we have taken out of this country. At the moment they are prepared to invest in growing their own. It's an expensive business. McDonald's isn't the only organisation that feels it has to run its own university – you are probably all familiar with John Neill of Unipart and the extent to which he finds Unipart has to educate its workforce in the most basic skills before they can be of any use at all, to a car parts business. Thinking of that pharmaceutical company poised to move out of Britain, or at least to move its research, brings me to one of my main concerns for the future of corporate Britain, it is increasingly mobile.

We may be Driving Firms out of this Country (and Taxation is an Issue)

Do you remember that strange period between the election and of actually knowing who was going to be in government? I found myself in an almost surreal situation. It was the 70th anniversary of Winston Churchill becoming Prime Minister and the Surrey Business School decided to mark the occasion by holding a debate in the Cabinet War Rooms. So 48 of us were gathered down there to discuss leadership as the country was without

a leader, and being in the War Rooms which are underground there was no Blackberry signal. So if you can imagine, every so often search parties were sent out to see if they could find a signal to report back to us whether we had a leader. Mark Thompson from the BBC was there and even he couldn't get access to his own news service without running upstairs. But a reminder of just how dire it was at that time, there was a dinner afterwards for those of us who'd been down in the dungeon and I was told by the Chairman of one FTSE company and the Chief Executive of another FTSE company that, if David Cameron was not Prime Minister, they'd be off. They had already got the blueprint for their exit. If Cameron was not in No. 10 they would be out, they'd activate the plan and they would go. For one of them, which is half-English, half-Dutch, it wouldn't have been that difficult – you can guess which one; the other one, totally British, that would go. And it wasn't just the prospect of Gordon Brown for another term that terrified them. At that stage I have to say, it was the thought of Vince Cable as Chancellor that was equally terrifying to them. Somehow, in warm, friendly coalition Britain, they are prepared to give him a chance as Business Secretary. But the fact that they could contemplate it and had gone so far along the line in their plans is, I think an indication of just how vulnerable we are to that.

We have already seen companies leave the UK of course such as Experian and Wire and Plastics Producers plc (WPP). Tax is what has driven them to go, particularly the tax on overseas earnings. I find it highly dubious that WPP can call Dublin its Head Office while you'll still find Martin Sorrell here in London most of the time but nevertheless at the moment the tax man seems prepared to go along with that and we have lost valuable revenue here. Others will follow if we don't make this a more congenial place and that does mean looking at our tax rates. The 50% rate is already driving talent out of this country. It is no longer just a threat, I come across stories regularly now of people wishing not to be in this country because they would rather not pay an active rate of 52% on their earnings. Terry Smith at Tullett Prebon has given his staff the option of moving trading desks out of this country; they haven't all gone wholesale; it doesn't happen immediately because it takes time to move a business, it takes time to move a family but the trend is there, and I think that if we don't hear from this government soon that they really are committed to bringing down tax rates, we will see that trend exacerbated.

The same is going to happen with banking of course. Much as I don't believe everything that the banks have done in the past has been correct,

I don't want to see all of those businesses leaving the country and, unless we are careful, there is a danger their threats will be serious. It's very easy for HSBC to up sticks; it's already moved its Chief Executive to Hong Kong; it's an untenable situation for a bank actually, to have its Finance Director in London and its Chief Executive in Hong Kong, so it can only be a matter of time, probably a fairly short time, before that bank goes back to its roots in a way. But it would be foolish of us as a nation to drive out the other banks and there is a danger that we will go further and faster than other countries in taxing them and restricting them. We need strong regulation – I wouldn't doubt that for a moment – it's absolutely imperative that we make sure that what they do is properly monitored and controlled, and when I was at Barclays we had all sorts of demands from the FSA. One of the things we were asked to model was what would be the effect on the bank of an outbreak of avian flu. Much work went into this. We told them that we would survive an outbreak of avian flu; the business would continue; the country would be OK. They never enquired what would happen if credit dried up. The FSA was not really looking in the right direction. Luckily, we missed the avian flu.

Whilst Foreign Takeovers Remove High End Jobs (To France!)

There is another threat to corporate Britain though – the takeover from overseas. This is I think an increasing threat to the country and where I believe we shouldn't just be supine. Globalisation has to be embraced as a force for good. It's here. The UK has benefited from it. We are a small country that has always looked internationally and that should give us advantages. It's not yet been fully exploited. India, for instance. It was great to see David Cameron going out there in such a concerted way and trying to win business for Britain in a country where we had so many advantages. The High Commissioner there now is absolutely determined that part of his role is to see British exports to India doubled. Just as companies such as Vodafone are buying businesses all around the world, overseas firms, increasingly wealthy, foreign wealth funds are looking to buy British. It's not new. Pilkington, for instance, the great glass manufacturer, was taken over by the Japanese in 2006. Blue Circle, the country's biggest cement producer, was bought by the French Lafarge in 2001. In both cases, the work forces have now been dramatically shrunk. That may be because they weren't efficient. They needed to slim down. The quest for productivity would have had that effect probably whether they had been

owned in this country or abroad, but what concerns me is that the research and development function, which was important to Blue Circle – I can't get too technical about cement, but others can, and believe me there was a lot of R&D that went on – it's no longer done in the UK, it's all gone to France. And that's what happens in international takeovers. The head office leaves, and with it the high earners, and some of the possibilities for high end job creation.

Meanwhile only 10% of Corporate Britain is Owned by Individuals

That's why there should have been concern over the takeover of Cadbury's by Kraft, not because of any romantic notion of the importance to the country of retaining ownership of a great British brand, but because of the consequence of ownership going overseas. I don't advocate protectionist measures to stop such takeovers. I just think that the owners and the country need to be aware of the consequences. The Cadbury takeover inspired the Business Innovation and Skills Committee of Parliament to look into the issue and in July it produced its report. It pointed to the short-term considerations that had influenced the institutional shareholders to sell. They wanted to book a profit to bolster their performance numbers. There was some short-selling that influenced price movement. The Committee said, and I quote, 'It was sceptical about the extent to which informal engagement alone can instigate any fundamental change in institutional shareholder behaviour, in particular where there are financial incentives for fund managers and others to act in the short term.' Well I suspect that you, like me, would share that scepticism. Informal engagement isn't going to make much difference, if a quick profit is there and it's going to influence the outcome at the end of the quarter for the institutional fund manager. Besides which, the current ownership of quoted corporate Britain is really not going to be amenable to a gentle nudge and informal negotiation. The pattern of change in the ownership of our major corporates is truly dramatic, in 1969 individuals owned 47% of shares, UK institutional investors 24%, overseas investors just 7%. By 2000 that had changed so that individuals held less than half that amount; they were down to nearly 20%, under 20%, UK institutions were at 44%, overseas institutions at 36%. Despite all that effort of 'telling Sid' and so on, it didn't get better. By December 2008 the ONS shows us that individuals, private investors, had only a tenth of the shares in quoted corporate Britain; UK institutions had 40%; whilst the biggest holder, by one percent, with 41% was foreign

owners. They are not going to listen to any form of persuasion, from which you can deduce that the Financial Reporting Council's efforts, many and various I am sure, to produce a new stewardship code for British company owners – it's a pretty anodyne effort anyhow – is not going to make much difference to what happens.

So Boards of Directors Need to Look Beyond Short Term Gains (Non-Execs to the Rescue?)

What *is* capable of changing things? I think, first of all, boards. Boards have to pay attention to the longer term interests of their companies and, that ghastly word, stakeholders. It is in the interests of companies in Britain that Britain has a thriving corporate base, that we are a thriving economy, and boards need to look beyond just the short term. And in saying that you almost instantly bring about a conflict between executives and non-executives because so often the executives, actually it's the way corporate Britain is structured now, tend to make a bit of a windfall if ownership changes. They don't seem to worry so much about their jobs going if they are going to bank a lot of cash. So it's incumbent on the non-execs to take a more rounded view and to really think about whether now is the time to ask shareholders to sell the business or whether they should put up a fight and demonstrate that this business can on its own prosper and yield a better return. As I said earlier, all the evidence is that acquisitions don't generate value. The only value is to those who sell.

And Government must Encourage Longer Term Share-Ownership (Any Ideas?)

That's not going to be enough however. It's important that we provide an incentive to the owners of our business to think long-term and invest in our companies, and not to do the sort of idiotic things that happen now. I'm completely bemused by the logic that will see owners of companies lend their stock to those who wish to short it. The logic is completely beyond me. These organisations like to think of themselves as long-term holders and yet to turn a very small profit they'll lend the stock to those who are determined to drive it down. I know there are Chinese walls between the different bits of these businesses but that seems completely crazy to me and I do think that those who invest in institutions should push them very hard on this point. There are one or two, such as Legal & General,

which now absolutely refuse to lend their stock and I think there should be pressure to encourage others to follow that route. Shorting is potentially very dangerous. I wouldn't ban it. Banning doesn't really benefit anybody, but I'd like to see it discouraged and of course the EU is now moving in the direction of at least making people declare their short-term position. If they've got 2%; they want it out in the open, and I think that's a good move too. Again, not enough though.

This is where I come to the real nitty gritty of what I'd like to see, which is I'd love to see the government come up with some means, and it has to be through the tax system, of encouraging shares to be held for the longer term. It can't be beyond the wit of man, or at least the Treasury, to come up with some scheme which would award the equivalent of Brownie points to those who back long-term investment. If any of you can think of a mechanism I'd be happy to pass it on.

And of course I'd like to see a return to Margaret Thatcher's shareholding democracy. It never really got far enough, but isn't that what we want in modern Britain? Part of that is to encourage employee share ownership. Look at the John Lewis Partnership for an exemplar of how the model can work. The Partnership can take a long term view, invest for the future and build a strong business.

But most of all we need to support our businesses (not regard them with suspicion). If corporate Britain is to have a chance of a future we need a community that applauds business success. That means removing the unnecessary regulations that get in its way, a move which is already underway with the enlightened appointment back into his old stomping ground of the remarkable Lord Young of Graffham.

Putting David Young to work was an inspired move by the Cameron government and, I believe, a strong indication of where its business credentials really lie.

There is pain to come as the inevitable spending cuts are made but they should be a precursor to a lower tax economy in which business can thrive – the future for corporate Britain may not be over.

SILOS AND SILENCE HOW THE FRAGMENTATION OF FINANCE CREATED THE CRISIS

A talk given by Dr Gillian Tett, US managing editor and an assistant editor of the Financial Times, to members of the Economic Research Council on Tuesday 22nd June 2010

What I want to do is something a bit oddball perhaps – present a set of thoughts I recently developed about some of the social patterns that fuelled the current crisis and some of the challenges that I think the financial problems illustrated and challenges that go well beyond the world of finance, into areas even like the energy sector, drilling etc etc and challenges that are going to be with us long after this financial crisis has receded.

An Anthropologist in a Murky Place

I crashed into the world of finance, complex credit, the subject that later became the fieldwork, if you like, for my book 'Fool's Gold' back in early 2005. The reason I got involved in complex credit was somewhat haphazard, to be honest. I am not trained as an economist; I didn't work as a banker. In fact I trained as a social anthropologist before I became a journalist and did field work in a place called Tajikistan (and if any of you can identify Tajikistan on a map, or even know how to spell it, I think you deserve a credit). But in late 2004 I was working on the Lex column of the Financial Times, the comments section on the back of the first section, and out of the blue one of my editors asked me to draw up a memo outlining what I thought that we at Lex should be covering in terms of the financial system. So I started off doing what many of you would do when your boss tells you to do something, which is to write the official memo, which said something like three pieces a week on manufacturing, four pieces a week on retailing, etc etc. And then suddenly I stopped and thought, hang on a sec, what would happen if I was to imagine that I was an anthropologist who had crashed into the City of London for the first time, and to draw a sketch map looking at how the City of London worked, looking at the financial flow, and then compared that to how we at the media were actually covering modern finance. What would the two maps look like? How would they compare? What were we missing? So I sat down and had a go at doing that and the first thing I discovered was that actually it was jolly hard. Because if you went back to late 2004 you

couldn't go into a shop, you couldn't go on a web site and get easy ready-to-understand maps of how financial flows worked round the system, it was actually quite hard to plot out.

But I sat down and had a go and something immediately hit me between the eyes. If you think back to late 2004, there was a very stark discrepancy in the way that the financial system was being described and discussed in the media, and the way it actually operated. In fact, so stark was the discrepancy that in subsequent memos I came to describe it as the iceberg problem – not because I had some brilliant intuition that we were all like the Titanic, heading straight for the iceberg. If I had I would have looked like a genius, in fact I probably would have become a banker. But the problem was, if you look back to late 2004, part of the financial system was like the top part of an iceberg, totally above the water, visible to all, and widely discussed in the media. And that was essentially the equity market and to a lesser extent the foreign exchange market, the commodity market. But beneath that visible bit, there was this large subterranean murky mass that most of the time was submerged from wider vision, and that was the debt world, the derivatives world, the credit world and so on, all the stuff with which we all became so horribly familiar.

And that for the most part was almost entirely uncovered in the mainstream media, aside from the trade press, even though I could see in late 2004, somewhat dimly, but I could see, that it was growing very fast and delivering a lot of the revenue growth for the City of London.

So that pattern intrigued me and I bounced around, made a bit of noise and one thing lead to another, and in early 2005 I was moved from Lex to run the capital market scheme on the FT, and I should admit that when that job shift was first told to me it was not initially viewed actually as a promotion because Lex is the glory part of the FT, very high profile, high prestige; the capital market team back in late 2004 was a bit of a backwater. We had two and a half people, we sat in a cupboard about as far away as it was physically possible to get from the editor's room and still be in the FT and most of its outpourings appeared in the back section of the FT. I mean, hands up, how many of you turned to page 323 and read the capital market pages back in 2004 as opposed to reading the Lex column?

When I moved across to the capital market team I was actually pregnant with my first child, and one of my colleagues famously said to me by way of trying to be nice to me, don't worry, capital markets is a brilliant place to go and have a baby because nothing ever happens; you can go home at five o'clock every day – that was the theory!

In the Grip of a Quasi-Religion – The Gospel of Risk Dispersion

But I pitched up in early 2005 and, partly because I am a bit weird, I am trained as an anthropologist, I have always been fascinated by subterranean weird places that other people don't want to go – apart from working in Tajikistan, I also worked in western China, and spent a number of years poking around the Japanese banking system. So I am bit weird, I like dark, shadowy places. And I got religious. I got absolutely fascinated, almost from day one, and not only set about trying to delve into these murky, subterranean depths of the iceberg, but I also tried very hard to get the rest of my team to go out and do anthropology with me. And it was a truly, truly fascinating journey. The first few months, when we set out on our kind of anthropological discovery of the murky bits of the City that weren't usually discussed, essentially we felt a bit like naturalists in the jungle; we were like the David Attenboroughs of the financial system going forth looking at this strange habitat and trying to present some kind of BBC series to the FT readers about what was going on there. So we started off writing all these slightly breathless pieces providing a user's guide to this strange new landscape, and then, bit by bit, as we began to poke around this dark, murky world, we began to get increasingly concerned. In fact by the time I went off to have my baby in the autumn of 2005 I was convinced that we were in the middle of a huge credit bubble which was about to burst, and I told all my colleagues that I thought my maternity leave was incredibly badly timed because I was going to miss the great crash. I was sadly dead wrong by two years – sadly because if it had crashed in 2005, I think the subsequent disaster would have been much less bruising. But we began to get very concerned.

At the time we couldn't explain it very clearly, why we were so worried, we could just see that there was a credit bubble developing, we could just see that lots of people were doing things that almost nobody really appeared to understand, either outside the system or inside the system. We could see that these instruments were becoming more and more complex every day. We couldn't quite put our finger on what was going wrong. Subsequently, with the benefit of hindsight, what I would say is that the system was in the grip of an extraordinary adherence to an intellectual theory, a creed, a quasi-religion, which contains endless contradictions, in many ways of pure bunkum, and yet at the time seemed to be very, very convincing to those who were practising it. The way you can describe this theory, this creed, this religion, was basically the gospel of risk dispersion. There was this idea that was propagated by bankers that, back in the bad old days, BCR

(before the credit revolution), banks had been engaged in making loans and keeping them on their books, and that was good because banks knew their borrowers; it was bad because it left them exposed to concentrated credit risk. And so you had disasters like the savings and loans crisis where banks went down because they had concentrated credit exposure.

And then along came the clever bankers with their new gospel of risk dispersion and they began to spread risk across the system, banks began to shed risk, slice-and-dice risk, either using tangible loan sales, i.e. selling cash instruments, or using derivatives to remove the risk synthetically, i.e. to protect themselves. And so along came this brave new world where suddenly anyone and everybody could slice-and-dice risk, scatter it across the system, hedge their portfolio, diversify their exposures, and supposedly this brought about a whole new safer system, a brave new world, a new type of credit cycle where, more to the point, the old type of credit cycles didn't apply any more. And certainly in 2005–2006, as I was moving across the system, many, many bankers repeated this theory, this religion, with enormous confidence, with enormous seeming belief, on one level they truly appear to have convinced themselves that this was true, and, as a journalist listening to this whole religious wave, this evangelising, it sounded pretty convincing.

New Risks – Opacity and Market Non-Competition

There was one big problem though which, in retrospect I understand clearly; at the time I didn't quite, which was, although the gospel of risk dispersion sounded brilliant in theory, and although in theory it should have been very, very helpful in terms of risk management, in practice the techniques that bankers were introducing to slice-and-dice risk and spread it across the system were so darned complex that they were introducing a whole bunch of new risks all over again. And essentially the systems that people were using to chop the stuff up and sow it across the system, were not transparent, they were not well understood by the people who were practising them, and they certainly weren't understood by people outside the system either. And that essentially meant that, not only did the bankers who were actually extending loans, making loans, have less of an incentive to monitor credit policy because they were selling the stuff on, but the end investors who were buying this stuff didn't have any ability to track credit quality either because they couldn't see along the chain to whoever was making the loan, and the regulators who were supposed to be in charge monitoring this stuff couldn't understand it either because all the

slicing-and-dicing was going on in murky corners, which for the most part were not being monitored either by the politicians or by the regulators or by the media, for reasons I have just explained.

So essentially, in the name of risk dispersion, you have introduced extraordinary new risks, namely opacity, an opacity that was so significant that nobody could actually see just how much borrowing was occurring, just how much leverage was in the system, just how big the credit bubble was becoming, and how badly it was spinning out of control.

As I say, in retrospect it is very easy to see what was going wrong, very easy to see the fundamental contradictions and frankly, when I look back at that period, in some ways I blush because there were so many core contradictions in this theory which were not spotted, you have to ask what was going on. One of my favourites, by way of example, is the fact that all during the period when bankers were evangelising to me about the theory of risk dispersion, one of their favourite buzz words was market completion – there was this idea that the whole goal of all this slicing-and-dicing was to create the perfect free market where any risk, any credit, any loan could be traded across the system and somehow you would end up with loans perfectly priced and credit ending up in the hands of the person who was best equipped to hold it. In retrospect that was pure bunkum because the very process of creating the instruments of sliced-and-diced credit essentially made a market where credits and products were becoming so bespoke, so very specialised and so complex, that by 2005–2006 most of the market was not actually being traded at all.

It was so darned complex that people couldn't value these things without banks and banks of computers and they were so bespoke that actually there weren't that many people who wanted even to hold these CDO-squared, CDO-cubed, so much so that when banks and hedge funds came to value this stuff they didn't actually have any market prices with which to do their market-to-market accounting in this supposedly free market system, they had to use models because there weren't actually any markets. A system that was supposed to create a perfect market, drive forward market completion, was actually making it harder and harder to actually trade in effect, and it was a fundamental intellectual contradiction. And yet, for the most part, that simply went un-commented on, unremarked, unobserved.

Those Involved had no Incentive to Blow the Whistle

Why? That's the key question. Why didn't people pierce the veil of this

kind of intellectual creed, spot the contradictions, why didn't people see what now seems blindingly obvious, that essentially you had a credit market that was spinning out of control. Well, the easy answer is basically down to sheer greed. I mean that is a popular phrase that is chucked about; it is certainly chucked about by politicians, by media, by many voters in recent months, and to a certain degree it is dead right. The whole point of this slicing-and-dicing as far as your average banker was concerned was, apart from supposedly propagating the idea of risk dispersion, it also meant that every time you sliced-and-diced you got a cut of the action, you got a commission of some sort, and so the more you sliced-and-diced the more commissions you got, the more you traded the more fees you got, and so essentially you got fat benefits. And certainly the reality is that by 2005–2006 the vast majority of people who were engaged in this game, who understood it to any small degree, were getting very rich off the back of it and had absolutely no reason, no incentive to blow the whistle.

Another way of looking at what was going on, aside from the label of sheer greed, was that you had a very classic pattern that anthropologists have seen in most societies most of the time, which is combative catch-up. One of the things about a training in anthropology that it does give you is an understanding and realisation that in any society you are going to have power structures, you have people who rise to the top, and in any society that elite tends to want to hang on to power. That's just the human condition; we are not all saints. In a sense you can be moralistic about it but that's the reality; people decided to have elites; they want to hang on to power, in the same way that the human body tends to have cancer. It's part of the human condition. And for the most part as an anthropologist you quickly learn that the rituals and ideology and creed that develop in any society usually have as a side effect, the function of keeping the elite in power and if you look back at the period between 2000 and 2007 you had a classic situation where the banking elite was becoming very rich off the back of a situation and, not surprisingly, they had very little reason to challenge the ideology that essentially was supporting it. It was very convenient. They had very little reason to have too many people poking their noses into what was going on or to encourage too many people to start looking into that subterranean depth of the iceberg.

Silos and Fragmentation – (i) the Banks

But there is another aspect to what was happening, which I think is very

important, and for the most part is not widely understood or discussed but which had a lot of implications going forward, as I said before, not just for finance but for non-financial parts of our society today as well, and that is the problem of silos and fragmentation. Because when I look back at what was happening from 2005 onwards, one of the key reasons why so few people understood what was going on was that you had a system marked by extraordinary fragmentation, not just structurally in terms of how people were organised, but also cognitively in terms of the cognitive maps that people were using to try to understand how finance worked.

What do I mean by that? Well, the silos essentially operated on many levels – is anyone in the room an investment banker, or wants to admit to it? – well, one of the things that struck me very forcibly as I went round the City of London from 2005 onwards, was that when I told bankers that I had been training in Tajikistan economy and I had worked in Tibet and I had worked in western China, often they would look at me pretty suspiciously. One of them famously said to me, isn't that rather hippy? back in the days when being a hippy was not a good thing. But they would say to me, what on earth did that teach you? And apart from the fact that it teaches you to be quite cynical about ideologies and creeds, it also teaches you to spend a lot of time thinking about power structures. And something that struck me about the average investment bank was that in a strange kind of way all the tools I had learned to help me to understand Afghan tribal power structures when I was a student were jolly useful when looking at investment banks, not because of the obvious thing, they want to kill each other, but as a serious point, because if you draw a sketch map of how your average investment bank operated, essentially what you had were lots of vertical silos. In theory all these banks have these wonderful diagrams about how they operate a giant bureaucracy. In fact what you have is a lot of vertical silos where power flows down, information flows up and they usually centred on a few powerful individuals inside the bank, and although in theory all the banks like to say that we all operate together as a great big happy family, in practice most of those silos are viciously competing with each other for power and, just like your average Afghan tribal structure, whichever Afghan tribe has the most goats and guns in Afghanistan tends to win and boss the other tribes about, basically in your average investment bank before 2007 whichever department, whichever desk had the biggest P&L, was producing the most revenue, tended to have the ability to tell the other desks and departments to get stuffed. And those desks and departments included the risk department which was supposed to be monitoring them.

So power and information tended to flow very vertically and this had a lot of implications for how the murkiness of the iceberg was developing because one of the things that was amazing when you look back to the period before 2007 and the way that some of the biggest banks in the world, like UBS, Citigroup, Merrill Lynch, were blown up dramatically, was that the people who actually blew up the banks were very small in number. The department that caused extraordinary losses, say at Citigroup, was actually just a few people. Similarly at UBS, the CDO teams were tiny. However for the most part, before 2007, the senior management had relatively little idea about what that particular CDO department was doing. I remember talking to the senior team at UBS just after UBS had revealed some amazing ten billion dollars' worth of losses on a product called super senior CDO, and Peter Kurer, who was in the pole position then of trying to run UBS for a period, said to me, oh yes, super senior, we never actually talked about super senior at the board level until the summer of 2007, by which time the stuff had already blown up banks. Banks were very silo-ised, very tribalised and information did not flow across the system in a way that would allow people at the top of the bank, let alone in the risk department, to actually monitor what was going on.

Worse still, you had a market place that was fragmented too, in that, before 2007, all the banks were competing so furiously with each other and hugging information to themselves, often the banks themselves didn't have much idea about how their activities fitted into the wider market place. To me, as a journalist trying to probe these subterranean depths before 2007, it was extraordinary because it was very difficult for me to get really basic data about things like how big was the seniors market, how big was the CDO market. You might get the figures from one bank if you were lucky but you couldn't then put it together because for the most part it was very, very secretive. Information flows were very fragmented in a way that made it hard to see how it all added up.

Silos and Fragmentation – (ii) the Authorities

In theory of course you are supposed to have some people in charge of the whole game, who are looking at it all and trying to see how the risks added up, and those people were the Bank of England, the FSA, the regulators etc. In reality of course they were very, very fragmented too in a way that not merely echoed the private sector fragmentation, but in some ways actually exacerbated it. Over in America, you had actual structural fragmentation

between all those warring different institutions and agencies; here in the UK we like to say we had joined-up the division in the form of the FSA but of course you had this cognitive fragmentation in that you had a split between the FSA and the Bank of England. For someone like myself who has worked in Japan and seen the Japanese financial crisis up close and personal, that always struck me as completely mad, because I have never seen how you can possibly hope to understand how money swirls around the economy, how water flushes around the system without looking at the pipes through which it actually moves, i.e. the financial system and its transmission mechanism. How can you possibly hope to understand the impact of liquidity obtained in the price of money without understanding the mechanism by which that money goes round the system? And yet, in the UK, we had this idea that it was quite natural, right and proper to separate out financial regulation and monetary policy and, for the most part, they were treated as entirely separate enterprises, which made it very hard for anyone to understand how all the bits were adding up.

Silos and Fragmentation – (iii) Geography

Last, but not least, you have the fact that finance itself had become something of a silo, semi-detached from the rest of society. I also think it is quite appropriate that Canary Wharf is an island, because it is not just a physical island semi-detached from anybody normal, it in some ways became a cognitive island. And when I was walking around and talking, doing my field work, looking at the world of complex finance before the crisis, I was repeatedly struck by the sense of separation and 'otherness' of the bankers who were involved in this activity. They spoke a language that very few people understood. When they talked about finance they did so in a way that often appeared to exclude real-life human beings. It was like finance is a kind of branch of astrophysics; it was cyber-finance; it was all about numbers and computers. You didn't get the sense that people were actually involved. I remember very graphically being called in to see a senior banker in the spring of 2007; he was very unhappy with the stuff we were writing back then, and he called me in and he said, why do you at the FT keep saying that structured finance is murky and opaque? It's not murky and opaque; anybody can get anything they want off the Bloomberg machine. And I said, well that's great. But what about that 99.9% of the population that doesn't have Bloomberg; what are they going to do? And there was a ten second pause and you could see he was thinking, you mean

there are people out there without Bloomberg, and we are supposed to care about them? Bankers had retreated into a private world, like philosophers in Plato's cave, who could see shadows of reality drooping on the walls or their computer screens, but rarely encounter themselves.

But the problem, the fault went both ways. Because it wasn't just the case that bankers weren't reaching out to the rest of society; in some ways a more important problem was the rest of society appeared to have very little interest in terms of peering in, of asking hard questions, of actually questioning what those guys in the corner were actually doing. Again, I remember getting very concerned in the spring of 2007 by the fact that, although the City of London is barely two miles away from Westminster, most of the bankers I spoke to had never been to the Houses of Parliament and appeared to have absolutely no interest in terms of what British politicians were doing, and yet those British politicians I encountered appeared to have complete ignorance about what was driving the City of London in terms of revenue, and a complete lack of interest in actually asking hard questions about what it was all about. And I became exercised about this, and I went along to a briefing session which was supposed to tell MPs how the City of London worked. It was billed as being a session to talk about derivatives and risks and insurance, which I thought was great because I thought we'll have a discussion about CDS and CDO, and in fact out of a two and a half hours' discussion, the MPs spent the first two hours talking about car insurance policies and why they wouldn't pay out to their constituents on time, and how bad that was, and right at the very end somebody said, oh yes, and there is this thing called derivatives. But there was a complete lack of interest, a complete lack of questioning. I was so cross about that actually I wrote a rather cross column called Why Bankers are from Mars and Politicians are from Pluto, and I'd like to say that, partly as a result of that, there is now a Mars and Pluto Group apparently in Parliament that is trying to bring the two sides together.

Silos and Fragmentation – (iv) Newspapers and Academic Journals

But the serious question you need to ask is, why weren't people asking about it, why, to go back to the image I started with about the financial iceberg, why were so few people peering into the depths? Was it because the bankers were all engaged in a great big conspiracy, a cover-up, deliberately hiding this stuff, or was there something else going on? And I would argue

very strongly that there was something else going on. Yes, on one level, the bankers were engaged in a cover-up in a sense that most of them did not have much of an incentive to talk about it. But at the same time, one of the key reasons why so few people were asking hard questions was because we, as a society, have come to accept this pattern of silo-isation; we have come to accept this idea that all around us in the modern world, as innovation speeds up, as the world becomes more complex, as technological advances develop, as educational gaps keep opening up, there are all these pockets of activity around us where, essentially, the nerds do their nerdy stuff and we can ignore it.

Think back to 2004. One of the biggest problems I had in trying to get my editors interested in all this weirdo, nerdy stuff about complex credit, was that it came wrapped up in horrible jargon like CDO and ABS, RMBS, CDO-squared, and, believe me, if you have ever gone to an editor on a news desk and said, gee whiz I've got this amazing story about CDO-squared and the goodness knows what financial formula, your editor is going to go AAhh! It ain't going to sell newspapers because it all seems nerdy and technical and boring. It's not going to grab people's interest. It's not the stuff that makes the heart beat faster, partly because, it should be said, this is a world where there aren't very many human beings who like to appear in public and, for the most part, the media tend to use stories with human beings with which to communicate things. Newspapers are not academic journals.

A Very Great Danger – Fragmentation in an Increasingly Interconnected World

But there is a tremendous tendency today to assume that basically, when it comes to geeky silo-ised areas of activity, just leave it to the geeks and that will be fine and we don't need to worry about it; leave it to the technical experts and we can all avert our eyes. And this creates a terrible, terrible paradox and challenge for us because the terrible irony of this pattern is that, at the very same time that the world about us is becoming increasingly fragmented, increasingly specialised, increasingly marked by pockets of 'geekdom' that no-one else apart from the geeks understands, becoming increasingly fragmented, we are also living in a world which is becoming at the same time increasingly inter-connected. The reality is that what those geeks in the kind of ribbed silos were doing back in 2004–2005 in the murky bits of the iceberg, actually didn't just matter to the geeks, didn't

just matter to the credit world, it had the capacity to blow up the system much more broadly. And if you avert your eyes away from the world of finance and look at other sectors, be it science, be it engineering, be it (dare I say) energy policy and oil, time and time again, you will see a similar pattern developing where geeks are strolling around doing something and have the ability to affect us all and yet this is only understood by geeks. How many of you before, say, April this year have ever understood what BP was actually doing on the floor of the Mexican Gulf? How many of you have the foggiest idea what all this undersea drilling actually entails? How many of you have the foggiest idea how the internet actually works? Do you actually know what happens to all your data, where it is going? How many of you actually know what is going on inside the drugs we take? Time and time again we are dealing with ever-expanding asymmetry of information and time and time again anyone who is not a geek just averts their eyes.

To my mind, this is a very dangerous situation. To my mind, the only way to deal with it is to start taking a good hard look at the field of education, to let the non-geeks try and catch up, and to take a good hard look at the question of who are the 'corporate translators' in our society more widely. Who are the people who are able to have both the geeky understanding and the big picture oversight to understand what the geeks are doing and understand the implications for everyone else. And in an ideal society those 'corporate translators') would be people like politicians, fiscal researchers, academics, rating agencies, risk managers, even (dare I say it?) journalists like myself. In reality though, at the very same time that we need those corporate translators more badly than before, almost every single group we look at is being eroded. How many politicians have the staff to research this stuff? How many universities have the ability to actually do research that is not directly aimed at achieving results tomorrow? And how many media organisations have the luxury of having teams who can actually do proper investigative work, who can actually delve around in the murky bits of the iceberg? In some ways we were unusual in the FT back in 2004 because as I say, I am a bit weird, I'm trained as an anthropologist, I like to go to weird places and poking around in the credit world was a lot more comfortable than poking around in Tajikistan or Tibet a few years earlier. And I was also very lucky because I had a very inspirational editor who supported me and we had enough resources to do it. And yet the reality is that although we got some things right, unfortunately we didn't get the whole picture. And the real tragedy was that there were so few people,

aside from my team, who were trying to look at what was going on and I just hope that some of those lessons are learned before the same pattern plays out in many other fields, not just in finance but in the non-financial sector too.

IS THE COALITION CONSOLIDATING GORDON BROWN'S GARGANTUAN STATE POWER GRAB?

By David B Smith

I am sure that you will have heard of the Laffer curve. That is the idea that, if you plot the rate of tax on the horizontal axis and tax receipts on the vertical one, you get an inverted 'U' shape akin to the normal distribution in statistics. The implication is that there are normally two points on the Laffer curve that will generate the same rate of tax. Also, beyond the peak of the Laffer curve higher rates of tax mean falling receipts. There are numerous micro-Laffer curves that vary from tax to tax. Just about everyone who has looked at the evidence has concluded that the 50% higher rate of income tax, and the new 28% rate of capital gains tax will both be on the wrong side of their respective micro-Laffer curves and will destroy revenue, output and jobs.

The bigger question is whether the British economy is on the wrong side of the aggregate Laffer curve? If it is, any attempt to tax one's way out of the fiscal deficit bequeathed by Labour is: 1) doomed to failure; and 2) likely to produce a downwards spiral in private activity and the tax base. I believe that the answer to this question is a firm 'yes'. The reason is the unprecedented peace-time size of the present British state.

I published an article in the December 2009 IEA *Economic Affairs* examining the size of the UK public sector back to 1900. One conclusion was that it was better to use the factor cost-measure of Gross Domestic Product (GDP), which excludes indirect taxes, rather than the officially-preferred market-price GDP figure, which is gross of indirect taxes. The difference is noticeable, especially when indirect taxes are rising. The June 2010 Budget

indicates that general government spending will be 46.7% of market-price GDP in 2010–11 (down 0.5 percentage points on the year) whereas the equivalent ratio using the factor cost measure will be 53.2% (down 0.1 percentage point on 2009–10).

The Model Based Evidence

It is logically impossible for the government to tax itself. It is correspondingly arguable that, with non-oil taxes equivalent to 84% of non-socialised factor-cost GDP, we are unambiguously on the wrong side of the macro-Laffer curve. However, economies are complex dynamic systems with many feedbacks. Before progressing, it is necessary to look at the evidence from macro-economic forecasting models. This takes one into the territory of the new Office for Budget Responsibility (OBR). In my 2006 IEA monograph, *Living with Leviathan*, I included the following 1993 quotation from the University of Warwick macro-economic modelling bureau:

> In order to analyse the impact of the various fiscal policy instruments it is essential to consider both direct and indirect effects. For example, the direct effects of tax changes on government finances can be quantified through an assessment of the size of the tax base to which the tax change is to be applied, and such calculations may measure the short-run impact on government revenue quite well. However, over a period beyond the first few months following the tax change, the indirect effects through the operation of the economy as a whole come to dominate. Simulations of models of the macro-economy are the only method of quantifying the size and time profile of these indirect effects.

This insight is crucial, given the fiscal mess that the coalition has inherited. The easiest course is to appease the spending lobbies while surreptitiously raising the tax burden on the rest of the community. The front-end loading of the VAT hike, and the rear-end loading of the spending cuts, suggests that the coalition government may have embarked on this course.

However, having simulated the effects of the VAT hike on my own forecasting model. I believe that the 20% VAT rate will both destroy output and jobs and exacerbate the budget deficit by some ¼ to ½ a percentage point of GDP. My one concern about the, otherwise welcome, appointment of Robert Chote to head the OBR is that he has moved across from the Institute of Fiscal Studies (IFS) whose calculations of the effect of tax

changes have traditionally been first-round static ones. There is a danger that the OBR will always end up advocating higher taxes as the solution to the deficit problem.

Growth Studies

This danger is exacerbated by the fact that the OBR has been almost entirely staffed by former/seconded HM Treasury officials and runs the HM Treasury forecasting model. This has almost no supply-side effects incorporated in it. One technical reason is that the model is run on the assumption that national output quickly locks onto a pre-determined growth trend. This trend is extrapolated using external assumptions about productivity, working hours, the employment rate and population. However, none of these assumptions have any behavioural content, and an income tax rate of 100% would have the same implications for trend growth as one of zero.

The resulting undue complacency about the effects of big government contrasts sharply with the rule-of-thumb, which emerges from thirty-five years of international studies, that adding 1 percentage point to the government consumption ratio reduces the growth rate of real national output per head by 0.15 percentage points. The 8.4 percentage point rise in the British government spending ratio between 1996–2000 and 2006–2010, a comparison that smooths out the recent recession, would correspondingly be expected to reduce growth by 1¼ percentage points. The implication is that the UK's sustainable growth rate is now only 1¼% to 1½%. Against this background, the government's main priority should be the nurturing of the private sector supply side. Unfortunately, neither the coalition government nor its advisors seem aware that they have a problem in this respect.

Overall Tax Rates

The Conservative Tax Reform Commission published a worthwhile report on these issues in October 2006 under the leadership of Lord Forsyth. My reservation about the report was that the Commission had apparently pulled its punches in order not to disconcert the 'timorous tendency' within the Conservative Party.

Now one aspect of the triumph of the Tories' timorous tendency is that the Conservatives have never challenged the big-spending and high-tax anti-libertarian rhetoric which Labour and Liberal-Democrat politicians

employ so freely. This may partly be because the Conservative element of the Cabinet is heavily composed of what Hayek called 'wealth conservators' rather than 'wealth creators'.

So the danger is that the Coalition are now consolidating Gordon Brown's gargantuan state power grab, not rolling spending back to the share of GDP that prevailed ten years ago.

While the government will be spending over 53% of GDP this year, very little of this expenditure will be on the 'primary' governmental functions of defence (3.1% of GDP) and law and order (2.7%). Even including debt interest, only brings the primary total to 9.2% of GDP. In contrast, almost 83% of government spending and 44½% of factor-cost GDP consists of 'secondary' functions, with social services, health and education summing to 62¾% of spending and 33¾% of GDP. A truly Conservative government could double the defence Budget, when it would still be a smaller share of GDP than in the early 1980s, and still have ample scope to cut back the excessive governmental fat that is clogging up the arteries of the British economy.

PRESENT TRENDS: GOOD FOR (SOME) SHARES. POOR FOR BONDS – AND UNHAPPY FOR THE UNEMPLOYED

By Damon de Laszlo

Now that the Summer and the silly season are drawing to a close, the gloom merchants may start to get some competition. While there has not been any startlingly good news in the last month or so, the promulgators of misery have largely had it their own way. The financial gloom has also been fed by the enjoyment of politicians and the media in holding the banking industry as a whole up for ridicule. Added to this has been the evident glee and righteous indignation of the US President's endeavour to publicly humiliate BP. An American oil man pointed out to me some months ago that BP was the predominant company which brought America oil from the hostile environment of Alaska and is the leading company at the cutting

edge of deep sea oil drilling. While BP may have made mistakes, it has to be remembered that deep sea oil drilling is as complex and dangerous as space shuttles – sadly these too can blow up!

The doom scenario has precipitated a 'flight to safety' by investors. This flight to safety, which looks more like a stampede, seems to be akin to joining a migration of lemmings. The rising value of bonds is inverse to the decline in interest rates, a phenomenon of the last 20 years. The more recent decline in interest rates has been due to central bank policy, both Greenspan and Bernanke flooded the markets with cash to deal with the present and previous crises and as part of a political push to encourage home ownership. *But* the trend line of lower interest rates and rising bond values cannot be extrapolated beyond zero. On a purely technical basis it is highly unlikely that bonds can rise in value much further. Purchasers of bonds are also assuming near zero inflation and are therefore happy with a yield of 2–3%. The inflationary evidence to date hardly backs this benign assumption. While central banks may be keen to show that they can help the economy they are also keen to be favourites with their political masters who do not have a great desire to curtail government profligacy and would like to postpone the political backlash from rising interest rates that excessive government expenditure will precipitate. At some point the 'flight to safety' will end at the proverbial cliff-top that has made the lemmings so famous.

While stocks and shares that represent productive enterprise have been very volatile in the last years they look like a much safer bet than government debt in the longer term.

Looking through the fog of gloom, most businesses have stabilised and a great many are prospering. There are, however, a number of companies that are in a so called zombie state, ie they survive but will inevitably collapse either when their sales pick up, because they will not have the funds available to finance the increase of work in progress or because at some point their bankers and backers will get fed up and just pull the rug. This group of businesses will probably provide some horror stories at the end of the current year and early next year. For the rest there is evident growth in much industry across Germany and Northern Europe to America with the main drive coming from Asia. Companies are naturally nervous as the political climate in the West is creating continuing uncertainty in general and for obvious reasons among businesses that rely on government expenditure. This nervousness is naturally greater in countries where the government represents 50% or more of GDP.

The overall GDP growth in the over borrowed West cannot improve greatly until the huge borrowing, both private and governmental, is reduced. This will cause a bifurcation in Western Economics as it is likely that sectors that grow and are successful will not be able to absorb the large numbers of people that will be left behind and unemployed, particularly those from the public sector.

Unemployment is likely to continue to be a major social problem for the foreseeable future, particularly in Europe as governments continue to increase the employment tax that businesses have to pay.

It may be optimistic to think that the Winter will see an enormous increase in economic growth, however betting on disaster and catastrophe looks to me like a no-win bet. While the future may be difficult for a lot of people one can be, in general, much more optimistic than a year ago.

MORE PRODUCERS NEEDED

Centre for Policy Studies Pointmaker, September 2010

There are times when two policy objectives have to be followed simultaneously for either of them to succeed. For example, just after the war the government needed to bear down on combines, monopolies and restrictive practices. Such activities had flourished in the 1930s when unemployment was so high that almost any disgusting anti-competitive action could be justified on the grounds of preserving jobs. So, in 1946, by pursuing Keynesian policies for full employment, pro-competition policies were possible – notably the Monopolies and Restrictive Trading Practices Act of 1947. At the same time a more competitive less sclerotic economy was a precondition for the achievement of full employment without cost-push inflation.

Today, cuts in public expenditure involving lost jobs in the public sector, can only be carried out – or at least can only be acceptable to the country – if, at the same time, policies are developed to expand private sector growth. Tactically, the Coalition Government has been inept by pushing 'cuts' as a precondition for ‘growth’. In reality it is the other way around and Britain today would be a much more optimistic place if there

had been an up-beat discussion on growth before grimly pushing cuts.

Anyway, 'we are where we are' and as many voices as possible need to join in the fray to develop initiatives and policies to complement the far too glib and simplistic notion that growth simply depends on more bank lending to small businesses. One such voice is this interesting short analysis from the CPS subtitled 'Why tackling workless households can lead to growth' by Peter Warburton and Joanna Davies.

To start with – some truly shocking statistics. Britain has a higher proportion (11.5%) of workless households than any other major EU member. Some 40% of lone parent households are workless, as are 31% of black African households, as are nearly a quarter of all households in the North East. Most worrying of all though is that a high proportion of young men – perhaps at least one in five – are not in work, education or training and for whom the future looks to be multi-generational welfare dependency.

The policy suggestions that follow deserve very wide recognition. I have often thought that rich benefactor's money could be very well spent by delivering significant think-tank publications to every letterbox in the country. This is barely practical of course because it could not avoid being seen as somehow 'one sided'. But nonetheless, in my ideal world 'More Producers Needed' would be a candidate for distribution.

So what policy suggestions emerge? Tax and benefit changes of course but more interestingly such areas as expanded public-private partnerships for regeneration, a practical look at regulations on outdoor employment and encouragement for greater exploitation of the UK's mineral wealth, and how about new enterprise parks next to large housing estates?

JB

1000 YEARS OF ANNOYING THE FRENCH

By Stephen Clarke. Bantam Press 2010 p/b £13.99

Ever since the Pope gave his support (and sent a consecrated banner) to Duke William of Normandy for his invasion of England in 1066, the Catholic Church and France have, as Queen Mary can attest, been at

odds with the successful ambitions of the independent minded offshore England.

And how annoying it has been for France to be beaten, upstaged, ignored, hated and scorned. And how obviously necessary it now is to chronicle this piece of history and perhaps to acknowledge that without our encounter with France, without the dire need to develop the capability to fight and to rule the seas, Britain would not have achieved .... (well – you know …)

Anyway, this excellent bed-time reading book is a factual but really very amusing account of the historical relationship between France and England. It is not entirely biased since there have been some occasions when France has scored a point or two. Indeed, it was this even-handedness by an apparently patriotic author which leads one to approach with mounting excitement the events of 1972. When Britain joined the EEC was this yet another 'plus' for England or was this a French triumph over its old antagonist? Europhiles can argue that joining has been a way to trash France's ambitions to dominate the Continent, an opening of the way for numerous new members and a triumph for the spread of the English language. Eurosceptics, on the other hand, can argue that French style bureaucracy, French inspired costs from the Common Agricultural Policy and Common Fisheries Policy, French style laws and legal systems have all been ways to exploit Britain's wealth and undermine its institutions. And who needs a Treaty of Rome to make any difference at all to the inevitable progress of the English language?

But sadly, it was the turn of your reviewer to be 'annoyed' when Clarke inexplicably brushed over this entire topic with the words 'When Britain joined, for good or ill, in 1972…'

All the same, maybe France is doing rather well at the moment and attention can be drawn to a fascinating passage – pages 504/5 – headed 'French Industry Rules the World' Clarke notes:

> The French owned Sodexo canteens (which supply US Navy canteen meals) are typical of the discreet way in which France, despite its claims that the Anglo-Saxons are taking over the world, is, well, taking over the world. Wherever you live, there is a high likelihood that the nearest oil refinery, nuclear power station, bus stop, advertising billboard and high-speed train will be French, whereas we usually assume that it is only the hypermarket – and most of the mineral water and cheese inside it – that came from France.
>
> French-owned companies run bus and regional train services in

many of America's biggest cities, and supply water, electricity and gas to huge swathes of Britain. To give just two examples: France's EDF entered the UK energy market in only 2002 and is already the country's biggest electricity generator and distributor. Its full name is, of course, Electricité de France, but see how many clicks it takes you on the company's British website, www.edfenergy.com, to find that out. And Veolia, which used to have the rather less discreet name of la Compagnie Générale des Eaux, has diversified from water supply and, after entering the US transport market in 2001, now controls transport networks in Atlanta, Las Vegas, LA, Miami, New Orleans and San Diego, amongst others.

In fact, the French are the best globalizers in the world, even if they refuse to say so because they think the word is too English. They call globalization mondialisation, and if you ask the average French person what this means, he or she will cite McDonald's, Coca-Cola, Gap and Starbucks, and accuse the Anglo-Saxons of trying to control the world economy. They will be surprised when you begin matching them name for name, with Carrefour, Perrier, Chanel, Danone, l'Oreal, Louis Vuitton, Occitane and Renault, for example, as well as all their big Champagne, fashion and perfume brands. Many French people just don't realize how spectacularly successful their country is.

And wasn't the 'Popemobile' a French machine?

J.B.

THE CONSOLATIONS OF PHILOSOPHY

By Alain de Botton. Penguin p/b £10.99

This book was published in 2000 but, since the subject matter covers some 3000 years, from Socrates to the present, spending a decade as a best selling book is reason enough for a review.

A review sparked by the Pope's UK visit reaffirming the Canon's of Catholic Christian philosophy and by (amongst many atheistic challenges) the statement by scientist Stephen Hawking that 'Philosophy is dead. It has not kept up with modern developments in science, particularly physics. As

a result, scientists have become the bearers of the torch of discovery in our quest for knowledge.' What better moment could there therefore be to review an excellent short 'Cook's Tour' of the subject?

Stephen Hawking's assertion finds no disagreement with de Botton's opening chapter accounting the philosophy of Socrates. Socrates valued truth above conventional views, unpopularity and the condemnation of institutions. De Botton says 'In Socrate's life and death lay an invitation to intelligent scepticism'. Indeed, modern scientific enquiry owes everything to Socratic method – to 'proper reasoning rather than popular opinion'. Logical enquiry carried out methodically to arrive at the truth. Plato and then Aristotle flow expansively from this starting point with Stephen Hawking no doubt still on board.

But then philosophy seems to go on its own rather different way. De Botton chooses Epicurus for his second subject – a man who could not conceive of 'good' without enjoying 'good things' – pleasures – especially sensual pleasures sought intelligently. Epicurus would say that truth is not enough; a man needs friends, freedom, thoughts – and some worldly means, but not wealth or power.

Move then to the Stoics and their determination to come to terms with reality. Seneca argued that if one is beset by anger one should examine whether one's expectations have been set too high; if one feels shock at an event we have failed to realise that the worst possible outcome should be anticipated; and if we feel indignant about an injustice we must realise that fortune is but a gift of the Gods.

But the work of the many Greek classical philosophers seemed sidelined by the great debates in Rome and by the developments within early Christianity. More famously than anyone else Cicero championed the primacy of law over power, the battle of words over that of the sword. The Roman empire was based on power but that power moved importantly towards the power of words. And in the meantime those building the early Christian church sought to appeal to those suffering oppression, injustice, torture and death by portraying Christian philosophy (through the 4 canonical gospels) as principally a promise of life and reward through Christ's resurrection.

All of which rather monopolised philosophy until more recent times. De Botton chooses to pick up the threads again with 16th century French philosopher Michael de Montaigne who studied at the College de Guyenne which, he felt, taught excellently such subjects as history, languages and crafts. But this he said was only 'learning'; it was not an instruction in 'wisdom' which he defined as 'everything to help men live happily and

morally'. He criticised his College saying 'It excelled at imparting learning but failed entirely at imparting wisdom'. Readers of de Botton's book will be impressed by the samples of Montaigne's examination questions to test for wisdom.

De Botton could have chosen to describe the contributions next of many from the 17th and 18th centuries – Lock, Hume, Voltaire, Hobbs, Smith, Montesqueue and many others, but, since his theme is 'consolations' he moves on to Arthur Schopenhauer (1788–1860), a man who understood our deepest feelings of despair and depression arising not from external oppression as understood in the Roman world, but from our own mental impulses, instincts and shortcomings. For him the goal in life was to 'transform our tears into knowledge'. If you are heartbroken you should go and read Schopenhauer. Seriously.

And so, on to the 19th century. Rather than discuss Mill, Marx, Weber or Bentham, de Botton finally takes us to Friedrich Nietzsche. Here was a man whose theme was the old saying 'every failure is a stepping stone to success'. Schopenhauer's knowledge was not enough – the role of hardship is not just to further knowledge but to give the chance for striving and overcoming and success. This, he said, was the way to live a fulfilled life – and fulfilment is what life is all about. And Nietzsche identified contemporary and historical figures who, he considered, lived a truly fulfilled life.

So philosophy is about truth, goodness, morality, self-control, wisdom, knowledge and fulfilment, it is about the meaning of the universe rather than about its construction. The way to challenge aspects of the Christian church institution is through ideas – through, for example the 'lost' gospel of Thomas emphasising the philosophy rather than the death of Christ. There seems a very long way to go before philosophy is at an end.

J.B.

THE LOST GOSPELS

1 Hour documentary presented by Pete Owen-Jones. BBC4 21st Sept 2010

Catch up with this beautifully made and hugely informative documentary to see why it warrants this brief but inevitably inadequate comment/ review. This is the research piece for those of us who wish to maintain our Christianity but who find problematic the narrative and meaning, as presented by the established churches, of Jesus.

The economics of the church are well known. In Britain church attendance is now so low that the Church of England is in serious financial difficulty but in America, Mexico, Italy; in Poland, Africa and Korea – to name but a few, church finances flourish. The pomp and splendour of the Vatican, of St Peter's Basilica and the image of the Pope himself, all attest to the wealth, success and power of Christianity world wide and Catholicism in particular. Obviously the key to worldly success is the number of active believers.

This was never more true than in the first few Christian centuries. The task for Christian politics – as in, at least, democratic politics – anywhere, anytime was to identify the issues arousing fear and ambition and then to present a solution for supporters. Back then the issues were oppression, subjugation, enslavement, death and ignorance in a Roman world of power and military control. The four canonical gospels, Matthew, Mark, Luke and John were chosen in the 4th century from a huge variety of writings about Jesus because their account supported a version – the Virgin birth, the death and resurrection of Christ, and the miracles – which was credible given the mysticism and ignorance of that time and which appealed to so many with the promise of justice and redemption in the next life. Emperor Augustine realised the widespread relevance of this manifesto and declared it the established religion of his empire.

But today – at least in Britain – the issues are not so much about crude oppression as they are about discovery, intellectual satisfaction, some sense of direction, some purpose justifying our manifest material success. We think we know (more or less) *how* the entire universe works, but we need to know *why* we exist and play a part.

This intellectual hunger of course has always existed and ‘the lost gospels’ refer to the writings of many including Thomas, Peter, Mary and Philip, the Gnostics, Marcian and the Ebionites – and many others. Suppressed in the 4th Century by the ‘official’ church versions like politicians’ ‘off

message', these writings now present some possibility of finding a narrative meaningful to our 21st century age.

And this is what Pete Owen-Jones sensitively explores. It is a minefield of misinterpretation, of vested interests sowing confusion and of mere fragments surviving of the original work. One can barely approach the subject (try understanding Marcian or the Ebionites via the articles brought up by Google) without a guide – which is where this BBC documentary is truly admirable.

And one finds relevance. For example, Owen-Jones, in discussing the 'hidden sayings' in the Gospel of St Thomas quotes him stating something like 'Bring forth that which is within you and you will be saved; bring not forth that which is within you and it will destroy you'. Anyone today can instantly see this as something similar to Freud's concept of repression of the subconscious. Today we do not find it at all unintelligible to link madness with suppressed urges, memories and thoughts. Or as Shakespeare had Brutus say 'There is a tide in the affairs of men, which, taken at the flood, leads on to fortune...'.

But there is something much bigger than such points – the issue of a spiritual world and Jesus's role in our perception of it. A starting point is that some of us (perhaps, all. Who knows?), having got involved rather deeply in some issue or cause, find that it is somehow 'taking over' our lives. It might be called an obsession or a commitment. The point is that one has the uneasy feeling of being used by something which cares little for your interests and drives you, quite possibly to destruction, in its service. Indeed, religions have always stressed the concept of readiness to serve when called. Jesus's disciples, we are told, did just that. So we sense and cannot give up suspecting that there are forces beyond our materialist understanding.

Another aspect which we readily now relate to is the experience in our own lifetimes and modern history of individuals who become larger than life, archetypes drawing strength from beyond. Winston Churchill spoke of the importance never to fail 'destiny'; Hitler, a mere painter-corporal, was surely a shell into which tipped some awful force. Evita tells a story of a woman beyond normal reality. We speak of charisma and will-power but it is more than that. Shakespeare the mere man didn't write all those plays, Beethoven didn't plod his way to constructing the sublime Emperor Concerto, Picasso didn't just think up the painting 'Guernica'. Inspiration is an inadequate word for these achievements – each master is more likely to explain that he was a vehicle through which flowed some creative

force, something beyond himself. To peoples everywhere and at all times, such things intuitively suggest something expressing itself through us. Shakespeare made no secret of recalling his dreams to write his plays.

Which brings us back to our television programme and the account of the Gospel of St Peter and the beliefs of the Ebionites and others. It brings us to understand that in those early times there were many who disagreed with the account of Jesus as the son of a union between God and the Virgin; who were unhappy with the established account of his death and resurrection. There was the concept that Jesus was born ordinarily, a man who at some stage (perhaps at his baptism) became used as a vehicle, became 'inhabited by divinity' or, as Owen-Jones puts it, was 'hi-jacked by God'. Whether or not Jesus was killed and resurrected, indeed whether or not he and Mary Magdalen bore a child, this divine spirit could and did reappear in his followers.

All of which makes more sense to 21st century man, and propelled this reviewer to draw your attention to the programme.

J.B.

NEW MEMBERS

The Council, as always, needs new members so that it can continue to serve the purposes for which it was formed; meet its obligations to existing members; and extend the benefits of members to others.

Members may propose persons for membership at any time. The only requirement is that applicants should be sympathetic with the objects of the Council.

OBJECTS

i) To promote education in the science of economics with particular reference to monetary practice.
ii) To devote sympathetic and detailed study to presentations on monetary and economic subjects submitted by members and others, reporting thereon in the light of knowledge and experience.
iii) To explore with other bodies the fields of monetary and economic thought in order progressively to secure a maximum of common ground for purposes of public enlightenment.
iv) To take all necessary steps to increase the interest of the general public in the objects of the Council, by making known the results of study and research.
v) To publish reports and other documents embodying the results of study and research.
vi) To encourage the establishment by other countries of bodies having aims similar to those of the Council, and to collaborate with such bodies to the public advantage.
vii) To do such other things as may be incidental or conducive to the attainment of the aforesaid objects.