

## Reasons not to be Cheerful : 4

*By Jim Steel*

### **The Credit Crunch and Gordon Brown**

Since 2001 this writer has produced a series of articles predicting a painful outcome to the continuing build up of public and personal debt. As we all now know, this has arrived and on a scale that has proved truly horrifying. What is amazing is that virtually all those in authority in government, regulators and banks could have been so ill informed as not to see it coming. Now that the Credit Crunch is here, it is possible to obtain a good idea of what had actually gone wrong and identify who were the main culprits were.

So far as Britain is concerned, Gordon Brown must carry a large part of the responsibility for the mess. His stewardship of the economy has been continually praised by his supporters. Sadly an examination of his record would lead any partial observer to a different conclusion. This is not to say that his opponents in the other parties deserve credit; they do not. Their lack of identifying the main dangers and voicing them strongly gives them little right to criticise. That is not to absolve the Government of its responsibilities; after all they were the party in power.

My criticism of Gordon Brown is that on many occasions he has inferred how well he has been running the economy and more recently the country and yet the facts do not support his claims. To support my view, I will outline my understanding of his many mistakes and why this country will be paying a large price for them for many years to come.

One of his earlier actions was to abolish the tax credit relief on dividends on pension schemes. The effect of this change was to transfer billions of additional tax proceeds to the exchequer and pass the resulting and additional tax burden on to private companies. He was warned what the outcome would be, but proceeded nevertheless. Up till that time most company pensions were salary related, with employees contributing around 5% of salary and employers contributing around 10% to 14%. Private companies were not prepared to face such a hit on their balance sheets and they began progressively abandoning salaried related pensions in favour of the much less attractive money purchase schemes for employees and in doing so they reduced their contributions to more like 5%. So, at a stroke the country with the best pension provision for its workers had it weakened and inflicted with a change that has led to a situation where now salaried related pensions are almost only for public sector employees. It is ironic that the wealth creating part of the economy is now being called to further subsidise the far more generous public sector pensions. However, it has to be said that with the recent financial crisis there may have been pressure to reduce private sector pension benefits anyway but, clearly in all common decency and fairness, if necessary, this should have been carried out in line with commensurate adjustment to public pensions. In saying so, it is recognised that to do so, although vital and necessary, would have required a Government of unprecedented strength and dedication to purpose.

In a book titled 'The Credit Crunch' by Alex Brummer, it was explained how, in May 1997, Brown created the Financial Services Authority and the financial regulation in Britain was split three ways between the Treasury, The Bank of England (the traditional regulator) and the FSA. Despite much boasting about the brilliance of such a change, it failed miserably to prevent the Credit Crunch. The author said that the team assigned failed to supervise the banks, was underweight and inexperienced. This meant that in the most serious banking crisis since the Second World War they never fully engaged. An article in the Daily Telegraph dated 2 June 2009 reported The House of Lords Economics Affairs Committee considered the Tripartite System had failed and concluded that the key regulatory powers should be handed back to the Bank of England. Another article in the Daily Telegraph in February of this year reported how Lord Turner, the chairman of the FSA stated that Brown had ordered 'light touch regulation' on banks; precisely the opposite of what he should have been doing. A further article in the Daily Telegraph of 27 February 2009 reported that Mervyn King, the governor of the Bank of England, stated that the PM ran up too much debt making the recession harder to deal with. He also supported suggestions that ministers had not done enough to support financial watchdogs.

Even worse, the amount of debt the government was building up was understated. Large amounts of public spending, through Public Finance Initiative and public- private partnerships were put off balance sheets and not fully accounted for. Only a small part of the liability was recognised in the annual budgets. Unfounded liabilities such as public sector pensions were also ignored.

These liabilities were further exacerbated by the chancellor's policy on employment. During the government's first ten years in office there was much bragging about the high employment they were achieving, but no mention of the fact that two out of every three new jobs created were in the public sector. It does not take an economist to appreciate that such a policy is more likely to lead to a Stalinist type economy as opposed to a vibrant capitalistic one.

In addition, there has been an explosion of salary increases in the public sector all of which has to be met out of existing budgets and include massive liabilities in future ones. A look at the level of current salaries of senior people in public bodies is all that is needed to appreciate the truth of this.

Another of the chancellor's mistakes fairly early on in his stewardship of the economy was to sell off the bulk of the country's gold holdings at a time when the price of bullion was about \$200/oz, somewhere around an all time low. An elementary rule of investment is not to sell assets when they are at a low. Gold bullion is now around \$1,000/oz which translates to a loss to the country running into billions of pounds as a result of the chancellor's actions then.

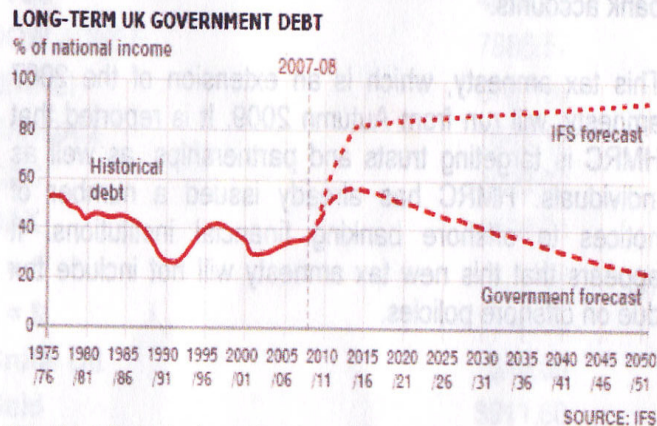
Now that the Crisis has arrived the government drums out how well the PM is dealing with it. One of his achievements stated is he saved the banking system from collapse by his facilitating the takeover of HBOS by Lloyds TSB. During the period leading up to formalising of the takeover there was much opposition voiced against it. The government's mantra was it was the only offer on the table when it was obvious another alternative would have been for the government to recapitalise HBOS as they already agreed to do with RBOS. To achieve the takeover the government had to overrule anti-competition rules and the FSAs objections. In the event, the takeover is now generally recognised as a mistake. Lloyds would never had agreed to the takeover if they had carried out due diligence as they should have done and as a result their shareholders have seen the value of their shares largely wiped out. The country is now landed with one bank less and a new bank which is so big in relation to the others that it will have a competitive advantage over its competitors which will lead to *more expensive* banking for consumers in this country. Apart from the greater job losses of banking staff as compared to what would have happened had there been no takeover, the European Community is now expressing its concerns about the uncompetitive nature of the takeover and there are suggestions from that quarter that it should be unpicked.

The above should not be left without mention of the main culprit of the demise of the once proud institution of the Bank of Scotland with a history of competence going back three hundred years. The BOS was essentially taken over by the Halifax Building Society whose chief executive was James Crosby and who subsequently became Chief Executive of the merged company HBOS. It has now emerged through the Treasury Select Committee's investigation into the Banking Crisis that he and his board were warned in 2005 by the bank's risk employee that it was pursuing a very risky business strategy. How was this individual rewarded for doing his job efficiently? He was sacked and given a substantial termination award in a gagging agreement. Not long after this, Crosby himself retired early with a substantial pay off and pension and was appointed by the PM as a special financial advisor and subsequently as Deputy Chairman of the FSA. The day after the revelation to the Select Committee, he had no choice but to resign and has disappeared with his ill gotten gains and never been heard of since. The PM's lack of astuteness in his assessment of people is further evidenced by his knighthood awards to Crosby and two other of his admired financial leaders; namely Sir Fred Goodwin and Sir Alan Greenspan. The latter is now recognised as the main perpetrator of the global Crash. He ignored the massive imbalances that built up between nations and the asset bubbles inflating closer to home, judging they could easily be mopped up after their explosion!!

Gordon Brown has repeatedly let it be known he was a son of the manse and inferred that this Presbyterian upbringing has been a strong factor in his christian motivation. Yet, it is common knowledge that he spent his entire period as chancellor scheming against his boss and more recently it has emerged that one of his closest political advisors, Damian McBride was a person severely deficient of good moral behaviour. Tony Blair's lack of support for his successor in his travails speaks volumes.

While it is accepted that the capitalisation of banks was necessary even with its consequential expansion of national debt: this solution was only one of a number of options and had been previously adopted by Sweden some twenty years ago. It eventually worked but not without pain. No one country's debt problem is the same as another. The issues and actions needed are extremely complex and solutions if not properly framed and executed can end in failure or the problems could take longer and cost a lot more to reach an eventual satisfactory outcome. Japan tried it in the 1990s with limited success. Given the uncertainties, Gordon Brown's jettisoning of around the world claiming ownership of the solution and proclaiming its soundness does not seem the action of an honourable or a wise man.

The under noted table shows just how long it will take to reduce debt levels in this country:-



For the first ten years or so of this Government's tenure, the percentage of long term debt to national income averaged around 40%. The graph shows how this will increase significantly in the medium term and that it will be 2030 i.e. 20 years before it returns to current levels which has been too high in any case. These estimates are the Government's own figures which are generally regarded as usually optimistic. Draconian as they are, they are much less than the International Fiscal Studies estimates which show the debt level rising to over 80% and not even starting to reduce at the end of the forecast period in 2050. It is patently clear that the only way to return to any sort of sanity in financial competence will be to implement severe cut backs in public spending **and** tax increases. Identifying how these economies are carried out is of critical importance. Get them wrong and the plan will not work or will take much longer and be more costly and painful to work.

Yet, the present government is guilty of crass stupidity or downright dishonesty by trying to gain voters support by frightening them that they will have to face cuts in public spending if they support the other party when they themselves will also have no choice but to implement cuts to help reduce the mess they have got us into. The truly awful scale of the above debt perhaps can be further appreciated when the shorter term picture is looked at. In the immediate years ahead new debt will be in the region of £200 billion **each** year i.e. around £4,000 for every man woman and child. How is it expected this will be met? The answer is borrowing from credit nations. However, there is a real danger that these countries will be frightened by the sheer scale of our debt and refuse to provide the loans. If that happens we will all know what real problems are!

That is why it is no service to this nation when its politicians do not seem to appreciate the difficulty and importance of getting the debt down quickly. Not only will public spending have to be cut severely, such spending as there is, will have to be carefully targeted to areas which will lead to economic growth. There is little doubt that much of the countless billions thrown at public services over the last decade has been disappearing into black holes. Anyone who questions this should read an article in the Times of 12th June 2009 which reported that the Office for National Statistics (ONS) had found across the whole public sector, productivity fell by 3 per cent between 1998 and 2007 while public spending rose by more than 75 per cent. The gap between the two figures should give anyone pause for thought; but not apparently the present Government. We can no longer continue with this appalling performance. The world does not owe us a living. If we go on only achieving low economic growth, a lot of which has been dependent on borrowed money while new emerging countries are achieving high growth built on savings we are doomed, and the sooner we as a nation wake up to this the less painful the future will be.

The first step is for government to recognise this fact. Given the enormity of our debt and the weakness of our economy it seems to me wishful thinking and misguided for politicians suggesting, as they are, that the worst is over.

Another example of financial incompetence was abolishing the 10% tax relief proudly announced by the then Chancellor when giving one of his last budget speeches. At the time, this writer could hardly believe it. Here was the party whose main selling platform was it was the only one which represented the common working man introducing a tax change that it only took a little mental arithmetic to work out that it would be the poorest level of worker who would be hit the hardest by the change. The most amazing thing was that no one seemed to realise this, either in Government or its official opposition. It was only when the workers the following Spring noticed that their pay cheques were measurably smaller that the penny dropped! The question that obviously arises is how a Government capable of such an elementary error can be trusted to handle the infinitely more complex financial issues of running a country.

To conclude, I can do no better than to refer to a letter of 12th May 2009 sent to the Daily Telegraph and signed by 14 members of the Institute of Economic Affairs (IEA) summarising their findings in a detailed analysis titled 'Verdict on the Crash'.

***Their conclusion is that the views reflected in the recent deliberations of the G20 that the financial crash of 2008 was caused by market failure are both wrong and dangerous. Government failure had a leading role in creating the conditions that led to the crash.***

***Regulators and central bankers failed to use their considerable powers to stop risks building up in the financial system and an extension of regulation will not make a future crash less likely.***

*Their evidence suggests that systemic problems have not arisen amongst unregulated institutions. As such no significant changes are needed to the regulatory environment surrounding hedge funds, short selling, offshore banking, private equity or tax havens.*

*They say while a revolution in financial regulation is needed, the proposals of the G20 governments and the EU are wholly misconceived. Specific and targeted laws could restore market discipline.*

The message our Government is still sending out is that the blame was primarily the greedy bankers and that the G20 led by our PM in his 'saving the world' mode was a great success. Sadly, the conclusions of IEA are more likely to be nearer the mark.

I hope the above article illustrates that the proper running of a country requires leaders of great intelligence, skill, judgement and moral strength. I believe Gordon Brown has been sadly lacking in all four of these over the last twelve years and that our children and grandchildren will suffer from these deficiencies in him for decades to come.

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P.S. Copies of reference articles can be made available on request.