



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

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## ALPHABET-SOUP

*By Damon de Laszlo*

Today the newspapers are full of political trivia. The news that British Members of Parliament have been paying themselves huge sums of tax free money is not new, but the extent of these payments and the trivia for which payments have been claimed is truly extraordinary, leaving aside the further amounts claimed and not accounted for. While the 'prudent' ex-Chancellor, now Prime Minister, has bankrupted the country's finances, virtually all Members of the Government and the rest of Parliament have become a disgrace to the integrity of the country. Britain is probably not even suitable as a candidate for Third World status. Of course, the machinations of Members of the European Parliament are a much more closely guarded secret! and we are sure nothing like this goes on in the corridors of power in Washington.

Back to more serious economic matters. The bottom of the cycle is more and more evident, the interbank market has improved enormously since the dark days of September/October last year, and the banking system is stabilising but general liquidity remains a problem as banks seek to improve their balance sheets and repay government debt. It is unlikely, in the near future, that we will see a rapid increase in bank lending, particularly to the private sector. Consumers in the US in particular are saving at an enormous rate, which is hardly surprising when it is estimated that consumer net worth in the last 18 months collapsed by an estimated \$16.5 trillion. These figures make the likelihood of GDP driven growth for the rest of this year difficult to visualise.

The recovery from the economic cycle is now in 'alphabet-soup' area –

V – for a quick recovery; U – for a slow recovery

W – for a quick recovery and then collapse and, L – for no recovery at all.

The good news is that there does not seem to be any prediction for a continuing downward slope. The forecasters of the various recovery patterns are, in some cases, discussing their own investment positions. The 'W' group, most interestingly, are those who feel that the recovery is here but they have missed the boat and are hoping for a dip to get into the market. The complexity of the various forces in the recovery pattern is such that

predictions on a month to month basis are fairly unusable other than to say, looking back to this period from a few years hence, it is likely to be seen as the bottom.

The stresses in the global trading system are to some extent an extension of debates that were going on in 2006–2007. Then the asset price boom was raising considerable debate about return on capital in large sectors of western industry. There was a lack of capital investment as management in many quoted companies were incentivised to produce short term returns. The best way to achieve this was to use spare cash to buy back equity. The process was encouraged by the private equity industry that was booming in the low interest rate environment. The private equity theory works when interest rates are low, bank lending criteria is lax, and asset prices are rising. In a nutshell, you raise a little equity, borrow a lot of money, buy a company, realise its assets and sell off its property to repay your debt, cut capital expenditure and R & D to the minimum to raise earnings and sell it on again in four or five years, then explain to the world what geniuses the private equity groups are, and proceed to do it again.

The private equity/leverage buy-out phenomenon has left a lot of industry in US and UK, and to a lesser extent Europe, with out-of-date manufacturing capacity compared with Asia.

Apart from private equity, etc. there were also considerable financial incentives for companies to outsource production to Asia as this did not tie up capital and could also produce greater margins owing to the lower labour costs. The question that arises from this shift in the manufacturing sector is complicated and has an important bearing on the potential for inflation in the next few years. Many economic models, and consequently the economists who run them, extrapolate from the numbers, that the slow down in the economy, the short-time working and shut-downs in the manufacturing sector leave capacity that can be started again when the economy picks up, therefore prices will not rise in the near future. As, however, a lot of the capacity that is being shut down is old, the likelihood of it being restarted is low. This applies not only in the manufacturing sector, but also in the commodity sector. For example, the average age of the stock of US on-shore drilling rigs and the men that operate them has been rising steadily for more than ten years. The shortage of rigs that was apparent two to three years ago will be even larger when drilling programmes start up again.

It is quite possible that as the economy stabilises, we will see a very considerable recovery in Capital Expenditure as industry re-starts. Lending

to the industrial sector will replace, but at a much slower rate, the recent lending to the private sector. Corporate profitability is likely to grow, driving stock markets, while the retail sector and personal expenditure stagnate for the time being. This is likely to produce a very different economic landscape to the one we have experienced in the last four to five years.

The rebalancing of the economies of the US and China will continue, the big question marks will remain over Europe and, to a lesser extent, over Japan.

If not *sunny days ahead*, at least the dark clouds are lifting.

## HOW CLOSE ARE WE TO PEAK GAS?

*On the 25th April 2009 the All Party Parliamentary Group on Peak Oil and Gas, in conjunction with the Economic Research Council held a panel discussion in the Palace of Westminster. Some very brief observer's notes give an indication of some of the points made.*

Dr Howard Rogers from the Oxford Institute for Energy Studies pointed to four 'choke points' in assessing future gas supplies. Overall one can make a 'probability assessment of gas availability' but much of this potential lies in countries where 'resource nationalism' may or may not lead to exploration. When drilling goes forward there is a 'success rate' of finding significant gas of only 1 in 8, and then there is the final choke point of 'viability' which depends of the limitations of infrastructure such as pipelines and LNG facilities. But 'for the world as a whole, we can be reasonably comfortable about gas resources for the next 60 years'.

The problem is that consumption areas differ from production areas. The biggest reserves are in the Middle East, especially in Iran, followed by Russia and then the USA, and at the bottom of the table, Europe. Consumption is concentrated in Europe, the Far East and America and so, as the consumer areas start to exhaust their local supplies (Britain will become a net importer in about 3 years' time) there needs to be a big increase in transport facilities – an increase beyond the ability of the industry to install in time which means that, medium term, other sources

of energy such as nuclear and clean coal will be needed. Even then, given the low energy density of gas, transport will always be expensive and, as we come to depend more on imported gas we will need up to double existing storage capacity to cope with seasonal capacity needs.

*Mr David Odling*, of Oil and Gas UK, reminded the Group that the UK is the largest gas consumer in Europe – ahead of the other two in the ‘big three’, Germany and Italy. But the UK is the only truly open market and so ‘let us hope liberalisation under the current EU plans will be implemented’. Turning to some of the political issues he pointed out that sellers of gas need the revenues as much as the buyers need the gas; there is ‘a huge interdependence’. In this context the rise of the LNG market is ‘highly beneficial’, but in any case we need more infrastructure and storage but ‘the planning system has been a nightmare’ – we have moved from NIMBY to BANANA – from Not In My Back Yard to Build Absolutely Nothing Anywhere Near Anyone.

*Tim Guinness*, Energy Fund Manager, agreed that we have about 60 years of proven reserves at the current rate of consumption but noted that the Middle East portion of those proven reserves has now risen to over 40%. On the other hand he described the rise of ‘unconventional gas’ which is going to be important in America following the discovery that gas from gas shales, using new techniques that work surprisingly well, can be extracted economically. The size of this is huge and is ‘good news for the world’.

Nonetheless he felt much more strident in urging alternatives to fossil fuels which we need to eke out for many more generations. He said ‘future generations will curse us for what we are doing with gas’. There needs to be a focus on offshore wind and we need more subsidies including transmission lines to points along the coast. Wave power and geo-thermal power also have potential.

Concluding, he expressed dislike for current carbon trading arrangements and added ‘We need a simple carbon tax. Clarity, generosity and certainty will best enable policy objectives to be met.’

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## A BANKING ‘BRIDGE’ TO THE FUTURE\*

*By Robert McGarvey*

Although many new bridges are about to be constructed in this period of ‘stimulus’, the one bridge that is not under construction, nor even contemplated, is potentially the most critical infrastructure project of all: the risk management bridge that could connect the enormous mountains of savings and investment that are accumulating in our financial system and the productive (but undercapitalized) heart of the nation’s value creation engine.

The collapse of Wall Street investment banking has unleashed a tsunami of unwelcome expectation on the banking industry. At the same time that governments throughout the world are pressuring banks to be more active on the lending front, their world is falling apart: bank balance sheets are unravelling while entire arenas of bank profitability are vanishing<sup>1</sup> before their eyes. To compound the problem, bankers have suddenly awoken to the true – shocking – reality of their risk exposures. All in all, the speed of the economic collapse, coupled with bankers’ growing uncertainty around their fundamental business model has led to a kind of institutional paralysis.

How did banking, of all industries, get to such a place? Well, during the past three decades, the conservative world of banking has undergone some remarkable and quite radical changes. Since the elimination of restrictions on banking activities in the 1980s many commercial banks have moved strongly into non-traditional (and higher risk) lines of business such as investment banking, securities brokerage, insurance, and mutual fund sales. In recent years banking profitability has become increasingly dependent on a host of non-traditional banking services, electronic funds transfer fees, credit cards services and account management fees. Advances in securitization have certainly accelerated this trend, increasing banks’ dependence on newer non-traditional sources of profit, including loan origination fees and, until recently, fees associated with asset-based loan securitization.

All this ‘service’ growth has diverted public attention from a disturbing trend: the precipitous decline in a pillar of banking industry stability, commercial and industrial (C&I) lending. According to Cobas Mote, and Wilcox: probably the most important change in banking (in the last few decades) has been the ‘...

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1 The seizure of the securitization market in particular, has crippled the business model and profitability of many of the world’s most important lending institutions.

\* This originally appeared in *Risk Management* magazine

*reduction in banks' role as a lender to non-financial corporations... the ratio of commercial paper outstanding to bank commercial and industrial loans, which was just over 10 percent in 1960, rose to about 30 percent in 1975 and to more than 100 percent by the early 1990s.*<sup>2</sup> . This trend has accelerated in the last two decades. Between 1986 and 2003 Commercial and Industrial loans declined from 31.53% to just 18.9% of overall industry loan portfolio<sup>3</sup>, as large business borrowers began to bypass regulated banks for Wall Street financial institutions substituting commercial paper or high-yield debt for bank loans secured against collateral grade assets.

This transformation in the banking business model has been driven by many factors including advances in technology, the development of sophisticated credit-scoring models, new financial processes, the Internet and, of course, by cold blooded financial pressures, the need to meet profit and growth targets in an increasingly competitive market. However, a significant, if under reported, reason for all this change in banking strategy is the persistent decline in the quantity of traditional bankable assets in modern corporations. According to the World Bank there has been a revolution in the underlying *engine of growth* in western economies; a precipitous decline in tangible industrial-type assets as a percentage of total market capitalization. Today, in most 'post industrial' economies market services and intangible assets dominate, contributing over three-quarters of GDP<sup>4</sup>.

What does all this mean in the conservative world of banking? Today as banks retreat from high yield financial derivatives and begin to search for solid collateral they are facing, head on, the transformation of the underlying asset foundation in western economies. Instead of the bankable assets of old, real property, plant or inventory, corporations in the modern economy are underpinned by a host of non-traditional 'assets'. These new assets include many of the 'harder' (potentially bankable) forms such as patented new technologies, copyrighted software, but they also include many new contractual based assets, not least those 'sophisticated' financial derivatives we've all read about, and a variety of unfamiliar relationship based assets such as 'brands', trademarks, social networks and related assets that are becoming more and more important in our economy.

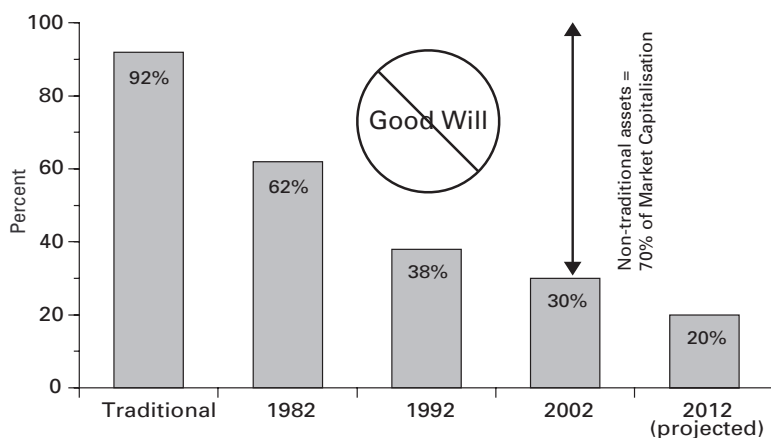
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2 'A History of the Future of Banking: Predictions and Outcomes', Maria Gloria Cobas and Larry R. Mote, Office of the Comptroller of the Currency, James A. Wilcox, Haas School of Business, University of California, Berkeley

3 'How do banks make money? A variety of business strategies', Robert DeYoung and Tara Rice, Federal Reserve Bank of Chicago, 2004

4 See World Bank.org, for more details, also refer to research done by NYU, Stern School of Business, knowledge and shareholder value, Baruch Lev, January 2000, Page 2





Source: World Bank Statistics

**Figure 1:** Tangible assets as a Proportion of Total Market Capitalization

The scale of this economic revolution and the immaturity of the actual assets (from the banking perspective) make it extremely difficult for banks to move quickly, to adequately fulfil the rising expectations of business, governments, regulators and an increasingly impatient public.

It's been a *long time* since bankers have faced such a challenge. The last time western banking went through as profound an asset transformation as we are presently experiencing was at the dawn of the industrial revolution two centuries ago. The dilemma then facing bankers was described well by John Jay Knox, in his 'History of Banking in the United States' (1903). *'Money banks... issued notes on the basis of obligation of merchants and manufacturers, in contrast to land banks which issued their notes on the basis of land and personal estates. The latter type of banking was considered (prior to the War of 1812) preferable to banking on mercantile credit because land banks were supposed to stand on solid ground and not to depend on the success of their borrowers as did the money banks.'* The historic importance of American bankers of the time, according to Knox, lay in their recognition of the changes brought about by the industrial revolution and an appreciation of the changing focus of (intrinsic) value in an industrial economy. *'Such were the ideas of the men who stood at the cradle of (modern) American banking, and their choice lay between banking on mercantile credit or banking on real and personal estates. It was in choosing the first possibility that they made history.'*

History has raised the bar again. The value creation engine in our economy is migrating, moving rapidly into new asset forms that need

institutional support of all kinds, including banking. If there is to be a significant role for banks in the post industrial economy some things must change and change quickly. To begin with banking risk management *standards* and risk tolerances will certainly need to be developed internally, predicated on first principles, and not simply outsourced to credit rating agencies. Secondly risk must be identified and managed, not veiled behind statistical models or blindly hedged with credit default swaps etc, and – most importantly – thoroughness, diligence and openness need to be guiding principles for managers.

It is no longer possible to support the fiction that the new engines of growth in our economy are simply Good Will, ‘services’ that can escape rigorous analysis. Fortunately the risk management profession has just the right mind set and tool kit to deal with all these problems. One of risk management’s most attractive attributes is its formal disciplined treatment of assets. Risk management processes seek quality verification of assets at discrete stages: (1) *identification* of the assets, what exactly is the asset, how does it deliver value to the company? (2) the *current state* of the assets, what does the company ‘own’ and what is its condition? (3) *performance* criteria, what level of performance or service are required, how is performance measured, how do these assets fail? (4) *life of the asset* determination and (5) what is the *strategic ‘best use’* of the asset, are there alternative uses of this asset?

Non-traditional assets need to be identified and given the same rigorous treatment as traditional assets. Where this is presently being done quantitative valuations of intangibles (software, patents, trademarks etc.) are beginning to show up on financial statements, strengthening corporate balance sheets. Software, despite its obvious attraction as an asset has only been treated as such since 1999 under GAAP. But intellectual property based assets are not the only, nor the most productive new assets: brands, customer equity, employee know-how (human capital) and other key stakeholders contribute significant value to corporations, and are beginning to appear on the radar screen of major accounting bodies as ‘potential’ capital assets of the future.

The question is will we, standing at the cradle of another new era, have the vision, the creative imagination and the strength of character of our forbearers. Are we prepared to engage once more in an historic act of social invention, to do the hard work necessary to unleash an era of new prosperity? Or will we continue to wring our hands, and hope that the Humpty Dumpty of 20th century banking can be put back together again? History is calling, are we prepared to answer the bell?

## WHY MOST THINGS FAIL: EVOLUTION, EXTINCTION AND ECONOMICS

*Extracts from a talk given by Paul Ormerod, author, commentator and academic, to members of the Economic Research Council on Wednesday 11th June 2008*

I want to talk about the interrelationships between biology and economics and we know that most biological species that have ever existed are extinct. There is only a tiny fraction still around ... some survived short periods of time, some lasted long periods of time, but they have gone, they have gone into extinction. And a characteristic of firms, whether it's in America or Europe or whatever, is that they too disappear. They vanish – over 10% of all companies in America and Europe disappear every single year, regardless of whether the economy is in a recession or whether it is in a boom. There is a tremendous turnover within companies – births and deaths are the characteristics of companies. The patterns of extinction between firms, the basic units of the western economy, and biology are very similar. It is on this capitalism under market-oriented economies that we have gradually evolved a system after many thousands of years of trying which actually has been tremendously successful in delivering material prosperity, massive increases in leisure time, massive increases in longevity, and huge increases in health. This has been like an evolutionary advance and it is the firm which is the basic unit that has done this. Yet the characteristic of a unit which has been so successful in delivering benefits is that it dies in the same way as species. The fundamental problem is how can this be? Now species can't attempt to plan their evolution so you can't say if you are a frog or something decide you'll try and grow a fifth leg. Well you might do, but it would just be at random and you can't just decide, plan to do it, have the intent of growing a fifth leg, whether it is as an individual or collectively. And yet we can. We can think about the future and we can try and anticipate it. We can act with purpose and intent. So what I want to talk about today is why there are so many parallels in failure between biological and economic systems when there appears to be this really fundamental difference between us, that evolution occurs at random and yet we ostensibly can think and try and anticipate and act with intent and purpose rather than acting purely at random.

Just for examples of firm failures. Going back a long way – 1469 – and a tremendous advance, the invention of printing. This was one of the more fundamental advances we have ever made in dissemination of knowledge.

Instead of one book taking two years to produce, they could at the start produce two or three books a day, so there was a huge increase, a stupendous increase in productivity. This was the internet of its day. And Venice was the New York and London of its day – a massive trade empire, where venture capital was provided to the rulers of Europe and for entrepreneurial firms. So here we had the print industry, a major technological advance. Twelve firms started printing. Within five years nine had failed. Very similar to the dot.com industry. Apparently these things go back a long period of time.

Skipping forward now, let's think about some examples from the early 20th century – take the invention of the car. Now that was a major advance in terms of human freedom – the ability to move around. That's why cars are so popular – you don't have to depend on trams or some timetable that somebody has set – you just get in your car and drive off and that's why people find them so tremendously popular. Well in the first twenty years there were around 2000 firms trying car production in America and almost every single one disappeared. At the start of this new technological venture people tried to enter the market, tried to produce cars, some of them with quite bizarre designs, but even when they settled on the petrol engine as the means of delivering this technology for the last hundred years, in the event most of the firms simply disappeared and yet it has been a tremendously successful industry delivering enormous benefits.

At the same time, the film industry has been tremendously important in the 20th century. I want to give some examples from cultural industries later on because I believe that these are particularly important for the future and have some very important implications, but we will get on to those. When we think of films now we think of Hollywood, but in the 1900s the European film industry supplied half the US market and dominated Europe, yet within 20 years it had become entirely marginal. The question now is whether Hollywood's dominance is under threat but certainly for the last 80 or 90 years films has meant Hollywood, which has been the centre of production, and we saw Europe's dominance of the market disappearing very suddenly.

These have all been tremendously successful industries, delivering huge benefits but at the micro level most of the firms which entered actually failed. None of them intended to fail; they were all acting with purpose to make profits and survive and yet most of them ended up failing.

Do giant firms fail? Most of the firms that fail are very small. There is a very high failure rate in the firms that make all sorts of silly mistakes and the death rate is very high. But do giant firms fail? Well, globalisation

is not new. There was a real wave of globalisation, the first phase if you like when companies were created on a truly global scale for the first time was around 1900 and around that time a company like United Steel in America had a market capitalisation at today's prices at least as big as (say) Microsoft now. There were massive companies suddenly created very quickly within a space of about twenty or thirty years. There was a massive merger movement around the turn of the century with around a trillion dollars in today's prices in terms of mergers and acquisitions, creating these massive companies. So if you like, there was a rapid period of evolutionary change, with big firms and then lots of shake-up, many disappearing, many being acquired, some simply disappearing through competition, and some real giants being created for the first time in world history, sort of, if you like, the giants of capitalism in the early 20th century. The survivors proved themselves by selection through this massive evolutionary competition that had taken place. What happened to these survivors?

If we take the hundred largest companies in the world in 1912 and ask what happened to them by 1995, we find that 29 went bankrupt and 48 disappeared – merged or acquired in some way. Only 19 survived in the top hundred, a big chunk of which were oil companies. There are all sorts of reasons why so many disappeared and there are all sorts of reasons why 29 of these huge companies went bankrupt – but anyway billions and billions of dollars of shareholders' money had gone, just disappearing in these firms.

So failure characterised most firms, even at the very, very largest level where people try and recruit skilled people, intelligent people to run their companies at all levels. There are planning functions, there are marketing functions, a lot of effort has gone into how to run these organisations, how to operate them, and yet their characteristic is that they have actually failed.

Success can be as unexpected as failure. We are used to the idea of Windows being the delivery system for PCs, which has been the standard around the world, and has been a massive success, but in 1980 Microsoft believed that RS2, which was developed with IBM, would be the operating system. Windows was very much a very marginal thing. I remember getting a copy of Windows 1. I used to use a program called WordStar which I thought was really good. I thought Windows was a disaster, it was much worse, you could hardly load it onto your machine and it took an hour to load. Then they brought out Windows 2, which wasn't much better. They said when Windows 3 comes out we will keep selling it, but there will be no more development to Windows. You can keep buying it

if you want, but we are going to cut back the development team to just three people. In fact it appeared in May 1990 and sold 2 million copies in three months! They were flexible enough to keep it as a successful pointer to the market, they did have a Five Year Plan and they didn't deny that it actually happened or try and rewrite history or pretend – they actually acted. They acted with intent and purpose and said, this is our strategy, we will act, we will go with this; we have been going with that, and now it is clear that Windows is tremendously successful. So they shifted the bulk of the company's development into that area very, very rapidly. They were fortunately able to escape from the consequences of potentially disastrous initial decisions. Google nearly went bankrupt. It was touch and go I think when they had a turnover of something like \$8 million, when they were tiny it was 24 hours away from bankruptcy and it was just some eccentric Californian who rescued them. A random event essentially rescued them.

Now let's try and think about why this might be. I have talked about how I am interested in cultural and creative industries – actually a very, very rapidly growing centre of the economy in all western economies, fairly broadly defined. Things like video games are growing very rapidly. This whole area is a massive area of growth for western economies. As an interjection on this, these industries tend to deliver a very, very skewed outcome. They tend to deliver massive success for a few winners, even more skewed than most economic processes. You get a very few very, very successful video games, a very, very few successful film producers, a very few successful actors, but most just scrape by. I think there is a challenge for inequality arising here. This is the broader issue.

So, which is the odd one here, of these four categories: Marmite, The Incredible Hulk, rugby league (a cultural favourite of mine, my roots help me maintain an interest in that) and Wagner? The answer is The Incredible Hulk because of the other ones, everyone has got a view. Do you like Marmite or not – no definitely not, I hate Marmite. Rugby League – again it's the same thing. You are either a complete devotee or you are simply not interested at all. Now Wagner – Wagner gives rise to strong emotions, you like Wagner or you don't. The Incredible Hulk is different. You might be a fan of this genre of film, you might be a fan of the stars, and Liv Tyler is one of the stars – you might be a particular fan of one of the stars of the film, but until you have actually seen this film, until you have actually seen this manifestation of that particular genre, until you have actually seen the stars in action, you have no idea, you have to form your

preferences anew. So a characterisation of innovation, a characterisation of new things is that even intelligent people capable of acting with intent and purpose, the consumers, don't know their preferences, and the important feature here is that people's preferences are formed, at least partly, by taking account of other people's opinions. So, supposing I were a fan of this particular genre, before I actually go and see *The Incredible Hulk*, then I would be interested in people's opinions – who had been to it? What did you think of it? And if he said, well it's not very good, well I might be less inclined to go. My preferences are very valuable. You can get waves spreading across a population. The key thing in many of these new offerings is the opinions formed by the first few people who have seen them. So in a biological sense we get cascades, like the way disease might propagate amongst the populations – opinions of behaviour, opinions of beliefs spread when we see a new offering for the first time and people influence each other directly.

A software market study recently showed that the key thing was that the site actually published cumulative totals of daily downloads of the programs. That was the deciding feature. By far the most decisive thing in affecting their choice was how many people had downloaded it that day. The average quality of the most popular piece of software was indistinguishable from the average quality of all software available on the site, but they were decisively influenced by what other people had done. People weren't interested in the rational evidence.

I wouldn't be an economist if I didn't have a model to illustrate this. I am connected on a social network. Everybody has a group of friends they particularly listen to. If we made some connections in this room, this group talk to each other, that group over there talk to each other; they are interested in their views. That's what I mean by a pocket network – the group of people you listen to or talk to about a particular thing, whether it is about films, whether it's about rugby league, or whatever. So let's just assume, for simplification, the only reason for deciding to see or not see a film or a performance, to take up or not take up a new creative concept, is what the people they interact with think. So you just form your opinion on what your particular friends, those to whom you are most closely connected on this issue, actually think. We'll say, OK, we'll choose some people purely at random to buy something first, so we'll say, you, you and you are designated for this particular experiment to buy and we split them into like and dislike in various proportions. We can repeat this many times to see what proportion of the potential total end up buying it. This illustrates the

point that the reaction of the first few is decisively important and generate a huge variety of outcomes. This increasingly characterises markets under capitalism and so this is a fundamental reason why things fail, why it is very hard to plan and anticipate the future, because even though we are acting with intent, we have to be really, really smart to be able to actually target the very first few people, to make sure that the very first few people who bought it are actually going to say they liked it.

That might seem technical to you, but it's a hobby for me, some peculiar thing that economists like to do. So let's think of something more simple than running a firm or running a government. How easy is it to play games? Well, I suppose all of us have played at some point noughts and crosses, and what a boring game it is. I think my son was about 7 when he worked out that the game would end in a draw unless someone made a really stupid mistake. So it is a very easy game to play. If the world were like noughts and crosses, we could always make the best possible choice. There is no reason for failure at any time in this particular game if the world was like this. It is almost at random. There was an example in *The Financial Times* about five years ago, a new casino opened up in Nevada, and to get people in they said, the first time you come in you get to play a game of noughts and crosses with a chicken, but the chicken always gets to make the first move, but if you win you get \$5000. And so they scattered chicken's corn on the board, threw the chicken down, and he goes thwack, and that's his mark, and in the first month only one human won the \$5000. So that's how easy it is to play. It is a very, very easy game to play. So, is the world like this? Well it is. It's like a rational planning mentality, the idea of acting with intent solves all problems, in a noughts and crosses world that's definitely true. Let's choose a game that's not much more complicated; you can teach draughts very quickly to people in a matter of a few minutes, but it's a much harder game to play. I believe very recently that it has been completely solved on computer so that for every conceivable position, the result is known. If you have children or grandchildren you can still enjoy a game of draughts with them because it is quite hard to play, even a very simple game like draughts. With noughts and crosses you know the best possible move to make every time, it's obvious what to do to stop your opponent winning. Draughts is a bit harder. Chess? Well, chess, I mean, how many rules are there in chess? Not many, about a dozen rules; you can teach the rules of chess to an averagely intelligent child quite quickly. An averagely intelligent person in about an hour could learn how to play, could learn all the rules. But think what a phenomenally complicated game



it is. I used to play years ago but I am still quite interested and will look at the chess column in the paper, but that is about it. But occasionally I buy a book on it, and I had to get this book by probably the greatest human chess player that has ever lived – Kasparov – and it’s called ‘My Great Predecessors’ – a very modest title, that’s one of the reasons I bought it – and he’s writing about the games of world champions because he was world champion. And some of these positions, he’s going back about eighty or ninety years, crucial positions in world championship history in a single game of chess, which have been analysed by world experts for eighty or ninety years, crucial positions, and Kasparov comes along, the greatest human player ever, and aided by chess computers he is still unable to come to a conclusion in many of these positions on what was the best move. He can rule out lots and lots of moves which are clearly wrong, and there have been hundreds of pages, or thousands, published on key positions over the intervening years and yet he was unable to decide, in an apparently simple game, what the best move is. So think about it. Is running a firm harder than playing chess? Yes. Much harder because in chess the rules are fixed; you can’t decide that the bishop, which moves diagonally, should start hopping from side to side as you go along during the game. But if you are running a firm, that happens. You think you have got it sorted out and a new competitor comes along which does hop from side to side and you didn’t realise it could do that. So what do you do then? You’ve got to anticipate that. So the rules are fixed and there is a very clear objective – the only way you win is by capturing the opponent’s king, most games don’t go to that level but that’s the purpose, that’s the only way you can win. Running a firm – what’s the purpose of running a firm? Well you could say it’s to make profits. But is it to make profits today, or maximise profits over the longer term; even if you think of profit maximisation as the goal of a firm, there are issues to be involved, and how do you think about doing that? So compared with running a firm, chess is a very, very easy game to play, and certainly compared to, say, running a government, which is also very difficult, and even the best analysts, the best people, with modern computers often can’t decide the best move. I think this is why failure is endemic. It’s not that we are stupid. It’s not that we don’t act with intent and purpose. It’s not that we actually really do behave at random. It’s just that the human world is so complicated, our ability to comprehend it is so relatively limited, it’s almost as if we are acting at random – not completely, we do have some foresight, some ability to influence it, but there is much more randomness, much more unpredictability in the human

world than people like to think. It's not a controlled noughts and crosses world; it's even more difficult to play than draughts.

### **The Beauty Contest Game**

Perhaps we could just have a quick experiment, just actually play a little game. I'll try and explain what it is, it'll be very quick. I can't play it completely because I'd have to take pieces of paper from every one of you. It's an important game – I'll explain why it's called the Beauty Contest Game in a minute or two – so if you know the answer you can't play, well you can play actually, you're allowed to, but don't shout it out. The Beauty Contest Game is a very simple game to play. Everybody in the room has to think of a number between 0 and 100 and the winner is the person whose guess is nearest to half of the average of everybody else's guess. So it's a very simple game; I've told you the game in two sentences, like noughts and crosses it couldn't really be much simpler. All think of a number between 0 and 100 – no conferring, no social networking here, you've got to think of it as autonomous individuals, what your guess is going to be between 0 and 100. So, has everybody thought of a number now? Right. Did anybody think of a number more than 50? You did? Sixty. OK, let's think about that. You should never play that strategy. Why should you never choose a number more than 50? Because if everybody chose 100, which seems really unlikely, then the answer can only be 50, that's the most it can be. So if you choose a number more than 50 you are certain to lose. There is actually a chain of logic, which a totally rational group of people would play immediately, if we acted like economic theorists, if we had complete foresight, and the answer is 0, everybody would chose 0 because if you think about what I said, that chain of logic that I've gone through, you'd say OK you never choose a number more than 50, so you sit there – if you'd had more than a few minutes, you might have thought this out and said, OK, well if I think that, everybody else is going to think that and so nobody is going to choose a number more than 50 so it's going to be 25, ah, but then people are going to think 25, and so you converge on 0. OK. So that's the formal proof. The trouble is, in real games, and this has been played, not just as an experiment with students for a few dollars, it has been played in Indonesia for prizes of \$500, for serious participants, but the rational strategy, the noughts and crosses world strategy, never wins because it takes people a long time to find this. Initially people typically look between 1 and 3 moves ahead. Not many people start by thinking 0 is the best move, and then they

would lose because everybody else hasn't thought that. But if you play the game repeatedly with the same group over a number of moves, eventually you do actually converge on 0, but even when they are very close to it, and you announce the winning number at the end of each one, they don't immediately go to 0, it still takes them time to get there.

The reason it is called the Beauty Contest Game is because Keynes used this for analogy in the 1930s when he used to talk about the stock markets. A popular newspaper pastime in the politically incorrect 1930s was that many popular newspapers in the summertime published pictures of girls in swimsuits, and the winners were not the people who judged the most beautiful girl, but the one who judged what the majority of readers would actually vote for. And that was called the Beauty Contest Game. Most people could anticipate one degree ahead, but in many markets, the stock market and the financial market, you have got to guess the average degree ahead which people who might be interested in it are actually looking. If you had all thought about it, even though I've told you the solution, think how complicated it is to get it right, to succeed rather than fail, to win rather than lose, rationality isn't going to get you very far because you've got to judge, even in an audience where many people know each other, how many moves ahead the typical person is going to be thinking when they rationalise their choice of number. So even in a game like that you are much more likely to fail. It is very, very hard to solve unless you are going to play it very, very repeatedly.

So, biological evolution takes place at random so that you can never anticipate the next step in biology, who will become extinct, who will succeed. And I think this is why, paradoxically, failure is the key to success. The social economic systems are much more like this than the imaginary world of the planner where everything can be predicted and controlled. So I think a lot of economic and social policy, especially over the last fifty years, has postulated a noughts and crosses world and that's not true, that's simply not true. We are much, much closer to the Beauty Contest Game where even very simple situations can become very, very complex very, very rapidly and it is hard to anticipate and plan.

So how do we make progress? Those of you who follow economics or social science will realise this is a fundamental point of Hayek's – a great hero of mine – that you make progress by experiments. You try and think about a best policy, which might get you a little bit of the way, but you've got to try a test and say, does it work, let's see what works. No matter how hard we try we will never be sure that something is going to work, so

we have to find out, we have got to try it out, and that's what evolution does, that's how evolution works. It's like a test and try policy. Is it worth growing a fifth leg? Well, I've never seen a five-legged frog so it may not be, but is it going to work? And we need to interfere constantly, to try different policies and strategies and some will work.

I mentioned briefly how successful capitalism has been, but we didn't get there in one. When we started to form cities, when we stopped charging around the plains hunting bison, and settling down in cities, however long ago that was, seven or eight thousand years, we didn't suddenly invent the market economy, we didn't suddenly invent joint stock companies, it took a long time for that to evolve, it's very precarious. We actually finally discovered a system that really works, that's fantastically successful, much more successful than any previously existing system, but it took seven or eight thousand years of human experiment to evolve that at a macro level.

So I think many firms understand this intuitively and that's why they survive because they are constantly having to confront their consumers, they know opinions can change, they know that things evolve, they know they have to innovate, they know they have to try different things, and the group of people who don't understand this are the ones in the Western public sector where we see repeated failure after failure after failure in many particular ways and I think these are the people who really need to understand much more about the parallels between biology and economics and why things fail.

## **THE TRANSFORMATION OF CHINA**

*Extracts from a talk given by George Yeo, Singapore Minister for Foreign Affairs, at Cambridge University on 27th March 2009*

The transformation of China is the most important development in the world today. Much has been written about it, but I would like to touch on three points.

### **Identity**

The first point is China's sense of itself which was written about by Joseph Needham many years ago. Over the centuries, it has been the historical

duty of every Chinese dynasty to write the history of the previous one. Twenty-four have been written, the first a hundred years before Christ by Sima Qian in the famous book, *Shi Ji*. And since then the later Han wrote about the Han and then the Xin, the Three Kingdoms and so on. So twenty-four in all. The last dynasty, the Qing Dynasty, lasted from 1644 to the Republican revolution of 1911. Its official history is only now being written after almost a century. When I visited the Catholic Society of Foreign Missions of Paris in January this year, I was told by a Mandarin-speaking French priest who served many years in China and in Singapore that out of the 90 volumes envisaged for the official history of the Qing Dynasty, 5 volumes would be on the Christian missions in China. When I was there at the Society, I met a Chinese scholar researching into the history of missionary activities in Sichuan province. No other country or civilisation has this sense of its own continuity. For the official history of the People's Republic, I suppose we would have to wait a couple of hundred years. It was Needham's profound insight into China's sense of itself that led to his remarkable study of *Science and Civilisation in China*. Ironically, China's sense of itself was mostly about its social and moral achievements within the classical realm. It was Needham who informed the Chinese of their own amazing scientific and technological contributions to the world.

However, China's sense of itself is both a strength and a weakness. It is a strength because it gives Chinese civilization its self-confidence and its tenacity. Chinese leaders often say that while China should learn from the rest of the world, China would have to find its own way to the future. But it is also a conceit, and this conceit makes it difficult for Chinese ideas and institutions to become global in a diverse world. To be sure, the Chinese have no wish to convert non-Chinese into Chinese-ness. In contrast, the US as a young country, believing its own conception to be novel and exceptional, wants everyone to be American. And therein lies a profound difference between China and the US. The software of globalisation today, including standards and pop culture, is basically American. If you look at cultures as human operating systems, it is US culture which has hyper-linked all these different cultures together, in a kind of higher HTML or XML language. And even though that software needs some fixing today, it will remain essentially American. And I doubt that the Chinese software will ever be able to unify the world the way it has been because it (Chinese software) has a very different characteristic all of its own, even when China becomes the biggest economy in the world as it almost certainly will within a few decades.

## Urbanisation

The second point I wish to highlight today about China is the astonishing urban experimentation taking place today. China is urbanising at a speed and on a scale never seen before in human history. Chinese planners know that they do not have the land to build sprawling suburbia like America's. China has less arable land than India. Although China already has a greater length of highways than the whole of the US, the Chinese are keenly aware that if they were to drive cars on a per capita basis like Americans, the whole world would boil. Recognising the need to conserve land and energy, the Chinese are now embarked on a stupendous effort to build mega-cities, each accommodating tens of millions of people, each the population size of a major country. And these will not be urban conurbations like Mexico City or Lagos growing higgledy-piggledy, but cities designed to accommodate such enormous populations. This means planned urban infrastructure with high-speed intra-city and inter-city rail, huge airports like Beijing's, forests of skyscrapers, and high tech parks containing universities, research institutes, start-ups and ancillary facilities. In March last year, McKinsey Global Institute recommended 15 'super cities' with average populations of 25 million or 11 'city-clusters' each with combined populations of more than 60 million. Unlike most countries, China is able to mount massive redevelopment projects because of the Communist re-concentration of land in the hands of the state. If you think about it, the great Chinese revolution was fundamentally about the ownership of land. This is the biggest difference between China and India. In India and most other parts of the world, land acquisition for large-scale projects is a very difficult and laborious process.

As we looked to the US for new patterns of urban development in the 20th century with its very rational grid patterns, we will have to look to China for the cities of the 21st century. Urbanisation on such a colossal scale is reshaping Chinese culture, politics and institutions. The Chinese Communist Party which had its origins in Mao's countryside faces a huge challenge in the management of urban politics. From an urban population of 20% in Mao's days, China is 40% urban today and, like all developed countries, will become 80–90% urban in a few decades' time. Already, China has more mobile phones than anybody else and more internet users than the US.

## Bureaucratic Supremacy

My third point is about China's political culture. Over the centuries, China has evolved a political culture that enables a continental-size nation to be governed through a bureaucratic elite. In the People's Republic, the bureaucratic elite is the Communist Party. When working properly, the mandarin state is meritocratic and imbued with a deep sense of responsibility for the whole country.

During the Ming and Qing Dynasties, there was a rule that no high official could serve within 400 miles of his birthplace so that he did not come under pressure to favour local interests. This would mean that for a place like Singapore, it would never be governed by Singaporeans. A few years ago, that rule was re-introduced to the People's Republic, and indeed, in almost all cases, the leader of a Chinese province is not from that province. Neither the Party Secretary nor the Governor, unless it is an autonomous region, in which case the number two job goes to a local, but never the number one job. It is as if on a routine basis, the British PM cannot be British, the French President cannot be French and the German Chancellor cannot be German.

Although politics in China will change radically as the country urbanises in the coming decades, the core principle of a bureaucratic elite holding the entire country together is not likely to change. Too many state functions affecting the well-being of the country as a whole require central coordination. In its historical memory, a China divided always meant chaos, and chaos could last a long time.

To be sure, China is experimenting with democracy at the lower levels of government because it acts as a useful check against abuse of power. However, at the level of cities and provinces, leaders are chosen from above after carefully canvassing the views of peers and subordinates. As with socialism, China will evolve a form of 'democracy with Chinese characteristics' quite different from Western liberal democracy. The current world crisis will convince the Chinese even more that they are right not to give up state control of the commanding heights of the economy.

With the world in turmoil, many developing countries are studying the Chinese system wondering whether it might not offer them lessons on good governance. For the first time in a long time, the Western model has a serious competitor.

I make these three points about China to illustrate how complex the process of incorporating China into a new multi-polar global system will

be. The challenge is not only economic, it is also political and cultural. Yet, it must be met and the result will be a world quite different from what we are used to. Developing countries will no longer look only to the West for inspiration; they will also turn to China and, maybe, to India as well.

### **A Multi-polar World**

The simultaneous re-emergence of India and China, together making up 40% of the world's population, is endlessly fascinating. Two countries cannot be more different. One is Confucianist and strait-laced, the other is democratic and rambunctious. Or to use Amartya Sen's words, 'The Indian is argumentative'. Yet, in both countries, we can feel an organic vitality changing the lives of huge numbers of people. The re-encounter of these two ancient civilizations is itself another drama. Separated by high mountains and vast deserts, their historical contact over the centuries was sporadic and largely peaceful. In recent years, trade between them has grown hugely, making China India's biggest trading partner today. But of course, we must remember that during the Raj, China was also British India's biggest trading partner. But they are suspicious of each other. India remains scarred by its defeat by China in 1962 during the border war, a point which Chinese leaders seem not to understand fully. We in Southeast Asia have a strong vested interest in these two great nations who are our immediate neighbours having peaceful, cooperative relations. Let me talk briefly about a project which may help bring South, Southeast and East Asia together again. This is the revival of the old Nalanda University in the Indian state of Bihar.

Through Chinese historical records, the world is aware of the existence of an ancient Buddhist university in India which for centuries drew students from all over Asia. At its peak, Nalanda accommodated ten thousand students, mostly monks. It had a magnificent campus with a nine-storey library and towers reaching into the clouds, according to the extravagant but remarkably accurate account of the 7th century Tang Dynasty Buddhist monk Xuan Zang. Xuan Zang's journey to India to bring back Buddhist sutras was such an odyssey, it has long been mythologized in Chinese folklore – the Journey to the West. He spent a number of years in Nalanda. Unfortunately, Nalanda was destroyed by Afghan invaders at about the time Oxford and Cambridge were established 800 years ago and again initially, mostly for monks. The Indian Government has recently decided to revive this ancient university as a secular university, offering it for international



collaboration. A 500-acre site not far from the ruins of the old has already been acquired. Like the old, it will be multi-disciplinary, drawing on the Buddhist philosophy of man living in harmony with man, man living in harmony with nature, and man living as part of nature. A mentors group chaired by Amartya Sen has been appointed by the Indian Government to conceptualise its establishment, of which I am privileged to be a member. I hope the new Nalanda University will help usher in a new era of peace and understanding in Asia. I also hope it will have strong links to Cambridge.

A multi-polar world is a messy world. It means that no particular value system will hold complete sway over others. The current crisis has already caused many people to question the nature of capitalism, socialism and democracy. Chemically-pure capitalism, to use a phrase coined by former French Premier Lionel Jospin, has become a dirty word. In contrast, John Maynard Keynes seems to have been re-priced upwards again and all of us have been dusting the old copies of *The General Theory* that we have on our shelves. A recent *Newsweek* cover proclaimed that ‘we are all socialists now’. Even Karl Marx is being re-read. Ideas, cultural norms are all being re-priced as countries search for ways out of the crisis. If high unemployment persists for many more years, dangerous ideas and ideologies may reappear as they did in the 30s.

In responding to the current crisis, let us be inspired by two Cambridge men, Darwin and Needham. Darwin’s publication of *The Origin of Species* 150 years ago represented one of the greatest intellectual leaps by mankind. At the British Museum of Natural History, they call it ‘The Big Idea’. It was a very big idea. Natural selection has an obvious analogue in man’s intellectual and social development. Like biological species, human ideas and systems are also subject to selection through wars, revolutions, elections, economic crises, academic debates and market competition. Those which survive and flourish should, we hope, raise civilization to a higher level.

Needham understood China like few other men did. As Simon Winchester wrote in his recent book on Needham, *The Man Who Loved China*, Needham might not be surprised to see the huge transformation of China today.

Both Darwin and Needham were drawn from our university tradition of being sceptical without losing our moral sense. Only by being sceptical can we be objective, can we see ourselves critically and learn from others. Only with a moral sense will we be motivated to work for a larger social good. It was China’s corruption and inability to learn from others in an earlier period that led to its long decline. The Qian Long Emperor told George

III during Lord McCartney's mission in 1793 that China had nothing to learn from the West. That marked the beginning of China's long decline.

Human civilisations learn from one another more than they realise, more than we realise. In a collection of essays published by Needham on the historic dialogue of East and West in 1969, he chose for his title *Within the Four Seas*. That title was from the *Analects of Confucius*, who said, 'Within the Four Seas, all men are brothers'. In the heyday of Third World solidarity in the 50s, the Indians had a saying – 'Hindi-Chini, bhai bhai' – Indians and Chinese are brothers. In these confused times, we need to learn from one another on the basis of a deep respect for each other as human beings.

## NEW DEVELOPMENTS IN ECONOMIC THEORY

*Extracts from an article by Anatole Kaletsky\**

Academic economics has been discredited by recent events and it is time for what historians of science call a 'paradigm shift'. Economics today is where astronomy was in the 16th century, when Copernicus and Galileo had proved the heliocentric model, but religious orthodoxy and academic vested interests fought ruthlessly to defend the principle that the sun must revolve around the earth.

Most modern economists *assume* that investors are 'rational' and markets 'efficient' and that the financial system is a linear, continuous, rational machine. Such false assumptions are built into the risk models used by many of the world's banks. As a result, the odds of financial ruin in a free global market economy have been grossly underestimated. These assumptions led inevitably to disaster once they were blown apart.

*Benoit Mandelbrot*

Benoit Mandelbrot, a towering figure of 20th-century science, who invented fractal geometry and pioneered the mathematical analysis of chaos and

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\* The Times 9/2/09

complex systems, wrote the above words six years ago in his book *The Misbehaviour of Markets*. Mandelbrot's ideas found fruitful applications in the study of earthquakes, weather, galaxies and biological systems from the 1960s onward, but the field that originally inspired his ideas turns out, in this very readable book, to have been finance and economics. Yet 40 years of effort by Mandelbrot to interest economists in the new mathematical methods, which appear to work far better in modelling extreme movements in financial markets than the conventional methods based on statistically 'normal' distributions, have been either ridiculed or ignored.

At the other end of the academic spectrum, we find economists treating ideas from sociology, psychology or philosophy with the same derision and disdain. George Soros is no mathematician like Mandelbrot, but he has repeatedly demonstrated far better understanding of how market economies work than any professional economist by using psychological and philosophical ideas. His books have explained convincingly how false beliefs among investors can create self-reinforcing boom-bust cycles of exactly the kind afflicting the world today. But the reaction to these ideas has been the same as to Mandelbrot's: a complacent refusal among academic economists, regulators and central bankers even to think seriously about approaches that challenge the central orthodoxies of modern economics: that 'efficient' markets inhabited by 'rational' investors send price signals which, in some sense, are always right.

Reality is very different, as everyone now admits: investors often misinterpret information and markets sometimes send price signals that are dangerously wrong. What Soros shows, moreover, is that such behaviour should not be regarded as irrational or an aberration. On the contrary, rational investors can find it very profitable to act on false premises – for example that credit will always be available without limit – if these false ideas become so widely accepted that they change the way the economy actually functions, at least for a time.

One reason why such fruitful insights have been ignored is the convention adopted by academic economists some 30 years ago that all serious ideas must be expressed in equations, not words. By this weird standard, the intellectual giants of the subject – Adam Smith, Ricardo, Keynes, Hayek – would not now be recognised as serious economists at all.

But even if we accept the mathematical formalism of modern economics, there is vast scope for new ideas.

A control theory approach, used by serious mathematicians such as Nicos Christofides and Shahid Chaudhri, working at the Centre for Quantitative

Finance at London's Imperial College, has applied advanced mathematics from aerodynamics and control engineering to analyse financial turbulence without the over-simplified assumptions, such as continuous liquidity, which have caused the recent disasters in risk management and regulation.

But the challenge that existing economic orthodoxy may find most disconcerting is Imperfect Knowledge Economics (IKE), the name of a path-breaking recent book by Roman Frydman and Michael Goldberg, two American economists. Building on ideas of Edmund Phelps, one of the few Nobel Laureate economists who rejected the consensus view on rational expectations, IKE uses similar tools to conventional economics to generate radically different results. It insists that the future is inherently unknowable and therefore that there is always a multitude of plausible models of the way the economy works.

With this obvious, but critically important, change in assumptions, IKE demolishes most of the conclusions of rational expectations. More importantly, it shows that reasonable assumptions about economic uncertainty can produce financial models that give less spurious accuracy than the rational expectations models but are statistically far closer to what happens in the real world.

These are just a few examples of the creative thinking that has started again in economics after 20 years of stagnation. But the academic establishment, discredited though it is by the present crisis, will fight hard against new ideas. The outcome of this battle does not just matter to academic economists. Without a better understanding of economics, financial crises will keep recurring and faith in capitalism and free markets will surely erode. Changes in regulation are not sufficient after this financial crisis – it is time to rethink the theory of economics.

## THE GREATEST PLANET IN THE UNIVERSE

*By Neville Lake. Published by Francis Press 2008 p/b*

This is a management strategy book masquerading as a science fiction novel. Marcus is on a G11 short training course to become the Governor of an about-to-be-developed 'Class A' planet. His uncle Lucius, supreme commander of everything everywhere has arranged for Marcus, guided by Grand Alf, to visit a business tycoon, (boss of StarCups), a military leader (the captain of a great inter-galactic battle ship) and, amongst others, a wise and accomplished manager from the public sector – Sir Bertram. On the front cover we have a picture of a vaguely habitable version of the planet Mars and we are told that Marcus' spaceship carries him along at speeds which allow the stars and planets to drift by his view from his cabin window. So much, so corny – but it is a generally successful attempt to enliven a subject (making business strategy and putting that strategy into practice) that is so often fascinating to practise but dull to study.

Subtitled 'A Business Novel, Episode 1, The Blueprint for Success' the reader is treated to Marcus' series of dramatic encounters with the various successful leaders. From each he learns about '5 points' or '10 principles' or '6 guidelines'. All this is presented in a rather folksey manner, rather like reading Warren Buffet. One is given useful homilies for success – but in this case for organisations rather than for investments.

Critics of the late John Kenneth Galbraith used to complain that in his books he presented ideas and insights without acknowledging those who originally put them forward. One has a similar feeling with this book. Points are made and the commonly used management terms that they cover are not mentioned. For example, the Captain says (p. 146) 'once you have an aim there is a common reference point and a guiding force for decision making'. There is no mention that this is *Management by Objectives*. Similarly, the StarCups boss tells Marcus that his personnel management policy is to 'make a difference to how they see themselves and encourage them to support, inspire and develop each other' (p. 172). There is no mention that this is the application of Maslow's *Hierarchy of Needs*. On the production floor of the Robotek robot factory, the principles of 'New Unit Production' are explained but no mention is made that this is *Just In Time* or *Lean Production* as made famous by Toyota. Similarly, we are told (p. 158) 'We absolutely trust that the other people on this ship know what they are doing ... Without trust we would be second guessing each other,

getting in the way and duplicating activities.' Francis Fukuyama, author of a whole famous book entitled '*Trust*' is given no credit or reference at all.

This manner of presenting ideas – as if they have never been noticed before – is perhaps good enough and impressive enough for a talk to executives at a business conference. But the commonly taught titles for concepts are not unimportant. They are the common currency for progressing their use; the reinforcement of emerging ideas. Ignoring them limits the recipient.

I could recommend this book only as a supplement to the standard Management textbooks but never as a substitute. It would provide the basis for at least one useful exercise – to ask MBA students to name as many as possible of the concepts implied but not named.

Meanwhile, though the book is fun and interesting enough to read, it has serious shortcomings in approach. At the trivial level one might object to the politically correct sideswipe about personal pleasures such as cigar smoking. More seriously, one wonders how a book can enable one to develop that perfect winning strategy without at any point considering 'competition' or, more fundamentally how to engage discipline in the control of organisations, both private and public. It is as if Lake has re-written Plato's picture of an ideal world ruled by a perfect 'philosopher king', whilst forgetting Plato's great question 'Who will guard the guardians?'

J.B.

## **THE SECRET HISTORY OF THE WORLD**

*By Jonathan Black. Published by Quercus, 2007, h/b £25.00*

This a monumental work – a huge book for a huge subject and the author's notes says that this 'is the outcome of a lifetime spent reading authors in the field and hanging around antiquarian bookshops'. The result has sparked great interest and excitement – a challenge which all of us who are interested in the development of ideas in the broadest sense should read. And although much is 'above one's head' the broad thrust of its message is rewarding.

The first point to make is that this is *not* a history of conspiracies. Just reading the title one expects perhaps to read about Bilderburgers,

Freemasons, The Protocols of the Elders of Zion, the truth about the Russian revolution etc, but this book is not a claim to have unearthed the world's manipulators – or at least not in the way one might expect. Many are mentioned – but as part of a wider canvas.

Some chapter headings give a flavour of the coverage. To pick just a sample – 'Imagining Ourselves into the Minds of the Ancients', 'The Genesis Code', 'Isis and Osiris', 'Solving the Riddle of the Sphinx', 'Zarathustra a Battle Against the Powers of Darkness', 'Akenaten and Satan', 'Esoteric Buddhism', 'The Two Jesus Children', 'The Gnostics and the Neoplatonists', 'Mohammed and Gabriel', 'Dante, the Troubadours and Falling in Love for the First Time', 'The Rosicrucian Age', 'Occult Catholicism', 'What really happens in Alchemy', 'Blake and the Sexual Roots of Romanticism', 'Napoleon's Star', 'Freud, Jung and the Materializing of Esoteric Thought', 'The Anti-Christ', 'Re-entering the Ancient Wood', 'The New Jerusalem'.

To start with, there are just too many words which send one scurrying to the dictionary to find meaning! How does Lucifer differ from Satan? One ought to know. What was the meaning of Isis and Osiris? A clear meaning for 'esoteric', for 'shaminism', for 'the Magi', for 'Occultism', and for 'Rosicrucianism'? The inadequacies of one's knowledge make reading difficult – especially when the message is in the flow more than each sentence. You can't enjoy a piece of music if you keep stopping to analyse each chord.

What is one to make of this glacier of indirect thought, innuendo, fame, significance and secrecy? How can one relate belief in stars, magic and the success of great men from Hercules to Rama and from George Washington to Winston Churchill? And what, in 2009, comes next?

Through the pages of this book I came to appreciate the difference between 'collective thought' and 'individual thought'. Take, for example, the belief held for centuries that the world is flat. Pretty obviously, many many individuals must have thought that the world was round – anyone looking at the horizon is likely to think so. But until it was accepted as a fact further thoughts about planets, the universe and so on could not develop. A body of thought leading onwards could not take place. Collective thought stalled before moving on to modern science. Something akin to this seems to presently affect current American thought regarding the Middle East. So strong is the taboo there against discussing Zionism objectively that total political support for Israel is compulsory. No American politician could survive expressing questioning thoughts. As a third example, take the case of attitudes in Europe towards the European Union. Many individuals here

complain about the costs of the Common Agricultural Policy or the waste, mismanagement and fraud that pervades the whole enterprise but everyone seems to have to the almost religious belief that 'Europe' is good. Homage must be paid. Any mainstream political party that suggests leaving is, in old fashioned language, branded 'heretic'.

Thus the growth of human consciousness down the ages is a story of new thinking facing road-blocks thrown up by the institutions of power. Each age fights its own challenges – often secretly for fear of retribution. Open minded and far seeing individuals have to encode their thoughts in poetry, in plays, in pictures with hidden meanings. These are conspiracies for truth rather than for evil. And as each hurdle is overcome mankind's consciousness grows wider and wiser.

Except that Lucifer seeks always to beguile us into false alleys and Satan sets us false goals. The modern materialistic world would have us diverted by baubles and separated from the divine – a new dark age where the spiritual world lies hidden from us.

This book is a quite wondrous read.

J.B.



## LETTER

### CAPITALISM AND BUSINESS MODELS

*Some 'down under' cynical accuracy from Mr Ray Veitch.*

The Global Financial Crisis (GFC to we aficionados) seems to me to be an inevitable cycle stage of capitalism. Perhaps extending the thought to all systems of human economic activity, that perhaps they all have within them the seeds of their own destruction. This thought first came to me during a visit to Berlin when the old Russian style system fell over. The only thing now which seems to differ from previous experience is its scale.

It seems to me that the world went slightly mad – hubris ruled the day, from the Russian oligarchs to Wall Street. Credit really has tested its elasticity – is there an economic term for that?

In Australia we have 'merchant Banks' which I refer to as 'Entrepreneurial Financial Organisations' which have used a business model which can be shortly stated as:

- 1 Borrow billions.
- 2 Move fast.
- 3 Use the borrowed billions to buy infrastructure assets such as airports.
- 4 Create new structures (usually property trusts) to manage such assets.
- 5 Extract vast fees from that management
- 6 Sell off the ownership of the new structures to gullible customers eg private equity firms, share equity buyers, hedge funds etc.

It all works a treat unless the stage 1 lender suddenly gets cold feet, which is what has happened in the GFC. Suddenly the lines of credit dry up and we are talking firesale, with everyone burnt except the financial engineers who have already walked away with their fees (and often a golden parachute to boot).

It all adds interest to my twilight years, and compensates to some extent for the fact that I too am affected through no fault of my own.

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