



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

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A VIEW FROM PRIVATE EQUITY

Extracts from a talk given by Jamie Constable, founder of R.Capital
to members of the Economic Research Council on Tuesday 9th November 2010*

*Opening the evening, Jon Moulton, Chairman of Better Capital**, painted a bleak picture of Britain's National Debt and of the extent to which the last Government was overspending so that the Debt is now about 450% of GDP and still rising rapidly – with the banking crisis by no means over. He concluded by suggesting that it would be better now to have interest rate rises together with deficit reductions – and the consequent rise in unemployment and business failures in order to have stronger future growth and less debt for our children's generation.*** Jamie Constable then turned to this cloud's silver lining ...*

I am not here speaking as an economic guru, that's one thing that I wouldn't pretend to be. I am just a street fighter; I've been there and I've seen it. Soon after I qualified back in 1988, there was a massive crash in the housing market. I remember it well because I was a 23 year old, and I used to jump in a car on a Friday night, travel up to the Midlands or the North, and put our £500 down on a deposit for a house somewhere. These houses were going up in price so quickly that three months later you ended up making a lot more money from the house. And there I was, in August 1988, and I was about to sell a house for £25,000. Now bear in mind that I was earning about £2,500 at the time. I was ecstatic. I'd already decided what colour the Porsche was going to be, and I was just absolutely over the moon. And on 31st August everybody stopped buying and the housing market collapsed. Along came the terms like negative equity – I had lots of that! I was actually paying three times my salary in mortgage payments, which was a lot of fun at the time!

But I was fortunate. I could lick my wounds. I joined up with a partner who was into turnarounds, and that's really where I learnt my skills that I use today. We used the Warren Buffet Noah principle – 'predicting rain doesn't count, building arks does'. Warren Buffet pointed out that Noah took twenty years to build his ark; people said he was mad, no rain, the sun was shining. Of course he didn't look so mad when it started raining.

* R.Capital specialises in financing and restructuring firms in financial distress.

** Jon Moulton was formerly Managing Partner of Alchemy Finance.

*** See also Jon Moulton 'Pain Aversion', Centre for Policy Studies, and 'Cut harder, we can't go on as debt junkies.' The Times 1/2/2011

We spent a lot of time and our capital building our ark, waiting for that rain. And R. Capital – everyone asks me what was R. Capital? R. Capital was simple to name because it was our money that we were using so it was R. Capital. We set it up in 2004 ready really for the rain to come. So we now feel we are equipped with a very large boat.

I do believe that this recession is now over and there are a lot of things similar to how it was back in 1989/90 and 1991/92, but I'd like more to compare 2010 to 1997. I don't know if any of you watched the Austin Powers film but Austin Powers was frozen in 1967 and came back to life in 1997, still with Dr Evil. So if in 1997 you were frozen and you were unfrozen today, you would go to see your old friends at the bank and say to the guys 'I want to buy some businesses, what sort of leverage can I get – two to three times, three times at best?' Sounds about right, that's where we were. You then might say, 'I want to buy some property'. You then ask the rate and they quote 3.5% over base and you are absolutely shocked until you realise base is only 0.5% – last time you looked it was 7%, fourteen times more. Then you go for fixed rate and you cannot believe how cheap it is to borrow. You take comfort in the fact that there's no rampant house price inflation; but there's no obvious reason why houses are going to decrease in value either. You look at some trading businesses; you are quite happy with what you see, quality assets, the price isn't too ridiculous. You look at the retail picture; consumer spending remains healthy. You are slightly surprised by the loans that Her Majesty's Revenue and Customs (HMRC) have lent to businesses and how weak some of the balance sheets are, but the current trading seems fine. You see a Coalition government – there's no interest in calling a General Election any time soon; the Chancellor is determined to fight the deficit. You see a vibrant banking sector. You see little manufacturing; what you do see you like because the exchange rate is so good against the euro and the dollar and in general you see businesses run so much better in 2010 than they were in 1997 – good management, information systems, procedures etc. So what do you think? Great, then let's go to work!

I think one of the reasons that everyone is so tempted to be negative is because of what we have had in the last thirteen years and the assumption that it was normal, and it just wasn't normal. Austin Powers will play his mojo; swinging London goes on and Dr Evil in the shape of the double-dip will again fail to win the day. But there are going to be some uncomfortable moments going forward, without a doubt. I think the shocking thing about this recession is how quickly it actually hit. We now live in a very volatile

world; the press, well there are so many stations that you can watch news on nowadays, it's quite amazing.

And a simple statistic shows how quickly we fell off the cliff – Volvo, the truck and lorry firm, in the first quarter of 2008 took 150 orders, compared to the third quarter of 2007 when they took 42,000 orders. It is just amazing how businesses fell off the cliff. We saw this in general businesses, where their turnover was halved in a matter of months. And the only way you can rebuild that is you've got to reduce your overheads and you've got to do it very quickly to deal with that drop-off in turnover. And I think what we are seeing is the biggest soft loans ever from Her Majesty's Revenue and Customs to UK PLC to allow you time to pay your PAYE and VAT, and that's actually allowed businesses to get through what would have been an unbelievably catastrophic time. The problem you always have with any business is that your sales are variable and most overheads are fixed and it takes time to get through that and this is what has been allowed to happen.

Look at some of the madness of the last thirteen years. A good example is the chain called Little Chef. It wasn't a case that the business was not focused on its customers, it hadn't been look after, it wasn't delivering, but what really broke Little Chef was an outrageous sale-and-leaseback done on a 6% yield and at rents that the company could barely afford. That's not unusual. But what I found astonishing in this particular case was that the people who were buying the properties, and this was a big purchase, this was a very big chain, was that their due diligence was to ring up the CEO and ask him how trading was. He said OK, and they wrote the cheque! That was the limit of the due diligence. Now that just wasn't normal.

What we are going to see over the next five years is the unwinding of these situations. There is going to be a lot of pain there and a lot of the banks are going to have to take that pain. More bad news, probably, but then again the banks seem to be making so much money at the moment just by changing covenants and charging excess fees they don't need to lend money; they are making a lot of money and can probably take the pain.

The biggest lender after the banks to UK businesses now has to be HMRC and this is an unsecured lend to businesses. Now we buy distressed debt and we often debate in the office what would we pay for HMRC debt and you'd struggle to get above 5p in the pound. We believe it is £40–60 billion that's actually out there in unpaid VAT and PAYE. That's a really big number. In the year 2008–2009, lots of businesses didn't pay their VAT for a couple of quarters, probably didn't pay their PAYE for three months.

Now that can equate to anything from 10 to 15% of turnover. Now I don't know many businesses out there at the moment that are making anything like that per year in cash generation; in fact the average is probably nearer 3% in cash generation. The question is, how is HMRC going to be repaid? My answer is that I don't think they will be. There is going to be a huge amount left unpaid. I don't think that will actually affect the recovery, just more debt we've got going forward.

One thing we learnt from the previous recession is that insolvencies peak as you come out. The working capital requirement in a business increases as growth comes back into the economy. If you take the last recession it was 1993 that the insolvencies peaked. Now it was all over by 1993; I have to tell you, I was there and things by 1993 were fine but that's when we had most of the insolvencies. In this recession it is going to be even worse because HMRC and the banks and creditors have allowed businesses that historically would have gone bust earlier to carry on trading with the loans that they have made. But this doesn't actually mean that the economy is going to contract. From our point of view this is now the best time; this is the time when we want to be lending to businesses and restructuring businesses because the banks will not be lending any time soon. We have been preparing for this moment. 2004 (not 1974) when we started; 2005 we have been waiting; 2006 we have been waiting; 2007, and at last we are in a position where OK, now the rain falls, we should launch the ark.

My prediction is that interest rates will stay lower for longer than we expect. As a nation we have got used to low interest rates very quickly. Any increase will have a big impact on the consumer and could lead to a double-dip but the Bank of England does have a mandate to avoid this. We are also going to see a small growth in the economy, especially as we react to the government's austerity measures but I don't believe that this will actually cause a double-dip. We are going to see a huge number of insolvencies over the next few years but this is more adjusting balance sheets and removing HMRC's debt and some of the bank loans. Nearly all those companies will continue to trade.

Inflation could well be a hidden danger. If we can't raise the base rate then inflation could rise to unacceptable levels but for my money, the biggest danger we have – similar to what happened before – is the scaremongering of the international media. In 2008 the news was full of the fact that we were going to go into a recession and consumers stopped spending, and then you've got a self-fulfilling prophecy, the prime example being what happened to Volvo.

The recession is now ‘officially’ over. In hindsight my view is that March 2009 was probably the lowest point; we bought three businesses in March 2009, and the skill in our business is not being too impressed by exuberance or too put off by gloom. There is a great quote from a French philosopher: The height of ability consists of a thorough knowledge of the true value of things. I will certainly buy a lot of businesses in the next twelve months; I think this is a great time to buy. There is going to be a flood. I think it is a great time to find a bargain and we’ll certainly be investing.

THE FUTURE OF EUROPE AND THE EUROZONE – A PANEL DISCUSSION

A Panel Discussion on ‘The Future For Europe And the Eurozone’ was held with members of the Economic Research Council on Thursday 9th December 2010. The Chair, taken by Damon de Laszlo, invited a European Union Representative, a journalist and a British Parliamentary representative to contribute.

The Founders of the ‘Euro’ Intended it to Force Political Integration

*Extracts from the contribution given by John Stevens,
Former Conservative Member of the European Parliament*

Most of those who have supported the euro from the start have said that we always recognised that it was an incomplete exercise and it was, in the true way in which all European integration has taken place, going to force further development. The debate has always been essentially a political one between whether further progress on the logic of having a single market and a single currency drives you in a regulatory government-orientated, tax-orientated, fiscal harmonisation, fiscal integration path or whether it is more market-orientated with strict rules, with fiscal disciplines, with market disciplines. You’ve got, broadly speaking, the Germans favouring a more free-market approach with rules and wanting the private sector investors to take the hits, and you’ve got the French talking more about having fiscal harmonisation, large-scale structural funds and all the rest – essentially a

left/right debate and no-one, on the continent certainly, was under any illusion that the creation of the euro was going to lead in due course to other political, economic and institutional developments. European progress has always taken place in the context of crisis so there is nothing unusual about this situation.

I think that is particularly the case if you recognise that the crisis that we've got in Europe is essentially a concentrated version of the crisis that we have globally. We have enormous problems of global imbalances, fiscal imbalances, trade imbalances; we have a difficult banking crisis, we have a question about the stability of Europe and the global economy.

It is going to be a lot easier to sort out things in a European context, and we may be about to move from a world essentially dominated by a process of globalisation that was benign, that was led by the United States, into a world that is likely to be more regionalised.

In comparing the Eurozone with the global economy, essentially they have the same problems – a banking crisis, a crisis of the sustainability of government debt and trade imbalances. I would say that we are likely to muddle through in some way, there will be muddling through at a global level and there will be a muddling through at a European level. The elements of what needs to happen are pretty clear, but they are clearer at the European level than they are at a global level and I would say that there are essentially three elements to look at. Firstly there has to be an arrangement in which there is a management of the debt, maybe a rescheduling, a 'hair cut' for investors. The whole point of creating the euro, from the point of someone like myself who favours a free-market approach, is that by creating a single currency, by taking away from governments the power to devalue and to print and therefore defraud their creditors, you are making governments the same as any other creditors and that, in my view, is a very positive development. And I would go further and say that what this euro crisis has done in all its brutality and all its chaos has been to expose things that really needed to be exposed – the corruption and inefficiency of the Greek government, the Irish government, a whole range of governments, the illusions that we have had about the way in which a lot of our monetary affairs have been arranged. If this crisis forces a discipline that allows those issues to be confronted, then that in my view is an extremely positive development.

Secondly, we need to sort out the European banking system. Clearly there are far too many banks in Europe; a lot of them are bust. There needs to be a European path for the reserve accounts at banks. The Basel

3 rules have actually had a torpedo put right through the middle of them because the quality of a lot of debt has clearly been shown up as not what it was assumed to be.

The final element is that you will need, in my view, to have some form of European bond issued in the name of Europe. Now at the moment the Germans are saying that they don't want this and I quite understand why. But I am absolutely convinced that the end of this story is going to be that, and I think the real question about the way in which this crisis is likely to develop, is what price the Germans are going to require for having a European issue of some kind and what rules they attach to it.

I think everything depends on whether we get growth or not. That is true in working out the imbalances between the US and China and it's certainly true of sorting out the Eurozone. If we get reasonable growth now, then the muddling through, the management of the crisis is likely. If we don't, then I think a more likely scenario is that you get a much more intense integration of the Eurozone, one that would be hostile potentially to those on the outside or on the periphery, in particular the UK.

The real lesson of this crisis has been to expose the competitive weaknesses of the European economy, and that is only a subset of the competitive weaknesses of the West in general that have been exposed in this crisis, and we have seen an enormous, unprecedented shift of power from West to East. Now you can argue what the true significance of that is, in political terms or economic terms. I think you can argue whether the western social, economical, political model even, of free societies and free economies, is still valid, but this is an enormous shift. But what it does mean is that the case for Europeans hanging together, of a greater degree of unity in Europe, is much stronger now. The rise of Asia, in my view, and the challenge that that constitutes is what is going to ensure that the euro survives.

'Euro Zone' Members Have Failed to Make Their Economies More Flexible

*Extracts from the contribution given by John Peet,
European Editor of The Economist*

There was always a problem with the euro – what do you do about fiscal policy? The German solution to that problem was the Stability Pact. There were two problems with the Stability Pact. One was that nobody ever

believed they were going to find members of the euro area so exceeding the limits on the budget deficit, but the second was that the first country to breach the Stability Pact was Germany, and as soon as Germany and France had breached the Stability Pact – this was under Gerhard Schröder as the Chancellor – the whole thing became utterly implausible. From that moment, 2001–2002, it was quite clear that restrictions on fiscal deficits in the euro area had no credibility. The astonishing thing to me was that the bond markets seemed to take a very long time to wake up to what happened when Germany and France breached the Stability Pact. Immediately that happened the credibility of countries like Greece, Ireland, Portugal, Italy and Spain should have been shot to pieces, and it took an astonishingly long time for the markets to wake up to that. Of course it was the Greek lies about their numbers that really came home to the bond markets and we then had the crisis in May and the bail-out of Greece, followed by what has recently happened with Ireland, but I think that some crisis like this was almost inevitable from the moment that Germany and France breached the Stability Pact.

Why are countries in the euro so vulnerable after ten years? We knew about the problem of Italy and Belgium from the very beginning of this project. It was quite clear that they were the two countries that we should worry most about, but interestingly those two countries, the most vulnerable ones, have been the most careful about their debt position. What we didn't realise and I would have to admit as a journalist I didn't realise, was how terribly the situation could develop because of Greece, Ireland, Portugal and Spain. And in a way, I think they were victims of their own success. I don't think it's fair to say that their problems have been caused by the euro. I would note simply that non-euro countries such as Iceland, Latvia, Romania, Hungary, even to some extent the United Kingdom, have all experienced problems; we've had bubbles and we've had difficulties with the banking system.

But I do think what happened once Greece, Ireland, Portugal and Spain joined the euro is that they became overly complacent about their situation. And that complacency I think took three forms, which they all shared to some extent. The first was, let's not worry about our public finances; forget about it, the Germans and the French have already breached the limits; we don't need to worry about it – that was particularly true for Greece and Portugal, Greece especially because their numbers were totally bogus. The second aspect of complacency: let's have a property boom. We don't mind about property booms. The Americans are having a property boom;

the British are having a property boom. It doesn't really matter about asset prices going up too fast; we'll reap the tax proceeds; it's great – that was the Irish/Spanish problem. And the third aspect of complacency was to forget about the banks. We don't care if the banks are lending a lot of money; we don't care if they are lending money particularly for property, it's their problem. We don't need to control their lending; we don't need to worry about their political links to parties – this was something that I think affected not just Ireland, but also to some extent this country as well.

In each case, I think the euro may have contributed to a small extent, but I think it would be very erroneous to say the euro is responsible. Iceland had a much worse property bubble than Ireland; Britain's property bubble was pretty bad – fortunately we've escaped the worst consequences, largely I think because planning laws in this country prevented people from building too many houses, unlike in Ireland. But I think it would be an oversimplification to say that these countries had this boom because of the euro. They could have done something about it inside the euro, and plenty of countries outside the euro had the problem. However, I do think membership of the euro is making the cure much harder and more painful. Iceland and Britain, as we know, have suffered – both countries are still suffering – but I think a currency devaluation in both cases is helping, so to that extent I think the euro is making life much more difficult for countries like Ireland and Greece. I think they are stuck in the euro. I think to deal with their problems is going to require what you might call an internal devaluation. They are going to have to run primary surpluses to repay debt, and that is going to be challenging and extremely painful. I think Ireland might manage it; I am not so sure about Greece, although I am very impressed by Papaconstantinou. I'd worry rather more about the Iberian countries, and actually, underneath it all, I still worry about the country that we worried about most in the 1990s, which was Italy. So I think there is a big problem about the euro there.

Now some people would say, of course, that Europe is lacking in leadership in tackling this general problem. I would agree with that. Europe is always lacking in leadership; I think it is rather like the US Congress. I think it was one of Norman Lamont's predecessors, Nigel Lawson, who once said that you can divide up public policy initiatives by finance ministries into too little, too late and too much, too late. And I think in the case of the eurozone it's been too little, too late. I'm not sure that I would say that they're all to blame for that. I think there is an inevitability about the structure of the eurozone, but I think that some of the lead-

ers – notably Angela Merkel – have made things worse – the quarrel with Jean-Claude Juncker that we’ve seen this week – the politics in Germany makes life much more difficult for Angela Merkel; she has a constitutional court to deal with; she has the tabloid *Bild* to deal with. She is moving, but she is moving slowly, grimly, and with evident reluctance towards a situation in which Germany helps the rest of the eurozone. I don’t think that adds up in my book to a fiscal union, but it does add up to one in which the Germans do help the rest of the eurozone. I don’t think there is a political will to move towards what you might call a United States of Europe, but I think it is true that the eurozone is quite likely to turn into something that begins to resemble more of a federal union. We will have more intrusiveness from the centre, more help through the ECB. I don’t think we will see a big federal budget because there is no appetite for that, but it will look slightly different from what we’ve got now and I think that does have some implications for this country, because I see in the future a bigger divide between the countries that are in the euro and the countries that are not in the euro. I am not necessarily saying that we should immediately therefore join but I think that we should recognise that that divide will grow in the future.

But my real worry, and in a way this is the main point I want to make, is that all the argument about debt, Eurobonds and dealing with the situation of Greece and Ireland in some ways ignores the real, underlying fault line that was always there in the euro project, and I speak as somebody who was not perhaps as strong a supporter as John Stevens but was maybe more of a supporter of this idea than Norman Lamont. I thought that the idea of European economic and monetary union might bring benefits to the European Union and the members of it. The reason why I thought it might bring benefits to those countries was because I thought that if they were in a single currency they would be ‘forced’ – perhaps it’s a strong word, but it’s a word we like to use in journalism – they would be forced to introduce reforms that would make their economies more flexible, their labour markets more flexible. I subscribed very strongly to the Mundell view of single currencies; there are benefits to be had from a single currency, in that it’s bigger than a single country and that it could apply to the European Union, or to some countries in the European Union, but it will only work if you have more flexible labour markets, more flexible product markets if you reform your economies, and the real problem of the euro area, which I have to admit I got wrong as a correspondent in Brussels in the 1990s, was that that dynamic failed to work. I argued, as many journalists did

in the late 1990s, that this would be a good idea, provided that countries like Italy, Spain, Portugal and Greece treated the European economic and monetary union as a reason why they needed to apply serious reforms to their economies. They needed to make their labour markets more flexible in particular, but not only that, they needed to do general reforms, pensions, services, single market reforms of all sorts, and the real problem with the euro area I think is not the level of debt – although that has become in a way a proxy for the problems in the euro area – but that governments that got into the euro, and I particularly think of the Italian government in this context, treated it as something that *solved* their problems. They thought, we’ve made a big effort, we’ve reduced our deficit, we’ve had a special euro tax; we’ve just about qualified (although they didn’t qualify for the debt criteria), and they’ve let us in, and they thought that was it, no problem, they could now relax. Whereas the argument that I would have made would have been to say, if you get into the euro, that is the beginning of your problems and not the end of your problems. You needed to address much more seriously the competitiveness of your economy, and we’ve seen, since Italy, Spain, Portugal, Ireland, Greece got into the euro, that their unit labour costs against Germany have risen very substantially; their competitive position has deteriorated hugely, and I think that is the biggest problem in the euro. It’s been seen particularly by the continuous current account surpluses in Germany and the Netherlands, and large current account deficits in Spain and elsewhere. And my worry about the current situation is that I think they are not really addressing that.

And my final word is to say, I think echoing what John said, I don’t think the euro is going to collapse, mainly because I think the costs of it collapsing anywhere, and I include Germany and Ireland and other countries in this, outweigh the benefits of leaving, so I think the price of leaving the euro is going to be greater than the price of staying in it, but I do think there are serious problems because of competitiveness.

I Always Thought the ‘Euro’ Would Survive the First Recession

Extracts from the contribution given by the Rt Hon Lord Lamont of Lerwick

My job of course was to keep Britain out of the euro, something I was enthusiastic to do, but I spent a whole year of my life listening to the architects for the euro and the plans for the euro, and the more I listened the more I became convinced that this couldn’t work. The reasons I thought

it couldn't work were, firstly, I didn't believe you could have a common monetary and single interest rate for an area with divergent and different economies. I believed that wouldn't work in an area that was not – we've already had a reference to Robert Mundell – a natural single labour market in an optimal currency area. The fact that it was not a single labour market, to my mind, pointed in the direction of the necessity of fiscal transfers, which was ruled out, and because I felt the logic pointed to fiscal transfers I felt the only way in which this could work ultimately was if it became a full centralised political union; if Europe became something like a government, something like a state, and that was something I was completely opposed to.

What was interesting, as John Peet said, was how from the very beginning the rules were broken. The debt/GDP ratios were completely ignored by countries like Belgium, Italy and Austria. And of course the moment the single currency came into existence, another interesting divergence happened – the diversion of inflation rates. Interestingly, in order to qualify for the single currency, you had to have an interest rate that was within a given percentage of the central average rate of inflation of the whole EU, but the moment the currency was established, those convergence divisions broke apart and inflation rates became more and more diverse, which actually has helped to create the problem of competitiveness of the southern countries to which John Peet referred.

I very much agree with what John Peet said, that it would be wrong to say that it was the euro entirely that was the cause of the problems of countries like Ireland or Spain. The banking crisis, as he said, affected Iceland and affected us as well. But I think the common interest rate did play a part in exacerbating the boom, probably in Ireland and Spain, and I think another interest rate problem was the convergence of interest rates in the bond market. Because there was a no-bailout rule – during the negotiations, the Germans – who were terrified that they would have to bail out the Italians – wrote in a no-bailout rule, and because of that countries like Italy, like Greece, like Ireland, had a bit of a free ride. The markets failed to discriminate between the bonds of one country and the bonds of another and this, I think, exacerbated the boom in some countries, and I think one of the things that has to happen and hopefully will happen in future, is that the bond markets will actually work and discriminate between different countries.

I think in many ways the crisis that we have had in the euro – and I was rather interested in John Stevens saying that it had all been really planned in advance; the idea was to force further development – well, people didn't

really tell us very much about these further developments that were going to happen. I noticed Peter Sullivan wrote an article in the FT not so long ago saying everyone had expected the crisis in the euro zone. Well, I didn't hear very much about that during the Maastricht negotiations or during the time when so much abuse was hurled at people who were rather sceptical and hesitant about joining the euro.

But I believe there is a long term problem that is there and which I think is going to be very severe. In one sense, we ain't seen nothing yet! This was the point that John Peet referred to, that countries like Italy, Spain, Greece have seen their unit costs viz-a-viz Germany rise by amounts up to 30%, in some cases 20%. They are becoming more and more uncompetitive, and in the absence of an exchange rate adjustment they face decades of very low growth and rising unemployment and I think that will put great pressure on the euro and on those countries' membership of the euro in years to come.

The anomaly of the euro is that it is a currency without a country, and I have been interested to read in newspapers like the Financial Times the criticism being made of Germany, identical to the criticism that they make of China, that the government promotes growth too much through the mechanism of exports and does not encourage domestic demand, and papers like the FT rail against the German and Chinese governments for not encouraging domestic demand in the interests of stimulating other countries. I am a little bit sceptical about this argument; I am not sure I'd pay a lot of attention to it if I was in the German government, but it does illustrate – you can't possibly really expect the German government that is elected to look after the interests of Germany, to alter its policies in ways to make it easier for Italy and Spain to become more competitive. They are just not going to do that in the absence of a European government or, what the French have always desired in the euro, a European economic government. So I think those very arguments, the railing against Germany for not expanding domestic demand, shows the weakness of the idea of a currency without a government.

What is going to happen now? Well, I obviously don't know, but there is a real risk of contagion spreading, spreading possibly to Spain. If it does reach Spain I think this will be a very real crisis for the euro indeed. I don't think it is certain that Germany will bail Spain out; one sees many figures quoted, some of them as high as €400 billion for bailing Spain out (I have no idea whether these are right or wrong), but I sense the change of opinion in Germany; I sense the reluctance of the German government

to bail Spain out, but what I would guess would happen is that the euro will be partially rescued by the IMF. There would be a rescue partly from the EU and the members of the eurozone and then there would be an IMF rescue of the euro as well, to which – wait for it – Britain will have to contribute as well (I'm sure that we are all overjoyed at that!) but we will be paying our part in that too.

I agree with what John Stevens said, that there will have to be haircuts for bond holders, both of banks and of governments; I think there will be a rescheduling of debts of some countries, particularly Greece. I think the eurozone has little option but to move, if it wants to preserve the euro in the long run, towards a fiscal and political union. I don't think it's going to be just enough to say we want everybody to submit their annual budgets to the Council of Ministers before they are approved by their national parliaments, and we want to have peer pressure on fiscal deficits – that will never work because it's rather like having a jury made up of the criminals, everybody is judging everybody else. It will simply not work within the EU, and I think that if they want to make it work they will have to move towards something like a carbon tax that is used for eurozone purposes. Helmut Kohl was always crystal clear about that. He famously once remarked, you can't have political union without monetary union, and vice versa.

That was what it was all about but I don't think there is now the political will (I would never have wanted to be part of it) in Europe to create that political union. What I think will happen is that you will see loads of tax payers' money chucked at it. Spain and other countries will be bailed out because it is a project in which so much political capital has been invested by the political elite in Europe; regardless of public opinion, they will carry on with it and they will get through this crisis. I agree with that. I always thought the euro would not break up in the early stages but history shows us that currency unions between states have often lasted twenty years or so and then broken up, and I have always thought that the euro will survive the first recession but the second recession, with the problem of Italian and Spanish competitiveness in the long run, that is a different problem and the strains and the crisis will come back and hit them again at a later date.

ECONOMIES ON THE MEND

Damon de Laszlo

Exciting things have happened since the beginning of November. President Obama has managed to get the Bush personal tax cuts extended for another year and has introduced 100% Capital allowances to encourage American industry to invest. He has also signalled a change of heart and started to engage with business, which he now regards as 'a good thing' rather than 'a bad thing'!

The economic numbers now clearly demonstrate that the American public is paying down mortgages and, where they are re-financing their mortgages for lower interest rates, the surplus appears to be being used to pay down debt rather than spent on consumer products. House prices are declining which will enable the market to clear slowly, but there is still a fundamental surplus of housing and shopping malls left over from the building boom. Corporate profits continue to rise along with corporate productivity, which will now be enhanced with a growth in capital expenditure. One can also expect to see a slow improvement in employment.

The good news is tempered by increased inflation, a global problem, as the surplus cash sloshing around the world drives up commodity prices which are further driven by ever-increasing Chinese demand. It is beginning to dawn on the consultants and large swathes of the investment community that interest rates are more likely to rise than fall. The Fed's QE2, along with the US government deficit, is also causing the conventional wisdom of the last five years to be challenged. Meaning that, in general, investors are beginning to be less certain that Bonds are a safe haven. The switch of the popular trend out of equities into Bonds will, as it reverses, have a major upward impact on the equity markets. The equity markets will further benefit from the trend that is now developing from the re-industrialisation of the US where import substitution is growing and the return of production from Asia to the US is playing out. Companies like General Electric and Caterpillar are building new plants to take advantage of improved productivity and avoid the trend in increasing freight costs around the world. This will add impetus to the improving US/China balance of trade.

While the US government deficit is nothing other than frightening, it is likely to be ameliorated by increased corporate revenues and possibly an increase in tax revenue as individuals pay down debt and reduce their interest deductions.

The UK is starting to address with a vengeance its government deficit and it is clear that government action is speeding up, with the consequence that the first quarter of 2011 will be a painful but necessary adjustment with rising unemployment, business bankruptcies and falling house prices.

Against this, companies, excluding the building sector, that went into the recession well funded will be able to take advantage of the growth in Northern Europe and North and South America. They will also be facing less competition from Asia, and China in particular; the same trends that are appearing in the US also apply to the UK. The borrowing binge that was poured into wasteful consumption is going to take time to re-pay but it will nevertheless gradually pan out.

The more difficult problem for Europe is sorting out the sovereign debt crisis and the inter-European banking chaos. Beautifully highlighted in the *Financial Times* of 2nd December by a chart (see below) showing exposure. Incredible numbers appear as it is revealed that banks are holding masses of safe but now toxic sovereign debt in other EU countries. It is almost impossible to see a way for this to be unravelled without resort to rescheduling. Perhaps the ECB by being given the political support to embark on a system such as the US adopted with Brady Bonds.

China, the country most responsible for the lack of inflation in the west as it poured low cost manufactured goods into the western economies, is reversing trends. The 12th Chinese Government 5-Year plan, 2011–2015, aims at increasing domestic demand in both goods and services to sustain its

Countries' Banks Cross-border Exposure, end June 2010 – \$billion

	<i>French banks</i>	<i>German banks</i>	<i>Greek banks</i>	<i>Irish banks</i>	<i>Italian banks</i>	<i>Portugese banks</i>	<i>Spanish banks</i>	<i>UK banks</i>
France		196.8	1.9	18.1	31.6	8.2	26.3	257.1
Germany	255.0		5.7	32.1	254.4	3.9	39.1	172.2
Greece	53.5	36.8		7.8	5.3	10.0	0.9	12.0
Ireland	50.1	138.6	0.5		15.3	19.4	14.0	148.5
Italy	418.9	153.7	0.5	40.9		3.4	32.6	66.8
Portugal	41.9	37.2	0.1	5.1	4.7		78.3	22.4
Spain	162.4	181.6	0.7	25.3	25.6	23.1		110.8
UK	327.7	462.1	19.7	209.0	44.0	7.7	386.4	

Source: *Financial Times*, December 2nd 2010

country's growth. The switch from export-led growth to internal consumption will have a major impact on western prices. The belief that inflation is dead will be horribly shattered, along with the complacency of a lot of western Central Bank thinking that seems to be predominantly based on economic models. If a few of the Members of the Monetary Policy Committee of the Bank of England actually went shopping, they would discover that prices are rising, and might realise that their explanations that inflation is due to exceptional circumstances were hollow.

In the UK in particular, there is a shortage of industrial capacity and skilled labour, and government policy of increasing the tax on capital expenditure is not going to help this situation improve. Interestingly a policy diametrically opposite to US government policy.

In general, the financial bubble that caused the distortion of the last five years has burst and most of the western economies are on the mend. The hang-over after the binge is hurting but things will begin to improve. There is still possibly six months more of pain to be endured but by the end of 2011 things will look a great deal better than they did this time last year.

THE DEBT, THE DEFICIT AND THE FUTURE OF THE PUBLIC SECTOR

Extracts from a talk given by Mark Littlewood, Director General of the Institute of Economic Affairs, to members of the Economic Research Council on Tuesday 13th July 2010

I want to sketch out a little of my thoughts about the state of the public finances, the public sector, and crucially, because this is really my job, I am not an academic, I am a chief executive, to sketch out what I think the free marketeers need to do, not just to solve the immediate economic and financial crisis but to try and change the terms of public and political discourse about the market, and I will say a little bit about how we got ourselves to the position we are in and have trapped ourselves by, not merely to avert a catastrophe now but to construct an economy and an economic model that is fit for future generations. And within that I am

going to say something specifically about what I want the Institute of Economic Affairs to bring to the table.

The history of government debt is a long one; before the 1600s it was customary for governments to fund their wars, just wars, by raising taxes. By the end of the 17th century, the Nine Years War, the English government was in a pretty terrible financial state and was forced to borrow £1.2 million from the newly-created Bank of England at an interest rate of 8%, and debt financing on government spending was born and is never going to go away. The present system of modern sovereign debt really takes its shape from that time. So by 1700 the English government was £12 million in debt but this figure rose dramatically after the Napoleonic Wars to £850 million by 1815. The First World War unsurprisingly sees another incredible increase in debt financing on behalf of the British government; the government borrows heavily; sovereign debt skyrockets to almost £7 billion in five years from just £650 million. World War II arrived; we had already amassed a pretty big debt by then but by 1946 the debt had ballooned to £24.7 billion, 250% of GDP in roundabout terms. After the war the debt did decline rapidly as a proportion of GDP but largely thanks to high rates of inflation running right through to the 1970s. So in the 1970s it falls down to £31 billion but the problem has been with us and is growing.

I think one of the staggering things to note about the situation we are in now, and I say this without wanting in any way to disparage the efforts being made by British troops in Iraq or Afghanistan, is that historically catastrophic debt situations have been born of the country being at all-out war of some description, that the very future of the nation has been at stake. Not surprising to find in 1918-1919 the state of the UK's public finances being in a disastrous state, nor indeed in 1946 but the crisis we find ourselves in 2010 is almost a flippant crisis.

When the Labour Party was elected to office in 1997 the proportion of government spend to GDP was about 38%. When they left office thirteen years later the proportion was 52%. The approximate estimates of the total proportion of GDP spent by the Union of Soviet Socialist Republics stand at 62%. Ten more years at that rate of debt growth and we would have been almost literally at Soviet levels for spending. So we have got a debt problem and a deficit problem. By the end of last year, even on the most modest estimates, I would say the national debt was £950 billion. If you start factoring in liabilities like public sector pensions, the debt is enormously higher.

So what are the present government intending to do about it? There is a recognition of sorts that there is a crisis and I think that's a refreshing change from a year or two ago. The government is at least giving the correct rhetoric; it's talking in the right terms about the need to get public spending under control. But that rhetoric has yet to be backed up by the sort of policies that we need to see because each day this year we will be adding £300 million or so to the debt – incredibly costly to maintain; the debt payments by 2013 could go as high as about £60 billion and I would say this is – not an unsustainable position but a chillingly expensive one. By the end of last month every man, woman and child living in the UK had a share of the debt totalling £14,668 a person, or if you are only looking at those in employment £31,701 a person.

So, let's have a look at the approach of the Chancellor of the Exchequer, George Osborne, and his able deputy, Danny Alexander. What do I make of it? I would say that the Coalition is to some degree pointing in the right direction. But it doesn't end the policy of borrow-and-spend. And of course this has been mixed in with tax rises. This is a government that still sees raising money by borrowing and by taxation over and beyond the last Labour government, as a necessity.

However, I don't think a 'needs must' argument is going to be sufficient for free marketeers in the long run. I don't think we should be cutting public spending just out of necessity and I think there is a real problem, a real dilemma in the argument for us here, because I think majority mainstream opinion is that we should be cutting these things, not because they are bad, not because the public sector can't deliver them well, but because we can't deliver them any more. That mustn't be the key reason for cutting back public sector funding. We need to make a much stronger argument that it's not merely a matter of not being able to afford them and requiring emergency surgery but, even if we could afford a number of these things, it would be a rational approach to not want them delivered by the public sector, to want them delivered from the private sector. So I think arguments from necessity – we can't have it any more, I'm sorry we are going to have to let you go – will only work for so long. They may actually patch up the public finances over the next two or three years, but they will not over the long run put the free market in a particularly strong stead or standing, and I think we need to make the moral case for the market, not just the immediate surgery case for the public finances.

In making the moral case for the market there are two particular areas that I wanted to focus on: the National Health Service, and the Welfare

State. These are the two areas that the government has ring-fenced – the ‘sacred cow issues’.

I have no doubt in saying that the reason that the National Health Service budget has been ring-fenced while serious cuts are being asked for elsewhere, is the perceived public relations needs of the British Conservative Party rather than the economic merits or demerits of providing health care through that particular mechanism. I think that what we will see as real cuts happen in other government department areas is, oddly, rather than over the long term protecting the national health service, they will find they actually bring them under the microscope. If very big cuts of up to perhaps 40% are happening in Department X or Department Y, but not in the National Health Service, that will bring the question of health provision in the United Kingdom under intense scrutiny, and I think that we need to prepare ourselves now for arguing that the National Health Service – far from being one of the greatest inventions of the 20th century according to the present Conservative British Prime Minister – is actually one of the most wasteful, ludicrous and appalling ways of delivering health care to the wider population of any modern western democracy.

I think we need to look very, very swiftly at alternative models of health provision and the one that I would like to commend to you in particular is the Singapore system. I won't go into all the details but perhaps you can invite me back in a couple of years' time and I can go into all the details of it when I think this will be a live issue. In essence it is based around a system of personal health savings accounts, not an insurance-based system which does have substantial problems. It is compulsory; it is not a pure libertarian system. You as a particular patient or customer have access to that pot of money and you decide entirely yourself where you access your treatment from, and the treatment you access is then deducted from that account. So the sort of choices which are then exercised by individual patients or consumers become rational ones. To give you an example, I suffered a year ago from a minor knee injury; it wasn't particularly painful and, given that I had already ruled out any prospect of being selected for the England World Cup squad, I wasn't in a hurry get it fixed. But if I was an athlete or somebody who relies on that or who relies on walking around or running around, I would have prioritised and been willing to have spent out of my own personal health savings account a substantial amount of money to get the job not just done fast but well. As it is, as somebody who relies principally on his brain and his voice I realised it wouldn't something I needed to be worried about. But the National Health

Service doesn't distinguish. They treat somebody who uses their leg exactly the same way as somebody who uses their arm. You have got to make those decisions at an individualised level.

The advantage it has over an insurance-based system, and one of the arguments I think we need to break open is this preposterous idea that the only way you can provide health care in the western world is either the NHS or the American system. One of the problems with insurance-based systems is that they are not good at keeping down costs. To paraphrase the problem, you have a fight with your insurer about whether you are covered for this particular injury or whether you had had one glass of wine too many when you were going down the ski slope and broke your leg, you get in a fierce battle with them. If you win that battle you then have very limited incentives to look for anything other than copper-bottomed top-rate treatment.

I want next to say something about the welfare state which is one of the largest areas of government expenditure. There is downward pressure on it, that there are some proposals for reform on it; I think some of the Iain Duncan-Smith's reports on that are quite interesting. But we have to find an argument on the welfare state which draws I think to attention the extent to which the expenditure is out of control and does not relieve poverty.

A statistic that I am using again and again and again, is that one-third of households in the United Kingdom are reliant on state handouts for more than 50% of their income. You cannot, even if you believe in generous state provision of benefits, believe that that is anything other than a system that has gone totally out of control. It is certainly not a system that specifically targets the poor. Two million people, in roundabout terms, are on incapacity benefit – yes, the coalition has decided that they want to take a harder look at this. These numbers are utterly implausible. We are getting towards 10% of the working population, who are apparently so ill or disabled that they cannot even enter the work force. I think we need to bring those large global numbers to public attention, not focusing just on issues such as particular stories about an individual single mother who has been irresponsible on a particular housing estate. This cannot possibly be government expenditure which is targeted at the genuinely needy. It has become hand-outs for vast tranches of the population who we could reasonably expect to stand on their own two feet.

So, what does this situation mean for people who are sympathetic to free market solutions? It means that there is a public acceptance that things cannot go on like they have been; which creates a fertile environment for new and radical ideas.

I want to say something now about the tactics that we at the IEA will be deploying and I commend these to other free market groups. Firstly, I think it is very important that a good chunk of the free market movement remains as outsiders, not lobbyists. It's not our intention to try and change or twist a particular government policy in a particular direction. If you want to be a policy adviser, try and become a special adviser in the government for specific policy prescriptions. That doesn't mean we shouldn't have specific prescriptions, but we should not be bending our agenda to what is immediately feasible over the next week or two.

Secondly, we need to understand the difference between influence and access. I think that we can focus on our influence via the public debate, not by actually sitting across the table with George Osborne or his advisers on a day-to-day basis, and we shouldn't trim or tack in order to try and get round that table.

What's the IEA going to do? Damon I think was generous in his opening remarks that people had felt perhaps that the IEA had drifted for some period of time and didn't have quite the impact that it had previously. I would say in defence of the IEA over the last five or ten years is that it's been damned difficult for free market institutes to thrive in thirteen years of Labour government, but nevertheless there are probably things that we can and should do better.

But I want to start with the Institute of Economic Affairs strengths because, when I came in and started this job six months ago, I was asked to look at everything and come back with a plan. The quality of our research material and publications is first-rate and we therefore have an established reputation – and I think a deserved one – for intellectual and academic rigour and for quality research work that stands the test of time, that you can look back upon five, ten, fifteen years hence and will still have relevance.

And another advantage, (it might sound like a trivial one but I don't think it is) is that everybody I noticed very quickly had heard of the IEA and knew what it was, and they knew what the Institute of Economic Affairs was, and they knew that it was a free market organisation. But, one or two people said to me, oh are they still going? Is the IEA still about? What's it doing? So the weakness that the Institute had and, with one or two noble exceptions – the Taxpayers' Alliance actually showed the way here – the weakness that we had was our profile. We were spending a lot of time producing research which we were sharing amongst ourselves and were discussing with ourselves, but were not actually getting into the wider public debate.

So one of the first things that I want to correct at the IEA is our media outreach programme. I think that if you are serious about spreading free market messages, you need to understand that by far and away the most influential medium in the UK is television; there are no two ways around it, that is the way to get a message to vast numbers of people. I don't totally discount newspapers; I think there is value there as well, but the mass media and in particular television are crucial.

So we have set up a new communications team at the IEA – I say team rather grandly; it takes up about 30 or 40% of my time and two new staff devoted on it – whose principal work is going to be framing our arguments for the year. Not new research, not new policies; taking the policies we've already got and packaging them in a way to get on to television. And that has already yielded results. Roughly speaking, the IEA is on the national airways about eight to ten times more often than it was two years ago.

Secondly, we are going to make greater play of our online presence, which is going through the roof now. Our website gets about a million hits a month; the number of downloads of publications and monographs is very high; in the month of June alone, Hayek's Road to Serfdom was downloaded 25,000 times off the IEA's website, a particular spike because it was heavily trailed in a US show, but it was a huge number, but over a year we get about 180,000 publications downloaded from the IEA's website. This dwarfs our actual paper production of any of the stuff we print or produce, whatever the ebbs and flows of particular coverage of particular publications.

And I think, while I want to congratulate and compliment their work in this area, the IEA needs to invest a heck of a lot more in the next generation – people who are presently 18, 19, 20, at university or about to go to university, or just at the start of their careers, because – I don't believe that the debate is lost among my generation in their late 30s or early 40s but we've got to pick the leaders of tomorrow, and to that end we have appointed a full-time Education Director, who is going to start in September, who will be tasked exclusively with getting the message onto university campuses, both aimed at academics and undergraduates, and into sixth forms.

So I think we need to be direct on message but we also need to get our language right. It's important that free marketeers aren't seen just as defenders of the rich or a vested interest; that we are not unsympathetic to the weak or the dispossessed. And I think one thing that we haven't yet done as a movement, and probably the IEA in particular, is to seize the

opportunity provided by the general sense of political disillusionment that exists in the United Kingdom. People don't trust politicians any more; they don't trust governments any more; they don't trust the political classes. But we have as yet failed to convert scepticism about the state and the people who operate the state, into a paradigm-shift of believing that things should be done in a completely different fashion, i.e. politicians and bureaucrats shouldn't be in charge of it, and I think we need to do more to tap into that disillusionment and be a bit more of an anti-establishment movement in the years to come.

LOSING CONTROL – THE EMERGING THREATS TO WESTERN PROSPERITY

By Stephen D. King Pub. Yale University Press 2010 h/b £21 p/b £9.50

Over the title on the cover of this book is a comment by Martin Wolf, Chief Economics Commentator of *The Financial Times* which reads, rather like those clips on theatre billboards, 'Intellectually stimulating and excellently written'. Your reviewer felt keen to find out just what Martin Wolf could have meant by this somewhat enigmatic compliment.

The book is indeed 'recommended reading', full of vital information, pithy observations, useful insight and all within a coherent structure – leading to (fairly) clear conclusions. The book's title honestly describes the content. We begin by rubbishing the classical economic competition model and learn that instead, the 'secrets of Western Success' have been guilds, monopolies, restrictive practices backed by militarism which thus derived wealth by exploiting the rest of the world. Now, however, threats to these profitable activities are arising from 'anarchy in international Capital Markets', new pressures on the world's natural resources, the rise (or maybe return) of Chinese economic (and maybe military) power, and the enfeeblement of the West through adverse demographic change. But all is not lost. Stronger or new institutions can be developed to manage currency fluctuations, regional trading blocks can help keep work in the West and stronger international institutions generally can lead to prosperity for most (if not all) of us. In particular, the euro and the EU trading block development are showing the world the way forward. America cannot go

on much longer 'living beyond its means' by printing reserve currency and borrowing from poor nations, Japan displays the results of excessive outsourcing and the information revolution is undermining the West's knowledge lead. Economic 'realpolitics' indeed.

King is the HSBC's Group Chief Economist and the bank's head of economics and asset allocation research and so it is no surprise that his account of international monetary developments and the underlying processes leading up the financial crisis in 2007 are, for anyone still confused (or bemused) by these events, both excellent and layman comprehensible. He concludes: 'Monetary sovereignty is a myth. Whether through currency pegs, carry trades, unexpected price shocks or any one of a number of other examples, central banks are, individually, not as powerful as they'd like to believe. The gravitational pull being exercised by the emerging markets should change for ever the cosy Western attitudes towards monetary policy. No longer are developed world central banks in control.'

This reminds one of the (reported) conversation in 1976 between a British Treasury Minister and a financial journalist. The journalist asked 'What will happen if Saudi Arabia decides to take its billions of pounds out of London?' to which the Minister replied 'Oh, I don't think the Bank of England could allow that' (!) The point is that one must beware of accepting King's confident assertions at face value. 'Sovereignty' is not the same as 'control'.

Amongst the many good points raised it is disappointing to find simple logical lapses. King states 'Markets cannot easily resolve the key issues – economic instability, income inequality ...' (p. 217) and goes on to advocate increased public policy roles without noting either the more subtle Hayekian defences of market mechanisms or appreciating that state intervention creates unwanted unintended consequences. Speaking about exchange rate changes he contends that this market mechanism fails to solve global imbalances. As evidence he comments (p. 78) that the persistent increases in the value of the Yen has failed to diminish Japan's current account surplus. He omits to speculate what kind of carnage Japan might have done to American (and other countries') industry had the Yen-dollar exchange rate remained at its level of 40 years ago. Such an ultra cheap Yen would have resulted in protectionism, union hatred of unfair competition, unimaginable levels of American unemployment and maybe even calls for war.

Scorn for markets leads King to comment (p. 76) 'No one argues that the increase in drug usage that follows a fall in the street price of crack cocaine is a good thing, even though it's a perfectly reasonable example

of the market at work'. Nonsense, it is merely evidence of a downward sloping demand curve for crack cocaine – a demand curve which exists whether or not a market is able to operate.

Returning to Japan, King comments (p. 241) 'Japan's experience suggests that outsourcing and off-shoring can lead to domestic economic stagnation'. This is woolly headed – there are other more convincing reasons why Japanese money national income has stagnated, such as the fall in working age population, Japanese successful companies' ability to excessively retain earnings rather than put purchasing power into the hands of employees and shareholders, or the deterioration in the international terms of trade for a country dependent on manufactures for export, not to mention the collapse of asset values which some economists argue lead to a 'balance sheet recession'.

This reviewer was unimpressed by the many vague exaggerations that bully the narrative along. We are told 'Globalisation is not one-way traffic. Over the centuries, there have been many reversals and many shifts in economic and political tectonic plates. Markets work because nations allow them to: nations can just as easily stop them working if they wish to.' (p. 244) This, along with broad brush alarmism about economic nationalism, ethnic rivalry, demographic aging, war and the great threat from China just leaves one feeling that this is journalism rather than analysis.

But at a more intuitive level there seems an echo of a familiar debate – the debate between the ideas of J. K. Gallbraith and the ideas of F. A. Hayek – the feeling that if it is possible to condense the history of economic thought into two camps, the French and the British, then this book is the French spirit written for the whole world. From the days of Jean Baptist Colbert, economics minister for the Ancient Regime, the French have opted for government leadership rather than market-led developments. We saw this clearly in French 1945–1960s 'Indicative Planning' and we see it writ large in the activities of the European Union institutions. British open seas traditions in the spirit of Adam Smith's *Moral Sentiments* as the foundation of *The Wealth of Nations*, is a very different 'take' on our world. From the latter point of view one simply despairs at King's enthusiasm for the euro and approval for the EU's interventionism.

Which brings us back to the cover of the book. Asked for a comment on the Chief Economist's book, Martin Wolf must have been in quite a quandary – but did his best to say something nice.

J. B.

GLOBALISATION FRACTURES – HOW MAJOR NATIONS’ INTERESTS ARE NOW IN CONFLICT

By Charles Dumas, Profile Books 2010 p/b £15.00

This is going to be a short review, a simple recommendation or something closer to an instruction, because this is the set of perceptions and information that gives one a coherent and convincing understanding of the problems of each of the world’s major economies and of how the impact of each on the whole explains our current dilemmas. The charts are straightforward, the graphs well chosen and clear and their interpretation easy to follow. Economic concepts and complex theories pass by in language that both fully employs them yet present a text any intelligent layman can follow. The very best in applied economics and the very best in accessible presentation.

Take just one sample – the chapter on Japan. It is easy to say that in Japan savings are too high and that therefore the government there should run large deficits to maintain full employment demand. That is what you get in the ‘Gee-whiz, we know it all, fashionable best sellers’. Dumas however, goes to pains to show that Japanese household savings rates have in fact collapsed – from perhaps some 25% thirty or forty years ago, to close to zero today. It is business savings that are huge and which are either not particularly well invested or simply hoarded - often overseas. It is almost beyond the ability of the Japanese government to run deficits large enough and endlessly enough to offset this and there is little to be gained by asking households to spend more.

The author is nothing if not realistic. Early chapters are headed ‘The Roots of the Crisis’ and ‘The Fundamental Shock’, then we go through each country with chapters such as ‘China’s surge and relapse’, ‘US Growth held back, heading into deflation’ and ‘The Euro-catastrophe’. We end with the intellectually satisfying, but politically pessimistic chapter headed ‘What should be done and probably won’t be’.

Don’t even hesitate. This is the book to read.

J. B.

YES MINISTER – IN ROMAN TIMES

‘These people’, Cicero complained to me one morning, ‘are a warning of what happens to any state which has a permanent staff of officials. They begin as our servants and end up imagining themselves our masters!’

From ‘Imperium’ by Robert Harris

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.

