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Debt wish

"The duration of the slump may be much more prolonged than most people are expecting and much will be changed both in our ideas and in our methods before we emerge. Not, of course, the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least sub-normal prosperity, which may be expected to succeed the acute phase."

- John Maynard Keynes, writing in 1931, and cited by former BoE Monetary Policy Committee member Danny Blanchflower at a recent investment conference.

"The government borrowed £163.4 billion in the past financial year, the worst level of borrowing in Britain's peacetime history.."

- Financial Times article of 22nd April 2010.

Or, as Rogoff and Reinhart put it, financial crises are **long-drawn-out affairs** and their aftermath, unlike that from a volcanic ash cloud, tends to linger dangerously, for years rather than months. Pimco have made similar observations about the likely medium term impact on the western economies with their ongoing reference to a "new normal" that is likely to display distinctly sub-par growth and the dead hand of increased government intervention. Facing significant but as yet intangible crisis, human nature is not helpful. We can only stand so much grief, and then sunny optimism kicks in, whatever the objective reality. Another problem is the mob-like status of modern communications. The Internet has given a voice to millions with nothing to say. Finding meaningful and relevant (investible) signals within the relentless barrage of cretinous noise is an ever-growing challenge.

This would seem to be the case as regards the building sovereign debt crisis, something to which the IMF refers, in its deceptively bland way, when it describes how economic activity is "subject to downside risks, as fiscal fragilities have come to the fore". Translated into usable English, this probably equates to "the economy could easily contract since most governments are bankrupt". And some more bankrupt than others. The human tendency to be glass-half-fullish is most obvious in relation to Greek debt markets, oscillating as they have been between periods of temporary if baffling calm (new emergency funds will expand, not ameliorate, the country's current indebtedness) and nightmarish volatility.

In most walks of life there is a part to be played by optimism. Not so in matters of finance. This has not stopped the usual interest groups from denying reality amidst the Greek crisis. "We must dare, otherwise we will be led like lambs to the slaughter," commented the head of the

Communist Party of Greece. "Working people aren't about to be used to allow passage of policies that will bring the worst barbarity we've seen in the past 35 years." Well, be careful what you vote for – you just might get it. Greece already has. Anticipating harsher times ahead, Greek union members blockaded entry to the port of Piraeus last week, while others picketed hotels in the city centre. Enter the IMF, an organisation long associated with implementing painful reforms that incumbent governments are unable or unwilling to impose on their own citizenry. Impossible Mission Force might be a better way of describing the gulf between inevitable action required and public hostility to any loss in economic privileges.

We face a growing lack of accountability in both the private and the political sphere. (Facing an inquiry into an allegedly fraudulent fund ? Easy: just dump all responsibility onto one relatively junior member of staff, have management retreat to the presumed safety of "the brand", and leave him to face the music essentially alone.) Meanwhile the one source of wealth that is both too big and too diffuse to speak clearly in its own defence, namely the taxpayer, is being assailed from all sides. Take the airlines, predictably seeking compensation for lost revenues as a result of the Icelandic volcano. "Governments can pay." If they used the word "taxpayers", more people might notice. Even the biggest turkey only has so many feathers. The remedy, were executives and voters alike willing to behave like grown-ups, would be to return to the sort of managerial culture cited in the Hopper brothers' magisterial study of the American economic golden age, 'The Puritan Gift'. Such a return would largely banish consultants and supposed experts from the body politic and corporate, and reintroduce the iron concept of personal responsibility. The Hopper brothers' Principle Seven for good corporate practice states unequivocally: one man, one boss. No sheltering amongst multiple co-heads and amongst collective (lack of) responsibility.

Ahead of a UK election, one can only bemoan the adolescent level of current political debate – as we have indicated before, on both sides of the Atlantic. In the Aristotelian model, hypothesis is met with antithesis which begets synthesis. In the modern British political model, three parties tear strips off each other with no hope of establishing common ground to try and resolve grave and increasingly intractable financial problems. What is it about the phrase 'national crisis' that isn't getting traction in Westminster ? If it ever was, politics is now not the solution but the biggest risk to nascent recovery. An electorate childishly pursuing self-interest is, in turn, being courted with unachievable fancies and outright lies. The example of Greece today, its debts lately downgraded again, shows how politicians can defer difficult choices for very long periods but that economic fundamentals will assert themselves eventually. Lombard Street Research ("Sharpening the axe") have pointed out that the public spending cuts to come in the UK will be historically exceptional:

"With inflation subdued [for the time being] and real growth anaemic, tax at the threshold where higher rates diminish revenues, a £163 billion budget deficit this year, above 11% of nominal GDP, cannot otherwise be reduced.. [Other than in the aftermath of wars] one must go back to the 'Geddes Axe' in 1921-22 and its sequel, the 'May Report' in 1931 to find when public spending was seriously (some would say savagely) cut in peace time..

"***The three notable occasions when the axe was wielded, Geddes, May and IMF, were associated with coalition governments."*** [Emphasis ours.]

Lombard Street identify six aspects of the 'Geddes Axe' that helped to rebalance the public finances after the First World War:

1) Support from the top: the Committee was established and supported by the Prime Minister and the Chancellor;

2) Professionalism: the Committee was chaired by the foremost manager of the day and included other leading business managers;
3) Independence: the Committee members were politically non-aligned;
4) Speed of operation: the Committee worked quickly;
5) Public support: its proposals had the support of a large number of taxpayer voters – but, predictably, were condemned by the left;
6) Compromise: when the Committee's proposals proved politically unpalatable, Cabinet exercised political judgment and protected the implementation of less problematic elements.

So far, we have three political parties who have given no definitive or realistic guidance as to where the necessary public spending cuts will fall. Indeed, the incumbent administration, despite the embattled national finances, entered the election campaign pledging to ***expand*** personal healthcare provision. All major parties are competing to clobber the banks, and a confused electorate is being encouraged to become, or already has become, increasingly anti-business. Meanwhile our national indebtedness, in peacetime, has never been larger. And as Greece will testify, we are not exactly alone. Among post-election outcomes that now seem not just likely but almost inevitable: heightened social unrest; the prospect of currency flight; the prospect of a Gilt market buyers' strike. Somewhat ominously, the UK's most recent IMF rescue occurred when capital controls were still in place.

Mission Impossible, indeed.

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