THE CRASH

A VIEW FROM THE LEFT

edited by Jon Cruddas MP and Jonathan Rutherford

The crash – a view from the left

Our economy is in crisis. The future is uncertain and full of threats – before us lies a period of economic dislocation unparalleled since the 1930s, and the dangers of climate change and resource depletion loom ever larger. We are at a turning point in the life of our country.

The political fault-lines of a new era are beginning to take shape. They divide those who still believe that privileging the market and individual self-interest is the best way to govern society from those who believe that democracy and society must come before markets. These fault-lines cut across party lines and divide them from within: Thatcherite politics versus compassionate Conservatism; market Liberal Democrats versus social Liberal Democrats; neo-liberal New Labour versus social-democratic Labour. The pro-market politics of all three main parties have lost credibility.

The Crash offers an alternative politics of the social that is democratic, plural and green. Contributors analyse and explain the economic and social issues that lie at the heart of our crisis: the credit crisis, the housing disaster, secrecy jurisdictions, the practices of private equity firms and the intellectual failure of orthodox economics. They put forward ideas for a new kind of agriculture to ensure food security, a People's Post Bank, and a Green New Deal for tackling global warming; and make the case that Britain should think seriously about joining the Euro. And, taking a wider view, contributors identify historical trends in economic crashes, the immorality of inequality, and the arguments for a left alternative.

The task of this new politics is not to capture the political centre ground, but to transform it, and to embark on the deep and long transformation that will bring about a good society.

The crash – a view from the left is edited by
Jon Cruddas and Jonathan Rutherford

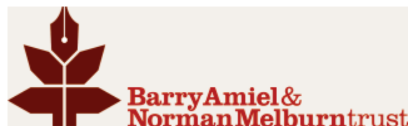
Published by *Soundings*

In association with the media department at Middlesex University
Supported by the Amiel Trust

LW editor: Sally Davison, www.lwbooks.co.uk
Cover design: Fran Davies, www.daviesbatt.co.uk
Typesetting: e-type

Collection as a whole © Lawrence & Wishart 2009
Individual articles © the authors 2009

Soundings
A journal of politics and culture



Contents

6 The crash: a view from the left
Jon Cruddas and Jonathan Rutherford

21 Taming the finance markets
Ann Pettifor
The credit crisis needs a radical approach.

30 The housing disaster
Toby Lloyd
Speculation was always an unlikely route to 'affordable housing'.

39 Secrecy jurisdictions
Richard Murphy
Tax havens are now under threat. That is good news for supporters of international social justice.

49 Private equity and the credit crunch
Adam Leaver
Private equity's practice makes short shrift of its supporters' legitimating theories.

58 Financial bubbles and economic crises
Interview with Carlota Perez
The author of *Technological Revolutions and Financial Capital* talks to Jonathan Rutherford about her ideas.

66 Time for Britain to join the EMU?
John Grahl
Joining a reformed EMU represents the best current option for Britain.

75 The Green New Deal
Colin Hines
A green strategy for tackling the economic and credit crisis.

79 A people's Post Bank
Lindsay Mackie
The Post Bank will be an important part of recreating resilient local communities.

86 UK food security: from U-boats to climate change
Robin Maynard
Peak oil, climate change and unstable commodity prices mean that British agriculture is in need of a radical transformation.

94 Climate change needs social change
Michael Prior
Tackling the recession must not mean forgetting the environment.

101 Why economics can no longer be left to economists
Clive Dilnot
The bankruptcy of dominant economics is an opportunity for rethinking.

109 The killing fields of inequality
Göran Therborn
Inequality should be seen as a violation of human rights.

118 Constructing a left politics
Bryan Gould
Neoliberalism has had its day. It is time to reassert the values of the left.

The crash: a view from the left

Jon Cruddas and Jonathan Rutherford

Our economy is falling into the unknown. No-one knows when or how it will land. The economic wreckage of market failure is growing across Europe. But it is here in Britain, where the neo-liberal economic revolution began in 1979 with the election of Margaret Thatcher, that the worst problems have been forecast. The political and business elites and their allies in the media have embraced free market capitalism as an article of faith. Successive Conservative and Labour governments have made structural changes to our economy and society that have been deeper and more wide-ranging than those in other European countries: 'there is no alternative', they insisted, and silenced all opposition. Even after the crash they remain trapped in the discredited orthodoxies of the past.

The government continues its piecemeal reforms to shore up the economy, but what is its long-term strategy and what kind of society does it want to create? It now faces the threat of electoral collapse. Nor do the Conservatives arouse much in the way of popular enthusiasm, in spite of their lead in the opinion polls – and they too lack a feasible alternative. In all the fear and turmoil, the political elites offer no analysis of the crisis and no leadership. Their goal is to return the economy to business as usual. But the status quo has vanished, and there is no turning back to the casino capitalism and globally unbalanced economic growth of the past.

This is a turning point in the life of our country. For a brief period, history is in the public realm and ours for the making; the opportunity will not come again for generations. In the face of a potential economic depression we have to rediscover our capacity for collective change. The task is not to win the political centre ground – it is gridlocked and dead – but to transform it, and

embark on the deep and long transformation that will bring about the good society.

The crash has allowed us to see more clearly the anti-social nature of the society we have been living in. This economic crisis is also a moral crisis, and we need a set of principles to guide us. It is time to address questions of how we live as well as how we make money: what kind of society do we want to live in? We believe that a good society can be created through drawing on our traditions of socialism – learning from our past mistakes but holding on to values that are rooted in the ordinary life of work, family and relationships. We only thrive as individuals when we experience a feeling of safety, when we feel respected, and when we have a sense of belonging. These are the basic social needs of human beings which a good society must value. And, as Goran Therborn makes clear in his essay, at its heart must be the value of equality, and an end to class and ethnic divisions.

We need a socialism of equality, freedom and solidarity – not dictated by the few from above, but made by the many from below. We must reverse the decades-long transfer of wealth and power from labour to capital. Capitalism must be made accountable, through economic democracy and by re-embedding markets in society. We need just institutions that enable popular participation and a sense of belonging in society, and democratic and egalitarian forms of global governance. Creating the good society will be the great challenge of our time, and it will shape the lives of generations to come.

Social recession

Three decades of neo-liberal capitalism generated historically unprecedented levels of choice and affluence for many. But it also created huge inequalities and a new set of social problems – widespread mental illness, systemic levels of loneliness, growing numbers of psychologically damaged children, and an increase in

eating disorders, obesity, drug addiction and alcoholism. We are in a social recession – a consequence of inequality and the way capitalism has restructured the class system around new kinds of production and consumption. There can be no going back to this kind of society.

The Conservative government of Margaret Thatcher engineered the deregulation and restructuring of the economy, opening it up to global capital and a new period of neoliberal hegemony. It was the sale of council housing and the promise of a property-owning democracy that helped secure its popular support. The effect was to align the modest economic interests of individuals with the profit-seeking of financialised capitalism. Risk was shifted from business onto the individual in the name of freedom of choice. A further alignment of interest between the business elite and shareholder value helped to create a tiny super rich elite – and became the unquestioned business model of the era.

Growth in the UK economy was driven by consumerism, and sustained by the hard selling of cheap credit. The housing market turned homes into assets for leveraging ever-increasing levels of borrowing. When Britain fell into a recession in September 2008 personal debt stood at £1.4 trillion, of which £231bn was unsecured.[1] The financial services industry created an indentured form of consumption, as it laid claim to great tranches of individual future earnings. Millions were entangled in the capital markets as their personal and mortgage-backed debt became the economic raw material for the profit-seeking of financialised capital. This commodification of society engineered a massive transfer of wealth to the rich. And it was facilitated by the use of state power to create new consumer demand through the marketisation of the public sector and the privatisation of public assets and utilities.

This neo-liberal model of capitalism has undermined the economic security of millions. Commodification has corroded democracy and the bonds of association, and it has weakened Britain's capacity to weather the economic storm. The dismantling

of the welfare state, employment regulation and workers' rights has removed many of the economic stabilisers that act as buffers to deflationary pressure – secure jobs, decent wages and proper benefits. In our flexible, financialised economy, the only fixed variable in the system is debt. And this lack of structural solidity is made more severe by government neglect of manufacturing industry in favour of finance. The declining share of manufacturing in GDP, and the relocation of industries to low-wage economies, has reduced the security and income base of the working class. Stagnating wages, coupled with high levels of indebtedness, mean that Britain is likely to fall further, and for longer, than other European countries.

Building the good society

In the three months to January 2009 the IMF reported an annualised quarterly fall in GDP of 7.5 per cent. By March Britain had committed 20 per cent of its GDP to prop up the financial economy, the highest amount in Europe (the US has committed 6.8 per cent).[2] This threatens to put our costs above the historical average and the banks are still not lending.[3] The decline in tax take and rising welfare expenditure have yet to take effect. In addition there is the cost of output losses, which during a banking crisis can average around 15 to 20 per cent of GDP.[4] A run on sterling would push total costs very much higher. The threat of collapse looms over pension funds and many of the companies owned by private equity firms. The risk of sovereign default hovers out there on the horizon.[5] The government – at first bold in its bank bail-outs – is faltering before the enormity of the disaster. The intellectual capital of its technocratic elite has been destroyed, and yet the mindset of the Treasury appears to be unchanged. The economic world view which led to the crisis is still underpinning the attempts to solve it.

A left response to the crisis must challenge and defeat the ruling neo-liberal consensus and offer a viable alternative political

economy. It must be capable of creating the conditions for recovery, and setting out a set of principles and a political direction for achieving a good society, and it must also address the threat of global warming. This will require a democratising process, and one which encompasses a series of strategies: breaking up the concentrations of unaccountable power within society, the economy, and the state; asserting democratic control over the economy and introducing democracy into the workplace; creating a civic state that is devolved, democratically accountable and transparent; strengthening our institutions of democracy and developing local government as centres of political power; reasserting the interests of the common good over the market (education, health and welfare are not commodities); redistributing the risk, wealth and power associated with class, gender and ethnic difference; remaking the relationship between the individual and the state in a social and democratic partnership; enlarging and defending individual civil liberties; and last, recognising cultural identities as equal in their differences and vigorously opposing racism.

A new kind of economy will be made up of a variety of economic structures, business models and forms of ownership. We do not want to substitute state monopoly for monopoly capitalism. The fundamental logic of this new economy must be ecological sustainability. As Michael Prior notes, very little real progress in reducing carbon emissions has been achieved under this government, largely because it has relied on market mechanisms. A New Green Deal must therefore be part of the new economy, as Colin Hinds argues in his contribution. Climate change, peak oil, the need for energy and food security are all core green issues at the heart of a new socialist political economy.

Alongside the productive economy we need to develop the care economy. A public service of childcare, centred on the emotional development of children, and working to reduce child poverty, is essential for the well-being of children and for equitable economic development. For older people a care system needs designing that

affords them the same substantive freedoms as others in society. Carers also need proper financial support, and unpaid work in the form of volunteering and socially valuable activities should be recognised for the role it plays in creating social good. There must be a non-punitive, publicly funded welfare system, run in partnership with local non-profit-making agencies, which puts claimants at its centre. In the longer term work needs to be uncoupled from paid employment with the introduction of a Citizen's Income – a basic unconditional income for all.

A socialist economy will need economic planning and development over the long term, and it will require an active, interventionist style of government. The market state created by neo-liberal governance, with its unaccountable regulatory bodies and technocratic management, is the wrong model for the task. We need a democratised state capable of asserting the public interest in the wider economy, but which is also decentralised and responsive to individual citizens and small businesses. A revival of local government with tax raising powers could help counter the centralising of power, and assist in broadening and deepening democracy. The advocacy roles of civil society organisations, including the trade unions, need to be strengthened. The economy must become a part of society, working for the common good.

Transforming the financial sector

The first step toward the good society must be salvaging and reforming the banking sector. Banking carries out important public functions, and it cannot be left entirely to the control of private interests. The continuing failure of banks to lend is precipitating the economy into deep recession. The overwhelming priority is to get money back into the system. The government's piecemeal response is putting at risk the colossal sums of tax-payers' money it has given to institutions some of which are terminally damaged. Failed banks have to be taken into public ownership. A globally coordinated

response is needed to detoxify the $600tn shadow economy of derivatives – these unregistered, often worthless, assets that have engulfed the financial system.

Banks were destroyed by their pursuit of shareholder value, and the regulators became the agents of this business model. The result was a systemic failure to maintain a proper capital base and a reckless concentration of risk. The banking sector has to be restructured with transparent and accountable forms of corporate governance. The bonus culture must be brought to an end, retail banking separated from investment banking, and credit practices more closely regulated. In the longer term the banking sector needs to be reconfigured around a number of public banks. The age of giant banks is over. They must be replaced by varied customer-focused business models, in the form of commercial banks, mutuals, regional and community banks, and credit societies operating on a variety of scales. Banks as public utilities will play a central role in economic recovery and long term, sustainable development.

On a global level, tax havens must be closed down. Richard Murphy points out that these 'secrecy jurisdictions' contain £8.2tr in private wealth, and cost Africa at least $100 billion a year in lost taxes. Transnational corporations must be made subject to democratic oversight. Private ratings agencies need reform and supervision by public authority. Capital controls and a tax on global financial transactions are needed to aid economic development and protect vulnerable economies. These reforms require international cooperation in a changing global order. America's brief unipolar moment is over, as geopolitical power shifts to Asia and to the emerging economies of China, India and Brazil. There will now be new opportunities for working in concert to reform existing global institutions of financial and economic governance.

On a local level, finance is the key to economic and social regeneration. As Lindsay Mackie argues, a coordinated public infrastructure of lending, savings and investment opportunities can

be created by turning the post office into a Post Bank. This would provide access to retail banking in neighbourhoods abandoned by the national banks and offer an alternative to exploitative doorstop lending. By operating at a local level, along with credit unions and Community Development Finance Institutions, a Post Bank has a role to play in local economic regeneration and community development, funding small scale social and for-profits enterprise.

A new industrial policy

Reform of the financial sector cannot be separated from the need to boost manufacturing and develop a new industrial strategy. The privileging of finance capital has led to an over-dependence on the speculative activities of the City, leaving the economy dangerously exposed to the vagaries of global capital. Because of this, we have depended on the imbalance between the huge trade surpluses of emergent economies and the deficits of the rich countries. Living standards have been maintained by cheap credit and by Chinese workers on subsistence level wages producing more and cheaper goods. This is unsustainable and we have to rethink our economic priorities.

Britain needs coordinated strategic banks for industry, small business, housing, energy and knowledge. A national investment bank can provide public equity to lever in investment from pension and insurance funds to develop key sectors, and to build the digital, transport and other infrastructures of a new economy.

Britain also needs a radical new housing agenda that can be a foundation for economic recovery. With 1.77m households on the local authority housing waiting list, government needs to directly fund social housing developments through a Housing Bank. If necessary one or more of the building companies should be taken into public ownership, in order to kick-start the construction industry, bring down unemployment and achieve national house-building targets. 240,000 homes are needed each year. Local

authorities and other public agencies must be able to borrow to finance the necessary levels of affordable housing.

Without stability in the housing market, financial markets will continue to disintegrate. The continuing and necessary fall in house prices to appropriate economic value has to be managed by creating a buyer of last resort. Social landlords and local authorities should be allowed to borrow to buy up unsold homes, and homes at risk of being repossessed. All foreclosures need to be halted, with the option for struggling home-owners to transfer into social ownership. Government could redirect some of its quantitative easing towards the housing market and purchase homes instead of bonds. To ensure the housing bubble doesn't re-inflate, a reform of property tax could cap capital gains on house sales. There is also a need for income-contingent mortgages, which can reduce risk by accounting for falls in income due to illness or unemployment.

Housing is central to a new industrial strategy, and so is energy. To halt global warming a low carbon energy system is essential. Action to avert climate change must be the key priority for policy even in times of economic recession. However the government has largely surrendered control in this area to a small number of large companies. Its energy policy has relied on market dogma, and this is undermining the prospects of achieving the Committee on Climate Change's carbon emissions reduction target. Energy efficiency should be at the heart of the response to the economic crisis: it is the quickest and fastest route to take for both job creation and cutting emissions. Advances and price reductions in large-scale renewable technologies have the potential to replace coal. And to ensure affordable warmth, energy markets and prices must be regulated, and the energy companies brought to account.

Britain's industrial future requires a successful knowledge economy that harnesses the new technologies for a more equitable distribution of intellectual capital and learning. Investment in innovation and the generation of high-value-added products must serve more than a small, privileged segment of the labour market.

Universities are currently driven by perverse funding incentives and commercial imperatives, and they are neglecting the convivial cultures in which innovation happens and ideas and communication flow. Similarly, education policies have imposed on schools a narrow and instrumental culture of control, testing and goal-focused learning. The deployment of new technologies in knowledge and culture-driven economic activity should be for the social good, not short-term market gain. To create a learning society education must be decommodified, and schools and universities decoupled from the market – and from the demands of business.

Fair pay and fair taxes

A new economy must be fair and just to individuals in its distribution of life chances and conditions of working life. Government needs to introduce a £100bn New Deal along the lines of the Green New Deal, to provide employment, to help avoid depression and to rebuild the economy for the future. And this should also include a New Deal for the Arts, both to help cultural activity flourish and in recognition of its integral role in society. Measures are also needed to maintain income and hence spending power. Workers under threat of redundancy need to be kept in their jobs by government subsidy, providing a check on deflationary pressure. For the unwaged, benefit levels need to rise to £75 a week (their current level is an impoverishing £60.50). Increases in benefit rates will help to stimulate demand while keeping to a minimum the environmentally destructive aspect of an ever-expanding mass consumer market.

The tax system requires comprehensive reform in order to create an equitable distribution of income and wealth. The wealthiest 10 per cent do not pay their fair share, the poorest 10 per cent face a punitive tax burden, while 'Middle England' bears the brunt of taxation. In years to come the costs of the recession must be shared out fairly. A significant amount of tax revenue can be collected by

tightening up legislation on tax loopholes and tax avoidance schemes. 'Secrecy jurisdictions' currently cost the British Exchequer £25bn a year. They can be closed down and corporate profits taxed in the countries where they are earned. Money can also be saved through the scrapping of some of the government's ill-advised spending plans – such as the renewal of Trident, and the introduction of identity cards.

Labour market policies under New Labour have centred on the drive for flexibility, and this has been intensified by changes in EU law. The growth in short-term contracts, agency work, sub-contracting and use of the 'self-employed' have left workers with fewer rights. In Britain the workforce is one of the least protected in Europe. Growth in employment has often been concentrated in low-skill, low-wage jobs, in poor conditions. And the increasing use of temporary and agency workers is now spreading these conditions to other parts of the economy. Reform of European regulation can end low-pay, low-skill and casualised labour, and create a level playing field for both migrant and indigenous workers. Strong trade unions are the best defence against exploitation. Work and quality of life could also be improved by introducing a living wage (rather than simply a minimum wage). This could be matched by introducing a maximum income, for example at a ratio of 1:20 of the living wage. The government's skills agenda should be extended, but also democratised and radicalised, so that it can provide the means not only to 'good work' but also to a good life.

Pension funds will play a key role in a new industrial strategy, contributing to wealth redistribution both within and across generations. But they are currently in crisis, with the shortfall in company pension funds at a record high. The decline in dividend payments and the falling value of bond-yields signals further losses in value to come. The longevity revolution and the failure of financial markets to guarantee decent returns on personal pension plans make social insurance an economic priority. In the last

decade, the replacement of defined benefit schemes with defined contribution schemes has had the effect of transferring risk from the state and business to the individual. This strategy has been beneficial to fundholders but financially disastrous for pensioners. The personalised pension system, dependent on the financial markets for their value, must be replaced by social insurance for both the private and public sectors.

We are integrated into a global economy, and the economic policies for a good society require the larger context of the European Union. The effectiveness of fiscal stimulus in response to the economic crisis will be multiplied by European-wide coordination. In Europe, the social model needs to be reaffirmed, and Britain must commit itself fully to a social Europe. If we are to secure full employment, fair levels of pay, and labour market rights that guarantee good conditions and protect workers against discrimination and exploitation, we must work for these goals alongside our European partners. Britain needs to begin negotiating reform of the European Monetary Union and the Central European Bank in order to create the right conditions for Britain to possibly join the Euro. As John Grahl argues in his contribution, sterling is now a relatively minor currency, and in the long term a run on the pound may force us to join under disadvantageous conditions.

Future democracy

Our political institutions are failing, and contributing to the cultural gulf between the metropolitan and political elites and the mainstream working-class population. For the elites the decade of modernisation has created work opportunities and varied consumer lifestyles. For many in the majority working classes, modernisation has been experienced more as a threat to identity and community, and its economic advantages have been much less obvious. This cultural divide has contributed to widespread cynicism about politicians and their motives.

Despite the disillusionment with political parties, there is an extraordinary level of political, cultural and community activism in our society. Politics has become more individualised, ethical, and rooted in a diversity of beliefs and lifestyles. This is stimulating a search for new kinds of democratic political structures and cultures, which can re-connect institutions of political power with social movements and political constituencies. Networks and databases, facilitated by the web, are of growing importance in campaigning, bringing political power to account and mobilising popular opinion. But political parties also remain an essential part of our democracies. They provide institutional continuity, while networks are often transient. There is much to be gained by synergies between the two. For this to happen, parties will need to allow their own cultures and organisations to be opened up and democratised in the process. Developments in Scotland and Wales since devolution point to some of the ways in which spaces can be opened up for more creative policies and practices.

Britain needs to reform its constitutional structures and introduce proportional representation. In particular we need an elected House of Lords and a revival of local government, and the devolution process also needs further nurturing. The economy and the workplace must be brought under greater local democratic control, to make business and employers more accountable. Party funding also needs reforming, to remove the influence of rich individuals and interests. Decision-making power, including economic decisions, must be devolved, not only within existing structures of government but also through new kinds of power-sharing collaboration between government and civil society institutions.

These are practical reforms, but there are wider cultural changes to make. We need to strengthen our democratic cultures by increasing opportunities for active participation and deliberative decision-making, thereby helping to develop the

ethos of democracy. We need a new culture of freedom of information, and more open access to the media. The collective agents of social change cannot be brought into being by force majeure. But we can strengthen democracy and so create the conditions for their emergence, and for the building of alliances with them.

A new socialism

The political fault-lines of a new era are beginning to take shape. The new division is between those who believe that privileging the market and individual self-interest is the best way to govern society, and those who believe that democracy and society must come before markets. These fault-lines cut across party lines and divide them from within: Thatcherite politics versus the New Conservatism; market Liberal Democrats versus social Liberal Democrats; neo-liberal New Labour versus social-democratic Labour. The pro-market factions of all three main parties have lost credibility. We need now to build an alternative politics of democracy and the social.

A new socialism will have a number of broad but defining principles. It will be grounded in the interdependency of individuals and the need for a just society, free of class, race and gender inequalities. It will be democratic, because only the active interest and participation of individuals can guarantee true freedom and progress. It will be ecologically sustainable and pursue economic development within the constraints placed on us by the earth. And it will be pluralist, because we need a diverse range of political institutions, and a variety of forms of economic ownership and cultural identities, to provide the energy and inventiveness to create a good society. This politics of a new socialism is the only viable alternative to the Conservative Party and to neo-liberal New Labour. What shape it takes is open to dialogue, but it belongs to the future, and it is for the many not the few.

Notes

1. See http://www.creditaction.org.uk/september-2008.html.
2. Fiscal Affairs Department, 'The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis', IMF, March, 2009, http://www.imf.org/external/np/pp/eng/2009/030609.pdf.
3. Patrick Honohan, Daniela Klingebiel, 'Controlling Fiscal Costs of Banking Crises', World Bank 2000,http://papers.ssrn.com/sol3/papers.cfm?abstract_id=282514.
4. Glen Hoggarth, Ricardo Reis, Victoria Saporta, 'Costs of Banking System Instability: Some Empirical Evidence', Bank of England, 2000, http://ideas.repec.org/a/eee/jbfina/v26y2002i5p825-855.html.
5. Willem Buiter, 'Can the UK Government stop the UK banking system going down the snyrting without risking a sovereign debt crisis', 20 January, 2009, http://blogs.ft.com/maverecon/2009/01/can-the-uk-government-stop-the-uk-banking-system-going-down-the-snyrting-without-risking-a-sovereign-debt-crisis/.

Politics after the crash

Soundings
A journal of politics and culture

Fifth annual Soundings event
10am-4.30pm, 20 June 2009

Join the debate on the new socialism. How shall we respond to the economic crisis and what sort of politics and alliances do we need to develop in the longer term? The future starts today.

Reserve the date in your diary – more information to follow. For updates see our website: www.soundings.org.uk, or email info@lwbooks.co.uk.

Taming the finance markets

Ann Pettifor

The credit crisis needs a radical approach.

The world is now faced by a terrifying prospect: large-scale, systemic and long-term economic failure of a liberalised, highly integrated economy. This crisis has been caused by the bursting of a massive bubble of privately created credit, issued at high real rates of interest, which has become unrepayable. The massive deflation/de-leveraging of credit and debt that is now cascading through the banking system is rapidly deflating the value of housing and other assets, and is likely to precipitate global economic failure.

This will not be a 'failure of substance', to quote President Roosevelt. 'We are stricken by no plague of locusts.' Instead we are stricken by the consequences of decisions by Anglo-American central bank governors and finance ministers to abandon their duty to act as guardians of the nation's finances and instead to deregulate financial systems, giving free rein to the private finance sector to engage in reckless, de-stabilising, irresponsible, unethical, and often fraudulent actions. The first to fall victim to this process on a large scale were the 'sub-prime' debtors of the United States. But now the debt dominoes are falling all over the world.

The Credit Crunch of August 2007 was precipitated by defaults and arrears on debts, which damaged the balance sheets of banks. The picture was further complicated by the fact that losses and liabilities had been hidden behind complex financial products in the 'shadow financial system' (and as the full of extent of problems in this area unfold there can only be more disaster ahead). These events led to the evaporation of trust between banks and the freezing of inter-bank lending. This has led to a further deepening of

the crisis, which has led to more defaults and major bank failures, and to the write-off of hundreds of billions of dollars of debt. And as the credit crisis effects the wider economy, and unemployment grows, it will lead to further rises in bankruptcies and job losses, so that we can expect another wave of defaults, leading to an even deeper, more systemic, banking crisis.

My argument is that this crisis is a direct consequence of the deregulation of the finance sector. It is only a new regulatory regime, which supports the interests of the economy as a whole, that can provide a long-term solution.

How did we get here?

The tragedy is that our predicament is the result of ignoring, denying and even concealing lessons known to our predecessors, especially those that dealt with the Credit Crunch of the 1920s and 1930s. The most important of these lessons is that *the interests of the private financial sector are opposed to the interests of society as a whole, and therefore have to be carefully regulated by bodies accountable to the public.*

Central bankers and elected politicians have since the 1970s gradually transferred to the private finance sector powers to create credit – effectively out of thin air. Because the power to create credit is such an extraordinary power, it has almost always been strictly regulated and governed by central banks and governments. The periods during which credit creation has escaped regulation have invariably ended in disaster, most notably during the Great Depression of the 1930s. But we have been living through a further era of liberalisation, in which politicians and governments have once again deregulated the sector, celebrating their 'light touch' over private credit creation. Because the creation of unregulated credit is almost costless; because the gains are so extraordinary; and because the private sector believed for too long that unregulated credit was without risk, they lent without limit or caution. Their gains were then used to gamble recklessly and profit massively.

In order to make gains on lending, many in the finance sector deceived fellow bankers about the creditworthiness of their borrowers and about the value of the assets on their books. They used false accounting to borrow more on international capital markets; paid large fees to rating agencies for inaccurate ratings on some very questionable assets; and then used these dodgy ratings to entice investors like pension funds into buying their financial 'assets'.

Market players, earnest central bankers and commentators call this misleading and fraudulent activity 'mispricing risk'. In fact it is simply unethical behaviour. Outright intentional deception was employed to deceive bankers, investors (including pension funds) and regulators as to the true state of a financial institution's liabilities. Only when this deception 'debtonated' on 9 August 2007 did a more accurate assessment of liabilities become possible.

Before the 1970s, government regulation of the finance sector required banks and financial institutions to provide collateral, to retain reserves or capital requirements for the debt they created – as guarantee or cover in the event of non-repayment. But with the loosening of regulation, capital requirements were lifted and the finance sector was given powers to issue debt without collateral – 'unfunded' or 'margin debt'. Instead of holding 'reserves', banks could simply issue credit and guarantee this against the value of an asset.

The ready availability of credit kept inflating the value of assets, pumping values to higher levels than the outstanding debt, creating the illusion that wealth was being created – eternally. But illusions, like bubbles, are fragile, and invariably burst. Asset price bubbles, we now know with certainty, do not inflate in perpetuity. Nor can they be deflated gently. Falls in the prices of assets quickly become cascades, while the value of the outstanding debt remains static, and indeed may even rise relative to falling prices.

The bursting of the sub-prime mortgage debt bubble was only one aspect of a far wider problem of indebtedness. Corporate

indebtedness is an even greater threat, often concealed by a mass of opaque financial instruments. While unpayable mortgage debts can lead to negative equity, foreclosures and homelessness, unpayable corporate debts can lead to bankruptcy and rising levels of unemployment. Unemployment in turn makes it very likely that debtors will default on their debts, and widespread defaults will bankrupt the financial system. Huge as the household debts involved in this disaster are, they are relatively small compared to outstanding corporate liabilities.

About $60 trillion of corporate debt is insured as 'Credit Default Swaps' (CDSs). But Credit Default Swaps are not swaps at all, but a form of unregulated insurance that is taken out with unregulated insurance companies by lenders to companies, including banks. These insurers have naturally demanded, and been paid, high premiums for taking on the risk. However, while the insurers have charged high fees, they have not provided the 'collateral' needed to compensate banks should companies default on their debts. This is because, unlike household insurers, CDS insurers are not regulated, and therefore not obliged to set aside 'reserves' or collateral, in case insurance claims are made. Thus about $60 trillion of corporate debt is unsafely insured.

How debt enabled the rich to become richer

The ease with which credit can be created has inflated the value of assets. Too much credit chasing too few assets inflates the value of assets, and this is nowhere more obvious than in UK house prices, which rose by 150 per cent between 1996 and 2007. Credit has inflated asset bubbles in property, stocks and shares, brands, works of art, vintage cars, and commodities like oil, grains and gold. Such assets are on the whole owned by the rich, and inflation in the value of assets has been a major reason for the rich growing richer over the last three decades.

Meanwhile those engaged in productive activity – the owners of

small businesses, farms or companies, the waged and middle classes – have not enjoyed a parallel inflation of prices for their wages, salaries, goods or services. They have therefore had to borrow to invest in their businesses, or to pay for a roof over their heads, or to send their children to university, or just to stay afloat. They are now burdened by debts, which are liable to become unpayable, through rises in the rate of interest, bankruptcy or unemployment.

Orthodox economists, particularly those with 'inflation-phobia', never complain about the inflation of assets; nor do economic commentators in the financial press. Instead economists let it be known in the 1980s and 1990s that rises in property prices had little to do with an excess supply of credit, but were a 'natural' result of the 'supply and demand' for housing. All kinds of theories were developed to explain this increase in demand: higher divorce rates, atomised families, and increased migration. However the weakness of the 'supply and demand' theory became evident in 2007 in the US, when credit tightened, and – though divorce rates remained high, families continued to atomise and immigrants to enter the country – demand for housing fell precipitously, and the supply of housing increased to alarming levels.

Central bank governors and finance ministers regularly rail against the threat of inflation in wages and prices, even as the threat fails to materialise, with core inflation remaining very low. In fact the rise and fall of commodity prices currently has a much greater effect than wages on inflation rates. It is likely that in the near future there will be a fall in such prices – and in wages – worldwide, as a deflationary spiral comes into play. If the falling prices of goods and services are then amplified by the rise of debts and the deflation of assets, whole economies can quickly spiral downwards in a debt-deflationary tailspin.

Despite the grave threats that the debt-deflationary spiral poses to the global economy, politicians, orthodox economists and central bankers continue to raise the spectre of wage inflation, and to hold down wages, particularly in the public sector. This approach stems

from a deeply flawed analysis of the root crisis at the heart of the global economy – and it is also counter-productive. To maintain the health and stability of the finance system, it will be vital to ensure that debtors enjoy levels of income that make debts repayable. The only alternative policy would be to grant debtors with unpayable debts a Grand Jubilee – the cancellation of all debts, and the promise of a fresh start.

Banking and responsibility

As the Credit Crunch took hold after the events of August 2007, central bank governors succumbed to demands from the banking sector to immediately lower *official* interest rates. However, privately-fixed interest rates – fixed in London by the British Bankers Association and known as LIBOR (the London Inter-Bank Offered Rate) – continued to rise, in defiance of the official rates set by central banks. This was the clearest evidence yet seen of the loss of control by central banks and governments over a key lever of the economy – the power to set the rate of interest over all loans, whether short, long, safe or risky. The growing gulf between LIBOR and the lower official rates fixed by central bankers showed the impotence of central bank governors in the midst of financial meltdown. The guardians of the nation's finances had ceded control over one of the most important levers of the economy – one that determines the cost of debts, the gains to be made by lenders, and the ability of borrowers to repay. The rate of interest is a social construct, not a product of market forces. By ceding control over rates, central bankers had raised their hands in surrender, abandoning the helm of the ship that is the economy, and with it millions of innocent victims of the crisis.

Yet the responsibility for the system as a whole remains with politicians and central bank governors. After the 'credit crunch' they panicked – because without the ability (or credibility) to borrow, many crucial institutions could fail – and de-stabilise the

whole economy (one good reason for careful regulation of the finance sector.) They therefore rushed to provide 'liquidity' to eligible banks. Taxpayers are now guaranteeing ever increasing sums to shore up the balance sheets of banks – and it remains something of a mystery how the funding for all these bailouts has been raised. However, these events have revealed that the Bank of England *can* of course create money – or credit – and that the Governor has used this facility to compensate for private losses.

However, despite all this extraordinary largesse – central bank 'liquidity' support, the lowering of *official* interest rates and all the high profile bailouts – the structural imbalances in the system remain, as does the issue of insolvency. The truth is that many institution and banks were not just temporarily short of cash; they were effectively insolvent. Pumping more liquidity into these failed financial institutions did not ease the risk of systemic financial meltdown. It was too late for that. The meltdown's cause was the ongoing process of 'de-leveraging', whereby banks and non-bank institutions were engaged in a massive write-down of their artificially and often fraudulently inflated financial assets. There were 'fire-sales' of these assets as they were 'marked to market' by accountants (who were fearful of suffering the punishment meted out to Enron's colluding accountants): de-leveraging brought assets closer to their true value. But this de-leveraging also led to the failure of institutions in the 'shadow financial system' – which in turn threatened systemic failure. The question was not whether systemic failure would occur, but how severe the losses would be.

Infusions of liquidity and bail-outs of bank managers and shareholders have not succeeded in stalling the financial crisis. A more radical approach is needed, and for this politicians and economists need the intellectual courage and rigour demonstrated by past leaders such as Keynes and Roosevelt, who challenged the finance sector, subordinated it to the interests of society as a whole, and helped drag western economies out of a morass of debt in the 1920s.

The Green New Deal

The Green New Deal (for more on this see Colin Hines in this ebook) is the only serious programme in Britain that seeks to address the financial crisis while at the same time recognising the need to integrate economic measures with those that address climate change and other environmental issues. It is therefore vitally important that this programme becomes widely discussed and promoted.

One of the document's arguments is that in order to salvage the global financial system it will be necessary to declare a Grand Jubilee of debt cancellation, to enable debtors to write off unpayable debts, and to allow banks to restore their balance sheets to health. Such a proposal might well prove unpalatable to financial institutions, but the only alternative for salvaging the financial system would be to raise the incomes of those that must repay debts. Indeed the government's current policy of holding down incomes as the debt crisis accelerates is likely to pose a fundamental threat to the interests of the City of London: the squeeze on real income growth is likely to mean an increase in debt defaults. Only when a new social contract is established, either through debt cancellation or through higher incomes for debtors, can we expect the financial system to be restored to stability.

The Green New Deal also proposes the reregulation of the finance sector, in particular careful regulation of the finance sector's powers to create credit. This will require the introduction of controls over the movement of capital; and the restoration of the power to set interest rates to publicly accountable central banks and governments. Above all, the Green New Deal calls for a framework of sustained low rates of interest to enable investment in its proposals for a £50 billion a year programme aimed at massively improving energy efficiency and the use of renewables.

We hope that support for the Green New Deal will help to bring a diverse range of social and industrial forces together, leading to a

new progressive movement: an alliance between the labour movement and the green movement; between those engaged in manufacturing and the public sector; and between civil society and academia, industry, agriculture and those working productively in the service industries. Economists and politicians need political ballast if they are to challenge the dominance of the finance sector, and to restore it to a role as servant, not master, of the economy. Such political ballast can be built by new progressive alliances, but first we need to provide solutions and develop policies. The Green New Deal provides a basis for discussion and debate, and thus the hope that we can stimulate the formation of new progressive alliances for change.

The full length version of this article is published in Soundings *41.*

Ann Pettifor was leader of the international Jubilee 2000 campaign, 1994-2000. She then moved to the new economics foundation (London) where she edited the *Real World Economic Outlook*, 2003 (Palgrave) http://www.amazon.co.uk/Real-World-Economic-Outlook-Globalization/dp/1403917957 which accurately predicted 'a seismic crisis' – the bursting of the credit bubble 'in America, not Argentina'. Her latest book is *The coming first world debt crisis*, 2006 (Palgrave) http://www.amazon.co.uk/Coming-First-World-Debt-Crisis/dp/0230007848 She blogs at www.debtonation.org and the Huffington Post www.huffingtonpost.com

The housing disaster

Toby Lloyd

Speculation was always an unlikely route to 'affordable housing'.

The housing crisis has exposed the shocking vulnerability of the entire economy to debt-fuelled speculation in housing – and the complicity of the banks, the regulators and ordinary home-owners themselves in another unsustainable asset bubble. And this crisis is far worse than the average bursting of a bubble market, because housing is the point where the financial economy meets the real, where ephemeral debt instruments meet solid bricks and mortar, and where the evaporation of investor confidence impacts directly onto people's lives and jobs.

However, the need for short-term intervention must not distract us from the need for reform of the economic and political structures that lie behind the current crisis. The goal of intervention now must not be to get back to the market of two years ago, but to tackle the underlying housing issues behind our economic and social problems.

If we are to change the fundamentals, we must first understand how we got here. Some blame can be attached to successive governments: they have allowed market ideology to dominate their thinking, at the expense of any understanding of the complexities of housing economics. They have left housing production almost entirely to the market, but expected private builders to deliver on public priorities and pay for wider social benefits. They have proclaimed fiscal prudence and sensible public investment, while relying on unregulated debt markets to actually pay for our homes. They have expressed concern about 'affordability', while allowing house prices to bubble out of control. Some intellectual honesty and

political courage about how this wildly imperfect market works, and the state's role in managing it, is clearly needed from our leaders.

But we cannot simply blame politicians or the bankers for the mess: their actions reflect the contradictions in our own attitudes towards our homes. We want to increase housing supply – but we resist new building almost everywhere. We want affordability to improve – but not for the value of our own houses to fall. We treat our homes as our castles and as our primary financial investments.

At the most simple level housing meets one of our most basic needs – a decent place to live. The extent to which this need is met is a major determinant of life chances, and a defining factor in terms of culture, class and identity. But compared to education and health care, our societal response to the need for housing is paradoxical and inconsistent. The middle classes use publicly funded education and health services, and politicians face severe criticism if they opt out of these universal services. The need for shelter is equally fundamental, but the professionals who work in social housing rarely live in it, and there would be an outcry if a minister was found to be living in a social rented home. Why do we accept and expect a level of rationing and means testing for subsidised housing that would be unacceptable in other parts of the welfare state?

While the right may have initiated the decline in social housing supply, particularly through the Thatcher government's Right to Buy policy, Labour have done little to challenge it. Though Labour invested heavily in health and education after 1997, its spending on housing shrank; it is only now beginning to get back to the levels inherited from the Major government. The share of public expenditure in England going to housing investment (net of receipts from the Right to Buy) has not been over 2 per cent since 1994.

In this context of chronic scarcity, it is easy to see why those concerned with social justice would want to focus the available support on the most needy – the poorest, the most vulnerable and those with children – but the consequences of this shift have in many ways been disastrous. As rationing has inevitably got tighter,

social housing has become the preserve of the most excluded sections of society.

Housing wealth

The lesson of our post-war housing experience is that it is impossible to reverse the polarisation of the housing economy by focusing only on the poorer half of the equation. It is vital to critically examine the other, richer half of the story. At this crucial moment in our economic and political history, when the housing system is once again in ruins, we have to look honestly at the problem of housing wealth. The guilty secret of housing is that most of us expect our homes to make us rich – and the better housed we are the better we expect to be rewarded for the privilege. This is why we accept such strict rationing of social housing: we regard housing as a source of private wealth, not a public welfare good.

Private housing assets are by far the greatest source of wealth in Britain, and are now equivalent to more than two and a half times GDP. At the peak in late 2007, the value of homes in the UK had risen fifty-fold in thirty years, and in the decade after New Labour came to power average house prices tripled. As a result, home-owners saw an average increase of 78 per cent in their asset wealth in five years flat, and despite the recent turn in the market, many of us still expect to be made rich by our homes, or to inherit large amounts of housing wealth.

Even during the boom years this explosion of wealth should have been problematic, because its distribution was highly unequal, with the wealthiest tenth of households possessing five times the housing wealth of the poorest tenth. Any increase in the value of housing is therefore extremely socially regressive. Under Labour, housing assets became the main driver of wealth inequality, single-handedly responsible for cancelling out all the progress in reducing income inequality made since 1997.

The media obsession with 'ordinary people' who became

millionaires off the property boom masked the true story of increasing wealth concentration, as most people were shut out of the market by sky-high prices. In London and other high-value areas most 'first-time buyers' were actually either wealthy arrivals or returnees from abroad, or those whose parents could help them to buy. In other words, inheritance became practically the only way to access property ownership: a new form of urban feudalism was created, with profound impacts for social mobility and inequality.

The growing concentration of landed wealth in few hands is in fact highly predictable, as economists since Adam Smith and David Ricardo have pointed out. Given a largely fixed supply of a necessity good such as homes, and uneven distribution to start with, the workings of the free market will inevitably lead to greater concentrations of wealth and poverty. This was the economic lesson that the game Monopoly was originally designed to demonstrate: in a normal property market if you play for long enough all the money will end up with one player.

There are perfectly good reasons for wanting to own one's own home, but getting rich by doing nothing cannot be one of them. The standard defence of accumulated property wealth is that homes now represent people's pensions. Given the pensions disaster of the last decade this may be well true in many cases, but using our homes as pensions is like using an aeroplane to drive down the road: you can do it, but it is massively impractical and inefficient. A good pension investment delivers steady, predictable returns, in line with earnings, and can be withdrawn in little pieces over many years. Housing wealth by contrast is erratic, insecure and extremely illiquid. We have a serious problem with pensions, but socially regressive, unsustainable housing bubbles cannot be the solution.

The cause of the housing bubble

During the boom, commentators attributed rising prices to the number of new households forming and the shortage of new homes

built. But attributing the crisis to undersupply and growing demand alone is another example of an over-reliance on market theory, which claims that prices are just the expression of supply and demand equations. The housing market is so far from the perfect market of economic theory as to render such assumptions laughable – if they were not so damaging.

While a shortage of new homes is a causal factor of the housing bubble, it is not the root cause. Even if new supply did meet the government's target of 240,000 new homes per year, this would still represent less than 1 per cent of the total housing stock: prices are set by the second-hand market for existing homes. Deregulated financial markets are clearly partly to blame here. House prices do not reflect fundamentals of need and supply, but what people can be persuaded to borrow: prices could not have reached the levels they did without excess credit being available.

Yet the banks are not ultimately responsible for our borrowing – people will only borrow so much because they expect it to pay off handsomely. We do not borrow this massively to buy cars, despite the availability of creative car finance packages, because we do not expect the value of our cars to rise. Speculation on future price growth is the true cause of the house price boom. This is why the bubble could burst despite the basic need for more homes – there is a speculative element of demand, exemplified in buy-to-let investors but a part of every home-owner's purchasing decision, and this can evaporate overnight. We borrowed so much to buy increasingly expensive homes because we expected someone else to borrow even more to buy them off us in the future – a classic recipe for a bubble.

An underlying driver of this speculative demand is hardly ever mentioned. It is the massive tax breaks that home-owners receive, which help make home-ownership such an attractive option. Home-owners currently receive a unique and immensely valuable exemption from capital gains tax, worth about £13 billion in 2007 (although this figure will obviously be lower for 2008). The shocking fact is that housing wealth is almost entirely untaxed. There is only

Stamp Duty, a distortionary tax on transactions rather than wealth, which is levied on hard-pressed buyers rather than sellers cashing in on their gains. Inheritance tax captures some of the gains indirectly, but this is widely avoided and even more widely resented.

Stamp Duty typically brought in around 1 per cent of housing value growth during the boom years, a pitiful rate of contribution from the nation's biggest asset class. No other asset gets that sort of treatment, so it is small wonder that people are prepared to borrow heavily to buy homes – pushing prices up and further boosting the windfall for existing home-owners, and encouraging more people to join the tax-free bonanza. This is how the speculative spiral starts, but it was not always thus. Up until the 1960s housing wealth was taxed, as all home-owners paid Schedule A tax on the value of their home, based on the 'imputed rent' that they were benefiting from. Between 1960 and 1970 both Conservative and Labour governments reduced and then scrapped the tax, and started to subsidise home-ownership with mortgage interest relief. The shift from taxing to subsidising home-ownership marked the beginning of the era of house price booms and busts, and the start of our national obsession with the housing market.

The drive for home ownership

Both Conservative and Labour governments have relentlessly promoted home-ownership, such that 70 per cent of homes are now in owner occupation. Part of the reason for continuing the distorted pattern of public spending on which this depends has been straightforward electoral calculation. When the majority think of themselves as home-owners, or hope to gain from inherited housing wealth, rising house prices and skewed housing subsidies seem to benefit most people, especially those groups most inclined to vote. And there has also been a rash of studies – largely from the US – purporting to show strongly positive social outcomes resulting from home-ownership.

The arguments in favour of mass home-ownership are fundamentally flawed however. Firstly, home-ownership is a good proxy for wealth and class status, making it dubious in the extreme to attribute positive social outcomes to forms of tenure alone. Secondly, there is much stronger evidence about the harmful effects of excessive debt – so encouraging more marginal homebuyers to enter the market when prices are high is dangerously irresponsible. Thirdly, high levels of home-ownership have damaging macroeconomic effects. The UK invests far less than its competitors into productive industries that generate real growth, because we plough it all into bricks and mortar. Somewhat counter-intuitively, high home-ownership is also a direct cause of unemployment, which rises by 2 per cent for every 10 per cent rise in home-ownership, due mainly to labour immobility. The World Bank blames the UK's high level of owner occupation for increasing the structural rate of unemployment by two percentage points.

But, most importantly of all, it is simply wrong to imagine that housing wealth can make us all rich, because the housing economy is a zero sum game. Owner-occupied housing does not produce any value; in fact houses deteriorate and require continuous investment to keep them up. Price rises therefore represent the redistribution of existing wealth from elsewhere in the economy, and from future generations in the form of debt. Housing wealth for some inevitably means housing exclusion and poverty for others.

Conclusion

For many years the political calculus has been against even raising these issues, as many got rich from housing gains, and many more aspired to join them. The wealth effect that home-owners experience makes house price booms political heroin: toxic, but highly addictive – and the longer the addiction lasts, the harder will be the withdrawal. Successive governments and society in general

have participated in the mass delusion necessary to sustain the bubble, and it has become impossible to even question the desirability or likelihood of prices rising eternally. The consequence of this complicity is an impossible policy of seeking to 'reduce unaffordability' without allowing prices to fall – a difficult position to maintain with a straight face.

Now we are experiencing the extreme cold turkey of a major housing bust, and the consequences will be painful. But perhaps the severity of the current crisis will also enable us to raise difficult questions and seek radical solutions based on an honest assessment of what the role of the housing system should be.

If we are to resolve the long-term crisis in social housing and rediscover the positive story of renting, we have to address the problem of subsidised home-ownership, which renders social housing a permanently residualised and under-funded service. We also need to drop the charade around public debt and investment, allowing local authorities and other public agencies to finance the construction of the affordable housing that is needed. House-price growth should be regarded as negatively as other forms of price inflation, and tax policy should be aimed at achieving stable house prices.

But it is the assumption that home-ownership can and should make us rich that is the main barrier to overcoming social and economic polarisation. Despite genuine attempts to improve the lot of the worst off, we have been too timid, or too venal, to examine the other half of the equation. The relationship between rising prices, our national obsession with home-ownership, tax subsidies and easy credit is viciously circular. The real question is not where the spiral starts, but where can public policy most effectively intervene – and that is clearly in the tax system.

The current crisis represents a once-in-a-generation opportunity to challenge assumptions and forge a new consensus around the place of housing wealth in our economy. But doing so will require tough political choices on tax and spending by a government braver

than any we have seen so far, and intellectual honesty from all of us about what we expect from our homes.

The full-length version of this article is published in Soundings *41.*

Toby Lloyd has worked on housing issues in the non-profit, public and private sectors. He has taught financial history at the London School of Economics, was a policy manager at the GLA under Ken Livingstone, and is currently a housing and regeneration consultant at Navigant Consulting. He writes and speaks on housing issues for Compass.

Secrecy jurisdictions

Richard Murphy

Tax havens are now under threat. That is good news for supporters of international social justice.

2008 was an extraordinary year for the world's tax havens. When it began few would have expected the storm that was to break over them as the financial crisis unfurled. But as it ran its course, President Sarkozy of France called for the closing of tax havens; a US President was elected who had said time and again on the stump that he would close tax haven loopholes – and had his name on legislation to achieve that result; Jeffrey Owens, head of tax at the OECD, recognised that tax havens had cost Africa 7 per cent of their GDP in total funds lost. The Pope (himself the head of what some people call a tax haven) has now questioned the role of tax havens in the world, and has described that role as harmful. Liechtenstein's secrecy has been cracked, at least in part (as a result of German secret service activity in early 2008); and Switzerland's has been made more vulnerable as a result. And the UK – in the opinion of many the most important tax haven of all – has announced a review of the activities of the ten or more tax havens around the world for which it has direct responsibility.

Tax avoidance and secrecy

The UK has a particular responsibility in the development of tax havens. Its trust legislation of 1925 provided the statutory basis for most of the trust legislation that is used in tax havens around the world. In 1929 the House of Lords proved that a company created under UK law could be registered in England or Wales but

be tax-resident elsewhere if their 'centre of management or control' was in that other place. The result was the effective creation of the offshore company, registered in a tax haven but not deemed resident there, and therefore not taxed by it.

Then in 1957 the UK created offshore banking. In September of that year the Bank of England ruled that transactions undertaken by UK banks on behalf of two customers (a lender and borrower) who were not located in the UK were not to be officially viewed as having taken place in the UK for regulatory purposes. Even when the reality was that the transaction was undertaken in the UK, was probably subject to UK law, and was only ever recorded as taking place in London, it was nonetheless deemed to take place 'elsewhere' – or offshore, to use the jargon of the financial community.

States other than the UK have also played a role in developing this phenomenon. In the USA Delaware was probably the first ever 'tax' haven; from the late nineteenth century onwards it competed with New York as a centre in which companies might locate – though it offered light regulation rather than tax as the primary incentive. To this day Delaware continues to compete with New York on this basis, and as a result more companies are registered in Delaware than in any other US state – including most of the largest US corporations. There they enjoy relatively limited disclosure requirements, relatively light accounting rules and – most important of all for management who want to act unaccountably – very limited protection for their shareholders, who have almost no right to complain about what management do.

But the extra-special attraction of Delaware is a simple one: no questions are ever asked about who owns a corporation registered there. And this means that no one, whether it be the State of Delaware itself or the US Internal Revenue Service, knows who owns the companies that are registered there. As a result, Delaware offers three things: lax regulation, secrecy and the opportunity for tax evasion – for, whether intentionally or not, the

first two combine to create the opportunity for the third. Just as the UK contributed trust and company administration to the offshore world, so Delaware has made its own particular contribution.

It is important to take note of each of these dimensions – it is a mistake to think of these locations as simply offering low tax as the basis of their appeal. Low regulation is at least as important. If undertaking business in a tax haven involved complex rules no one would do it. Nor, though, would most people seek to reduce their tax bills, or take advantage of their lax administration, without the secrecy they offer. These low-regulation regimes allow financial institutions based there to be almost wholly unaccountable. As I have argued elsewhere, they provide business with a 'get out of regulation free' card.

It is, however, the secrecy that they provide that allows individuals and companies to take advantage of the opportunities such places offer for taxation and regulatory abuse. In fact, secrecy is now so important to their operation that those working in tackling abuse sometimes refer to them as secrecy jurisdictions – the term usually used in Barack Obama's draft Stop Tax Haven Abuse Act. I have suggested that the appropriate definition of a secrecy jurisdiction (a term which covers both tax havens and offshore financial centres) is 'a place that deliberately creates regulation for the primary benefit and use of those not resident in their geographical domain and which supports this activity with a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so in their place as usual residence'.

The change in emphasis is important. When tax was the primary focus of concern, the secrecy jurisdictions could argue that larger nations were seeking to interfere in their internal affairs. Once secrecy becomes the focus of attention, those larger countries can argue that the secrecy jurisdictions are seeking to undermine regulation in their own domains. As a consequence the

focus of legitimacy within the campaign against secrecy jurisdictions has shifted.

The purposes of secrecy jurisdictions

This new understanding of what were previously called tax havens is leading to new insights into the way in which these places operate. Though it is usual to concentrate on the tax issue, it is a serious error to presume that this is their primary purpose. It is now reasonable to argue that there are at least four such purposes. The first is to assist tax avoidance (which may or may not be legal) and tax evasion (which is knowingly illegal). The second is to provide secrecy as a product in its own right. This, of course, facilitates corruption, whether it be that of the world's kleptocrats or of the criminals associated with drug and human trafficking, bribery, insider dealing and so on. Secrecy is also used by some simply to hide the transactions that they undertake – very often from their spouses or other members of their families, or, on occasion, to avoid enforced inheritance rules. Thirdly, secrecy jurisdictions are used to undertake commercial transactions at a lower cost than is available elsewhere. Almost invariably this lower cost is achieved through the transaction being carried out with lighter regulation than would have been the case in a mainstream location. Finally, there are a few transactions, apparently, that are only possible in secrecy jurisdictions, and it is this that provides them with the finger-hold on credibility that they are so desperately keen to promote. Each of these issues needs to be considered separately.

Tax evasion

It is an almost universal characteristic of the world's secrecy jurisdictions that transactions undertaken using companies or trusts established within them are not undertaken in the place where

those companies or trusts are created, and it is on this basis that secrecy jurisdictions treat such companies and trusts as tax-free. There is also no tax to pay in the jurisdiction in which the companies are normally registered, however, which means that there can be no tax evasion there either. As a result the argument that local tax practitioners present – that they are entirely compliant with taxation law – is true but entirely disingenuous.

Tax-haven tax practitioners ensure that they do not breach local law by ensuring that their clients are for tax purposes located 'elsewhere'. However, all research shows that such practitioners do not actually ask where 'elsewhere' might be. Thus, either as directors or trustees, they manage companies and trusts that they record as being not resident in the place in which they are registered, but fail to ask in what other country they might be resident – a country to which they would almost invariably owe tax if its jurisdiction was aware of their presence.

In many cases the local tax practitioner will also be supplying company director and trustee services to these companies and trusts. In other words, the tax practitioner is both the adviser and, at least nominally, the client. As a result they are supposedly managing the company or trust, and they are therefore responsible for its tax compliance wherever it might be. Indeed, the argument that someone else might have this responsibility suggests that the services they supply are little more than a sham.

Secrecy for its own sake

Secrecy is, in itself, pernicious. As the credit crisis has proved beyond any doubt, trust is the basis of business relationships. This is especially true with regard to banking. And yet that sector has – perhaps more than any other – abused trust, by using the secrecy that tax haven jurisdictions provide when creating or supporting various entities in these locations – such as special purpose vehicles, structured investment vehicles, collateralised debt

obligations, private equity and hedge fund structures. In many cases the banks lending to such entities, and the liability risk that they involve, has remained completely undisclosed. The consequence has been all too apparent: because the banks were aware that such things are not disclosed they have refused to lend to each other, fearing that each had risk on its balance sheet as bad as the one that they had on their own, but without ever being able to prove the point. The state has had to bail out the banks as a result.

Secrecy can, of course, be proven to be harmful for many other reasons, not least with regard to the enormous size of the criminal money flows that it facilitates through these locations; in the estimate of Raymond Baker, a world-renowned researcher on this issue, these total at least 30 per cent of all illicit money flows out of developed countries.

Avoiding regulation

The issue of the undermining of effective regulation has become one of enormous significance. The sub-prime crisis did not start in the world's secrecy jurisdictions; it started in the USA. However, substantial parts of the resulting sub-prime debt that has caused so much damage to the world economy were packaged and resold through secrecy jurisdictions. Estimates vary precisely because of the secrecy that surrounds this issue, but it is likely that 20 per cent of all US sub-prime debt was sold through Cayman – and it was not alone in this market. The biggest UK funds that have created problems of this sort were located in Jersey. The most notorious of these was Northern Rock's Granite fund, but as important was HBOS's Grampian fund, worth €40 billion at one point but entirely unrecognised on its balance sheet in 2006. These liabilities have helped destroy large parts of the UK banking system; but without the secrecy and lax regulation of offshore markets they would without doubt have been more difficult to create.

Legitimate uses

So what are the legitimate uses for secrecy jurisdictions? I have struggled to find them. The only one which I can so far suggest is that many UK expatriates have problems maintaining sterling bank accounts in the UK because of its anti-money-laundering regime, and instead do so in bank accounts in its crown dependencies of Guernsey, Jersey and the Isle of Man. That is it. I can find no other legitimate purpose which is not designed to undermine regulation elsewhere. It is, however, this guise of legitimacy that the secrecy jurisdictions hide behind.

The effect of secrecy jurisdictions in the global south

We should not ignore the greatest harm of all caused by these jurisdictions, and that is to the poorest countries of the world. This harm is caused in at least three ways. First of all, almost all high-level corrupt funds from such countries end up in tax havens. Without those havens such corruption would be much harder to perpetrate. Second, almost all inward investment-flows to such countries, as well as outward flows of profit, are routed through tax havens; and because their local tax administrations are so poorly funded and have such limited resources, the result is that the world's poorest countries receive virtually no tax on the profits of the multinational corporations who operate within them. Thirdly, the wealthy in very many of these countries participate in what is called 'capital flight'. This means that they illegally remove their funds from the country of their residence, breaking tax, foreign exchange or other financial regulation in the process. Tax havens are used to provide the secrecy that facilitates this arrangement.

Various estimates have been made of the total sums lost in this way. My own work for the Tax Justice Network, when combined with the results of research by Christian Aid and by Jeffrey Owens, indicates a loss of at least $100 billion a year in Africa alone. What is

beyond dispute is that each year tax havens cost the countries of the global south much more than they receive in international aid (a sum of $100 billion a year). This is why the United Nations has highlighted the closure of tax havens as a means of raising the necessary funds to achieve the Millennium Development Goals.

Prospects for regulation

Before the mid-1990s the tax haven problem was little understood, but as that decade developed, the sheer scale of funds flowing into tax havens began to be appreciated – a decade or so after the capital market liberalisation of Thatcher and Reagan had facilitated the process. Several reform initiatives subsequently resulted but they had remarkably little impact – largely because the US administration of George W. Bush was fundamentally opposed to such reform, believing that tax competition was of benefit, even if it appeared to embrace tax evasion, and that deregulation of all forms of financial activity was to be encouraged. As a consequence, since 2001 – terrorist financing apart – almost all attempts to regulate tax havens that have required US support have had very limited impact. This has left the European Union initiatives as the only successful attempts at limiting tax haven activity – but to date they have been avoidable because of the limitations in their scope.

The situation has now changed, however. Public awareness of the issue has risen enormously as a result of the work of organisations such as my own Tax Justice Network and activists such as Carl Levin, Jack Blum, and Raymond Baker in the United States. And of course the current financial crisis has also precipitated awareness of the issue. Most important of all, though, has been the election of Barack Obama as US president, since he has long been a supporter of action on tax haven abuse. The Stop Tax Haven Abuse Act will fundamentally change the relationship between US users of tax havens and the US tax authorities. There is already clear evidence that some major corporations that have

located activities in the tax havens named in the Act are seeking to relocate to avoid its potential impact. The precedent of this Act, if set, would encourage other countries to take similar steps.

The UK is now reviewing the future of its own tax havens, although with a different focus of concern: it wishes to avoid liability for any major bank failure in locations such as Cayman and Jersey. In Cayman, for example, the value of banking assets is more than five hundred times local GDP, and it is clear that the UK would have to undertake any bank bailout if there was a major banking crisis there. If this possibility is regarded as unacceptable to the UK government, the only possible course of action is to restrict local banking operations in tax havens, and this would fundamentally undermine the viability of these locations.

Germany and France are vigorously pursuing reform of the EU Savings Tax Directive. Reforms announced in November 2008 would, if implemented, make it very difficult for any EU person to use a tax haven without disclosure being made to the tax authority in their place of normal residence – thereby undermining the attractiveness of the arrangement for most who abuse these places. And finally, the Norwegian government is funding work to see how funds from tax havens can be released for the benefit of developing countries.

It is not the case that tax haven abuse will stop in the near future. That is too much to hope for; and there are too many locations to tackle for this to be realistic. It does seem, however, that a tipping point has been reached. From their high point in 2002, when they appeared unassailable, tax havens have now reached a point of significant vulnerability, from which it appears they cannot, in the long term, recover.

It is to be hoped that the benefits of this change will be apparent to many throughout the world. International trade will begin to be undertaken on a basis of a more level playing field, with all participants having to disclose their interests and activities. And it will begin to reverse the long-term trend that has been shifting the burden

of tax from capital to labour. Throughout the process of change there will be one common theme, and that is the creation of justice. The gap between rich and poor will be reduced. Progressive taxation systems will be easier to create. Corporations will be held to account.

Of course that is a dream, but it is a dream whose time has come, and for which the political will has, at least in part, now been created.

The full-length version of this article is published in Soundings *41.*

Richard Murphy is Director of Tax Research LLP: www.taxresearch.org.uk/blog.

Private equity and the credit crunch

Adam Leaver

Private equity's practice makes short shrift of its supporters' legitimating theories.

Nassim Taleb and Pablo Triana recently called for the withdrawal of funding to business schools, and the ousting of finance professors who persist in teaching now discredited 'modern finance' and portfolio theories. They argue that part of the blame for the current financial crisis must be attributed to academics who continue to teach students outdated financial models, despite the disastrous results of their application in the real world. Yet such outdated theories continue to provide apparent scientific authority for the actions of our financial elite. As Taleb and Triana attest, a bystander effect has been evident: financial actors, regulators and commentators appeared to believe that if there really was a problem somebody else would have noticed it first and intervened.

Finance theory also has a less than illustrious record in other segments of the financial market, most notably private equity. While the 'marketisation of risk' was the mantra supplied by theory to the trading desks of banks, private equity was heralded as a 'purer form of capitalism' by finance professors who were keen for the market to resolve the 'agency' problems of the giant publicly listed firm. Such academics argued that private equity's different governance structure would resolve the information and incentive costs associated with the diverging interests of 'principals' (shareholders) and 'agents' (senior managers) in listed companies.

Through the active involvement of individual owners on

executive committees and the more rigorous surveillance of management decision-making, private equity was seen as being better able to discipline managers otherwise prone to empire building and/or free-riding – as opposed to improving shareholder returns. Furthermore, the need to service the interest on debt used to buy out firms was seen as providing the necessary financial spur for management to improve the firm's operating performance. Governance changes and debt were widely put forward as panaceas for the operating inefficiencies that dogged the public firm; and it was argued that their widespread adoption and application would be to the benefit of the US and UK economies.

Unsurprisingly, private equity trade associations and industry representatives were quick to adopt the language of agency theory to explain the source of the industry's success – and the broader benefits of its activity. And such agency-based claims were then recycled uncritically by bodies such as the Financial Service Authority, the Bank of England and the Chartered Accountants of the ICAEW. Like bystanders, these institutions were happy to take the industry at its own estimation, convinced that its sudden expansion must be related to the things that it, and its academic sponsors, claimed that it did.

Of course, virtually none of this discussion drew on the recent history of leveraged buyout activity, which had collapsed amidst much recrimination in the US in the late 1980s and early 1990s. Even when attention was called to this unpalatable history, we were told that this time the industry had learnt its lesson – the 1980s and 1990s were the time of 'bad' private equity and now we had 'good' private equity. None of this discussion pressed the question of whether or not private equity resolved agency problems; or raised problems such as the fact that private equity general partners have a short-term interest in returning cash from the bought-out firm to their fund, whilst the bought-out companies have a long-term interest in reinvesting in order to remain a going concern. Nor was there any discussion of whether perhaps the high returns on private

equity were the result of low interest rates and excess liquidity, which for a short period had facilitated huge debt-based acquisitions.

The business of private equity

In order to gain a better understanding of the benefits or otherwise of private equity, it is first necessary to comprehend how the business works. Private equity companies in the UK raise funds with finite lives of ten years, which buy existing companies to sell on after a holding period of around three to five years (though there is some evidence that this holding period shortened considerably in the boom years of the mid to late 2000s). The funds are organised as separate limited partnerships with two classes of partner: the managing private equity financier, who is the general partner (GP), and outside investors, mainly pension or endowment funds, who are the limited partners (LPs).

The best way to understand the industry is as a series of commitments and rights based on three ratios: '70:30', '2 and 98' and '2 and 20'. Before the credit crunch of 2007, private equity funds would buy out firms with a mixture of equity and debt. Roughly 70 per cent of the purchase price was debt, and 30 per cent was equity (this is the 70:30 ratio). The debt raised for the buyout was loaded onto the company's balance sheet, and so responsibility for repayment lay with the bought-out company, not the private equity fund. The '2 and 98' ratio refers to the fact that approximately 2 per cent of the 30 per cent equity stake is generally committed by the GP, while the remaining 98 per cent is provided by the LP. Despite the relatively small equity commitment, however, the private equity GP is politically positioned to take disproportionate rewards. This is because of the '2 and 20' fee structure: the private equity GP receives a non-performance-related management fee of approximately 2 per cent on funds invested, and a performance fee of 20 per cent of the profits from the divested

companies. It is often the case that GPs receive more from their 2 per cent non-performance-related fee than from any profit-related bonus. Interestingly, this provides the incentive to scale up through larger acquisitions, rather than focusing on improving latent operating inefficiencies in the bought-out companies.

The cash nature of the business also encourages strategies of tax avoidance. Debt has long had preferential tax treatment, because interest payments are deducted before tax is levied. This makes leveraged buy outs highly tax efficient, since interest payments lower the taxable lump of net profit generated. Furthermore, the performance-fee money, or the 'carry', is not treated as income derived from deal-making on the 98 per cent of funds contributed by the limited partners, but as a capital gain on the general partner's investment of just 2 per cent of the fund, and as such incurs a lower rate of taxation. The effective rates of tax on business income are further reduced by the creation of chains of corporate entities, so that the operating businesses remit to offshore tax havens (for more on this see Richard Murphy's article in this ebook). Finally, those general partners who can claim 'non-domiciled status' by virtue of foreign origins or connection can also avoid all UK tax on non-UK earnings – which has a substantial effect given that the UK private equity workforce is quite cosmopolitan, and more than half of their investments in the early 2000s were being made in mainland Europe.

Cash extraction and the hierarchy of distributional claims

These organisational arrangements define private equity's business model, which is about structuring a political hierarchy of ownership rights and claims. This is fundamentally a cash business, which aims to crystallise and (re)distribute gains to the private equity financier GP whilst avoiding or displacing as much risk as possible. As such, it has very little to do with resolving governance problems and improving information and incentives within the firm. The business

of private equity is ultimately about returning cash to the fund – through securing the rights to control resource allocation (and extraction) within the bought-out firms; and through a form of regulatory arbitrage which caps its tax obligations.

There have been many well-publicised cases of private equity wrongdoing. Probably the most notorious case was CVC Partners and Permira's takeover of the Automobile Association (AA) in 2004, which prompted a well organised and bitterly fought campaign by the GMB Union. The post-takeover period was marked by significant downsizing at the AA, and a programme of work intensification. One third of the workforce were sacked or resigned, whilst the remaining employees were subjected to worsening conditions. This contrasted with the enrichment of the private equity partners overseeing the firm, who extended the level of debt loaded onto it from £1.3 to £1.85 billion, in order to pay out a £500 million 'special dividend' bonus, some of which may have contributed to the estimated £50 million payout for each of five CVC partners. During this period the service to customers deteriorated, as the AA raised prices by 30 per cent but slumped from first to third in the service rankings.

Perhaps more worrying is the exploitation of limited liability status. Originally designed to encourage risk-taking and entrepreneurialism, in the case of private equity limited liability has the effect of guaranteeing GP returns while displacing risk onto the corporation and debt issuers. Rights of ownership are used to load debt onto the bought-out company balance sheet, leaving the firm with the contractual obligation to repay the debt, while the limited liability status of the fund ensures that it is not liable for any bankruptcy in the firm. The debt is frequently used to facilitate large one-off dividend payments to equity owners – known as 'dividend recaps' – which cover or exceed the cost of the original equity input. Such payments are normally paid within the first three years of a fund buying a company. The money is thus made by using the firm as a conduit for channelling money from banks to equity holders,

and the extraction of cash is accompanied by the transferral of risk to the bought-out company. In such instances the firm's governance arrangements or operating efficiency are not really an issue.

This kind of cash extraction often leaves firms in very vulnerable positions. Here the case of Focus DIY is instructive. Under private equity firm Duke Street's management, Focus DIY expanded aggressively through debt-fuelled acquisitions, making the company the second largest DIY group in the UK by the end of 2002 – though at the cost of taking on £650 million debt. The size of the new company now facilitated large recapitalisations. In 2002-3, 28.9 per cent of the business was sold for £340 million to another private equity group, Apax Partners, allowing Duke Street to recover all of its original equity input through a dividend recap. After further sales, the general partners had realised an approximate 950 per cent gain on their original equity investment by 2003. Yet Focus's debt was so large that it could not survive a minor downturn in DIY sales. After various credit downgrades over fears of default and insolvency, it was finally sold to US hedge fund Cerberus for just £1. The final loss of equity was of no great significance for the GPs (or the LPs) because the equity loss of 2007 was much smaller than the gains from restructuring and refinancing between 2003 and 2004. Other stakeholders were less fortunate: senior debt-holders (i.e. those holding slices of the debt with a higher security rating) were repaid in full, but those holding mezzanine notes got just 40p in the pound.

The reason that certain debt-holders suffered was that in the rush to do business with a booming private equity buyout market, banks had offered better and better interest rates, with lower and lower loan covenants. By 2005 'cov-lite' and 'payment in kind' (PIK) loans (where the borrower can pay with paper rather than cash) were major sources of private equity debt. The growth of more risky private equity debt was thus at least in part driven by profligacy in the banking sector, who simply bundled and sold-on the loans.

Currently private equity is negotiating new challenges: its activity represents a kind of mobile opportunism to meet the demands of different conjunctures. However, these new practices make a nonsense of rhetorical claims about resolving agency problems: they tell us much more about the industry's use of fixed ownership rights to rearrange claims on corporate cash flows, prioritising and bringing forward investor repayments above other claims.

Private equity before and after the crunch

Historic returns were good throughout the 2000s because low interest rates provided private equity with access to cheap debt, and the channelling of that debt into the purchase of companies pushed up the price of those corporate assets. By selling into a rising market, private equity capital stood to take all of the upside, whilst the long-tail risks were borne by the bought-out firms and the debt issuers. Private equity, like other leveraged actors – such as hedge funds – that borrowed to increase gains, introduced a point rather than stream concept of value: value was crystallised by selling the coupon or company on the old trading principle of cashing out when ahead.

But when the credit markets closed in summer 2007 and asset prices started to fall, the old game ended abruptly. And as recession bites, some PE-owned companies will undoubtedly collapse. However the consequences for the funds will be moderated because so much of their borrowing is based on cov-lite loans and PIK bonds; this gives them the opportunity to extract cash first and pay down debt with paper. Curiously, private equity is also awash with money to invest, because large sums were raised but not invested before the credit crunch, and LPs cannot withdraw their funds because they have signed agreements which 'locked-in' their investments.

Private equity firms are thus reasonably well placed to take advantage of the current weakness in the financial markets –

weakness that they partly helped to create. Thus in some instances private equity firms are buying transaction debt at heavily discounted prices, from banks eager to offload risky loans and shore up capital. Astonishingly, a considerable proportion of this debt (an estimated $100-300 billion) is risky cov-lite private equity loans! Private equity is also buying portfolios of debt paper, and assets like property, that the banks – as distressed sellers – have to get off their balance sheets. In the most spectacular of these deals Lone Star bought collateralised debt obligations (CDOs) with a gross value of $30.6 billion from Merrill Lynch for around 5 cents on the dollar of nominal value, with three quarters of the purchase-price funding secured only against the CDOs themselves.

Such developments are inconsistent with the trade's earlier legitimating narrative about the benefits of ownership with control. When private equity buys below-par debt and cheap assets, it does not control the outcomes of such punts. This suggests the business now has for more to do with buying and selling assets at the right price, not direct management of operations in the holding period. Although private equity is perhaps better positioned than other financial actors to exploit the disordered present, this fortunate situation is the product of specific regulatory arrangements, as well as armies of self-serving lawyers and accountants, willing to do their clients' bidding irrespective of the consequences for firms, workers or the Treasury. Private equity has yet to demonstrate convincingly its inherently superior governance-based transformative powers.

Conclusion

Maybe it is time to go back to looking at what firms (and funds) actually do, rather than trying to imagine how they might work, while drawing on rudimentary models of human calculation and behaviour. After all, capitalism is no great respecter of theory, and firms do not behave the same way all of the time. This, above all, requires more transparency so that commentators and critics,

regulators and investors can keep track of private equity's strategic 'bricolage', as practices mutate to meet different economic conditions, and as one conjuncture segues into another. Now is absolutely the time to promote academic scepticism of cheap metaphors in mainstream finance, and instead to observe and describe economic behaviours accurately and honestly, lest we repeat the errors of the past decade.

The full-length version of this article is published in Soundings *41.*

Adam Leaver is part of the Centre for Research on Socio-Cultural Change at Manchester University (www.cresc.ac.uk). He is the co-ordinator of the International Working Group on Financialisation www.iwgf.org or email adam.leaver@mbs.ac.uk

Financial bubbles and economic crises

Interview with Carlota Perez

The author of Technological Revolutions and Financial Capital *talks to Jonathan Rutherford about her ideas.*

Could you briefly summarise the main outline of your argument?

In the past 240 years there have been five distinct great surges of development in capitalism, associated with five successive technological revolutions: the original 'Industrial Revolution'; the Age of Steam and Railways; the Age of Steel, Electricity and Heavy Engineering; the Age of Oil, the Automobile and Mass Production; and the Age of Information and Telecommunications. Each goes through a 'free market' period in the early decades, and a more oligopolistic one in the later period, when the state comes back actively. The switch between these periods happens after a major financial crash.

The 'free market' or 'installation' period of each surge begins in a state of economic stagnation and falling profitability. This began in the 1970s for the 'Age of Information and Telecommunications'. As the old technologies of mass industrial production matured and exhausted their wealth-creating potential, new information and communications technologies (ICTs) began to revolutionise the generation, processing and transmission of information, changing the techno-economic paradigm for all industries. This paradigm shift happens with each technological revolution. The use of the new technologies leads to a different set of best-practice criteria, a change in 'common sense' for the most effective forms of organisation and innovation that make a new higher level of productivity possible for all.

During the Installation period, finance plays a crucial role in unleashing the economic potential of the new technologies. Credit and venture capital are essential to break the old industrial trajectories and make radical changes. Alongside the rising power of finance there is growing inequality and unemployment, caused by rationalisation and the higher productivity of the new technologies. Economic growth is uneven, and there is an increasing polarisation between new and old industries and regions.

Installation ends in a 'Frenzy' phase. In the previous surge – for the age of mass production – this was the 'Roaring Twenties'. In the current one it was the 'frantic nineties'. A casino economy takes shape, ramping up speculation and financial bubbles, and creating a super-rich elite. Individualism flourishes. There are significant levels of migration from poor to rich areas. New markets are created; most of the old industries are rejuvenated; others wane and die. The productive sphere is restructured. Speculation in the stock market rides on the success of the new industries. Such major technology bubbles are endogenous to capitalism, and perhaps inevitable. They are the way in which the market system assimilates successive waves of wealth-creating potential. They are Sombart and Schumpeter's 'gales of creative destruction', leaving in their wake new growth opportunities on the one hand, and suffering and losses on the other.

The transition from the old order to the new requires these two or three turbulent decades, after which the manias end in major busts: canal panic, railway panic, the crash of 1929, the NASDAQ collapse. During the transition, asset prices decouple from fundamentals, and a breakdown becomes inevitable. It is the growing structural tensions in the system that eventually make it unsustainable. A post-bubble recession (sometimes a depression) then marks the Turning Point, a time for rethinking and reshaping the future that eventually leads to the 'Deployment' period. That period comprises the two or three decades – such as the Victorian boom, the Belle Époque and the postwar Golden Age – when the

new potential can be fully exploited across the economy, significantly increasing employment and gradually reversing the income polarisation of the frenzied bubble times.

So, we are now at your Turning Point. Is there then an opportunity to create a post neo-liberal politics?

Yes, indeed. After the bubble collapses, conditions are ripe for political forces to regulate the financial markets, redistribute wealth, and create institutions of social cohesion. Economic sustainability and a politics of well-being for all become feasible once more, and this is precisely what leads to the 'golden age'. Alternatively, political forces supporting the casino economy can try to maintain the selfish individualism of the 'frenzy phase'. Whatever the outcome, the turning point will define the particular mode of growth over the next two or three decades.

It is important to notice that wanting to bring back the role of the state to what it was in the previous paradigm is as big a mistake as trying to keep the casino. Each would, in different ways, prevent optimal levels of economic growth and social welfare. Each deployment period requires its own socio-institutional framework, consistent with the nature and requirements of the newly installed paradigm. Two of the many phenomena that distinguish the current paradigm from the previous one are globalisation and the direct role of social groups (NGOs, web 2.0, etc). The first demands an institutional architecture that harmoniously combines the national with the supranational and the local; the second requires participatory institutions that facilitate consensus building.

But finance is the most powerful force in the balance today. Won't it be very difficult to curb it now?

Yes, and the power of finance was unfortunately kept intact after the NASDAQ collapse. But now the Turning Point has really

arrived. The casino has been revealed as such and people are angry. That is what provides the impetus, the strength and the political will to curb financial power. The debate is no longer whether to regulate or not, but rather about good or bad regulation. On this occasion we have had a two-stage bubble. Whereas in 1929 both technology and finance fell together, this time finance got a new lease of life, especially after 9/11, with the massive injection of liquidity and reduction of interest rates intended to revive the economy at any cost. This second boom and bust is a typical easy credit bubble, but it was the direct result of the unfinished business of the regulators after the NASDAQ collapse. And it has been worse than any other, precisely because it is void of real economy substance, and because information technology has facilitated opaque innovation. I believe it will only end after all the dark corners of the casino have been put to light, and all the bubbles still to burst (hedge funds, private equity, Shanghai housing, etc) have done so.

Technology is embedded in social relations – it is shaped by them and in turn it shapes them. To what extent do you think that culture and the structures of class and economic power determine the character, distribution and impact of the new technologies?

As you rightly say, technology shapes and is shaped by society. The question is what is more useful when designing policy or political programmes. If you give the primacy to existing class and economic power structures you may come to the conclusion that the weak are powerless and can do nothing, because society is already structured in such a way that whatever technology comes along it will be absorbed and co-opted into the old social relations and nothing will change. If, on the contrary, you look at the new opportunities that the technology brings for changing social relations, then you understand why Barack Obama can come from the fringes to the spotlight and to the biggest power post on earth, propelled by an

Internet-based campaign energised by a network of the young. By looking at technology first, you can also understand why mass production led to mass consumption and to an across-class consensus on the welfare state – though in fact, as those technologies were taking shape, three different social structures arose leveraging the same mass production paradigm: Keynesian democracies, Nazi-fascism and Soviet socialism in all their many variants. None of them in their original form could survive the current information revolution with its flexibility, diversification, open network structures and other non-centralising and non-bureaucratic features.

Does this diversity challenge the idea that technologies determine the relations and structures of economic and social power?

Well, it certainly shows that the range of the possible with each set of technologies is extremely wide, but it does not deny that technology defines the nature as well as the limits of the stage upon which the social forces can battle and negotiate for their respective values and goals.

For instance, it is a lost battle to fight against globalisation. Information (and money) can travel transparently across frontiers and the global telecommunications infrastructure makes it easy to manage giant complex structures spanning the globe. Those are powerful shaping forces defining important directions of growth. Still, there are many options for globalisation, and the neo-liberal model is only one of the paths to follow. This paradigm offers the possibility of doing for the whole world what mass production did for the workers of the developed countries. And in the process the world could see one of the greatest booms ever imagined.

The logic of the developments you describe seems to involve a growth in the size of the commercial sphere and perhaps a diminishment of the non-

market sphere. Do you see new technologies as in any way facilitating the development of the non-market public sphere in ways that are free of commodification?

I am not sure that increasing non-market relations is the way to maximize well-being. Perhaps the market needs to be 'tamed' to fulfil a wider range of human needs. I suspect that much of the resistance against 'commodification' stems from the way mass production shaped consumption around the possession of goods rather than on any sort of spiritual satisfaction. By contrast, there are many things happening with markets in this paradigm that may be opening new directions towards the greater welfare of both producers and consumers.

The organic food movement, ethical trading and corporate social responsibility give different ways of conducting the market economy. These trends are bound to increase for two main reasons. Firstly, the far-reaching transparency of information opens behaviour to view (public opinion on the web has pushed Walmart, for instance, to significant changes in relation to its workers and to the adoption of a strong environmental policy). Secondly, in this paradigm, market competitiveness is more and more based on creativity, and creativity cannot flourish unless people feel satisfied at work. Meaningful work, whether self-employed or in a big corporation, adds an important dimension to the notion of quality of life that was absent – except for an elite – in the mass production paradigm.

Other new developments are the Open Source movement, the 'blogosphere' and the Commons that create new channels for expression and communication. Equally, Project Gutenberg, the MIT and Yale courses on the web, Google books, and Wikipedia are offering open access to culture and knowledge in ways that would have been unimaginable even twenty years ago. These are spaces that intermingle with the market in different manners, they live alongside it, they use some advertising as funding (Google's AdSense, for example) and sometimes they even teach the market.

Free music sharing sites were ruled out, but they gave birth to the dollar-a-song business model which is a positive sum game between users, artists and producers. The relative weight that these open spaces of non-market or semi-market relations will occupy in the long-run depends on many factors, but they are likely to have a significant influence on the behaviour of market-based web-sites.

It is easy to dismiss all that as merely weak trends destined to be crushed by the inexorable force of market calculation. That is very similar to what happened in the 1930s, when many on the left dismissed the official recognition of labour unions as a ploy and did not see the major transformations that the welfare state and the regular raising of wages with productivity would bring to people's lives. In this respect, we should reflect upon the fact that in the 1930s the goals in the current developed countries were mainly adequate food, shelter and education, whereas now that bottom line is taken for granted in those countries and the accent has moved to loftier values and aims.

Three of the deployment periods you discuss – the Victorian Boom, the Belle Époque and the post war Golden Age – have been times of intense political struggle. Where do you think the contradictions will emerge as we move out of the turning point into a new deployment period? Not just in economic relations, but also in class and social relations and culture?

Perhaps it is time for the left to stop centring its attention on the 'contradictions' and focusing on the ways in which interests can be partially reconciled for the benefit of both sides – or rather of all sides, because there are rarely only two. I think recent history has shown that the poli-classist approach of social democrats was more successful in improving people's lives than the single-class approach of the various versions of the Soviet society. The Scandinavian countries with their consensus policies were a resounding success during mass production in both social justice and overall quality of life. A similar path could be followed now

more widely to reap the maximum social benefits from the potential of the current paradigm.

Of course, if my interpretation is correct, maturity will also be reached within the ICT-based paradigm and the consensus will again be broken – as in 1968 – and the next technological revolution will confront and eventually supersede whatever socio-institutional arrangements are set up to cater to this paradigm. Finance will come back to force the next paradigm diffusion and advance until it reaches boom and bust … and so we go again.

Taking history as a guide, we are now going through times equivalent to those of the New Deal and Bretton Woods. This is the moment when the medium-term future is being defined one way or another within the wide range of the viable with this paradigm. To obtain the maximum benefit from the enormous potential now available it is necessary for the state to actively intervene in order to shape the space for market action, tilting the field in favour of social and environmental goals and facilitating innovation and widespread investment across the planet.

But if there is a time when concentrating on criticism rather than on positive proposals is truly a wasted opportunity, then that time is now. Identifying viable solutions, proposing institutional innovations and making them a central part of the sort of progressive agenda that can garner widespread support is, in my view, the more likely path towards achieving greater social justice.

The full-length version of this article is published in Soundings *41.*

Carlota Perez is an interdisciplinary researcher, lecturer and consultant. She is the author of *Technological Revolutions and Financial Bubbles: The Dynamics of Bubbles and Golden Ages,* Edward Elgar 2002. Her website is www.carlotaperez.org.

Time for Britain to join the EMU?

John Grahl

Joining a reformed EMU represents the best current option for Britain.

Should Britain join the European Monetary Union (EMU) and adopt the euro? There are two reasons why it shouldn't. The first is the possible need to adopt monetary policies in Britain which are different from those in Europe. The second, and a more valid reason, is that, even if Britain does not need separate policies as such, European policies might be ill-chosen from a general European point of view. However there is one optimal policy that is rarely mentioned. Britain should negotiate entry into the monetary union in a process which includes reform of the latter.

Is Britain different?

Over the last two decades, Britain has followed a path of development distinct from those in other European countries. Growth has depended very largely on the financial sector, on housing and on consumer credit, often linked to house prices. In spite of all the dysfunctions and imbalances which thereby resulted in Britain, it still tended, over the period after 1992, to outperform France and Germany in terms of production growth and employment; indeed, given Britain's acute social problems it may be that only a relatively buoyant economy prevented very severe conflicts.

Thus Britain was following a rather different economic strategy, and this may have necessitated distinct monetary policies. However,

this strategy has failed and has now been abandoned. It is no longer going to be possible to base economic expansion on a financial sector, which is bound to shrink, and on house price inflation, which has now gone into reverse. In future Britain will require higher savings, a more balanced pattern of production and employment, more exports and fewer imports; development will no longer have such a strong inflationary character and will not need to be accompanied by higher interest rates.

But if the need for a different interest rate policy has disappeared, at the same time the need to depreciate the currency has become more urgent. As the crisis broke out, Britain's massive current account deficit became completely unsustainable, because it was impossible to finance even in the medium term. The big depreciation which followed works to discourage imports and promote exports. Clearly we could not depreciate our currency against the euro if our currency *was* the euro.

An important qualification of this argument is that Britain cannot rely on being able to manipulate its exchange rate in the way that seems necessary. Sterling is now a relatively minor currency, traded on enormous global asset markets. The danger is that the pound will be pushed much too high or driven too low. An orderly depreciation to restore competitiveness is one thing; a drastic collapse, undermining incomes and setting off rapid inflation, is another. This danger seems to increase over time, and will perhaps in the end drive Britain into the monetary union.

Problems in the eurozone

If the specifically British reasons for staying out of the eurozone are starting to lose some of their force, there are more plausible arguments based on the general weaknesses of the monetary union itself. These do not relate to the policies of the European Central Bank (ECB) as such. In general the ECB has not grossly mismanaged the monetary policy of the eurozone, and in some

ways its reaction to the credit crisis has been more sure-footed than that of the Bank of England.

However, the central bank is only one part of a macroeconomic policy regime. Within most individual states it is combined with fiscal decisions that are designed to complement monetary policy. In the case of the eurozone there is no such thing as a common budgetary policy: tax and public spending decisions are taken by individual governments solely on the basis of domestic factors.[1] In the credit crisis this lack of a clear central budgetary authority has resulted in a somewhat incoherent response to the need to recapitalise major banks. Interventions took place at the level of individual states, with no coordination, and with no attempt to deal with their impact on other member states or to define common positions on how the rescued banks would be run. As a consequence, the EU's competition rules in the banking sector are in tatters.

The eurozone has neither a central budgetary authority nor any effective coordination of the aggregate spending and taxation decisions by the member states using the euro. Germany might have been able to provide a coherent budgetary policy for the monetary union but it has always refused to recognise the responsibility that its size gives it for general economic policies in Europe. For many years German budgetary policy has been very restrictive, with very adverse consequences for several members of EMU.

A certain degree of solidarity is necessary for the effective functioning of any monetary union. In the EMU such solidarity is completely lacking. The participating member states are on their own. It was known from the start that this was a threat to the project of monetary union but the risk was discounted because an extreme free-market position was adopted: member states could correct their difficulties by their own efforts through downward pressure on costs and prices. This unrealistic view is now called into question, as wide divergences have started to undermine the credit-worthiness of some eurozone governments.

The lack of a coherent overall macroeconomic policy in response to the crisis, and the fear of default by one or other of its weaker member states, has cast suspicion over the euro, which is why it has recently fallen against the dollar in spite of the aggregate strength of the eurozone. And the cause of these problems is not simply the imprudence or indiscipline of the weaker states. More important is the aggressive drive by Germany to lower its own wage costs and expand its already massive trade surplus, heedless of the pressures this puts on other countries. This German stance may well be unsustainable. If one of the weaker states is pushed to the brink of default, Germany and the other strong countries in the eurozone would have to decide either to come to its rescue or to risk its departure from the eurozone. The consequence would be a general loss of confidence in the euro around the world.

The dream solution

From Britain's point of view, these tensions provide a distinct reason to hesitate before adopting the euro. But debates on the British economy and the eurozone rarely mention one highly desirable approach. Britain and its EU partners should negotiate to bring about British entry into the European Monetary Union and the reform of the EMU at the same time. British membership would make the eurozone larger and stronger in economic and especially financial terms. After British entry the EMU and the EU would essentially coincide because the other countries with official or unofficial opt-outs – Denmark and Sweden – would almost certainly be prepared to join a system which had been reformed in a way acceptable to Britain.

Other EU states not yet using the euro should be permitted to adopt it as soon as they wish. There is no good reason for the prolonged exclusion currently enforced on them by the ECB. Britain would be able to join the EMU and give up sterling which is increasingly a hostage to fortune, confident that policy would be

decided with reasonable concern for its interests and that if, in the future, Europe-wide policy did bring problems for Britain, other policies would be used to compensate.

The main lines of reform which are needed are outlined below.

There is a need for clear legal subordination of the European Central Bank to the Council of Ministers and the European Parliament. Democratic institutions must have the power to control it. This subordination need not compromise the operational independence of the ECB, but it cannot be allowed to continue as a law unto itself.

There is also a need for a broader mandate for the ECB, endorsed by Council and Parliament in the form of a law which the Council and Parliament can also amend. It is absurd to inscribe a monetary doctrine into a constitutional document (in the actual case, a diluted version of the quantity theory so fashionable in the 1980s). The mandate should still place a heavy emphasis on price stability. But it should permit other objectives to limit the drive for price stability where necessary: the most important of these other objectives are the prevention and reduction of unemployment, the stability of the financial system, support for other EU economic policies and monetary cooperation with outside powers.

Moves should also be made towards a significantly larger central EU budget, able to redistribute significantly more resources than at present to low-income countries and regions; and the Commission should have the right, when supported by Council and Parliament, to run deficits. These borrowing powers should be used both to compensate for cyclical booms and recessions in the EU as a whole, and to extend credit to member states affected by specific disturbances. Correspondingly, the Stability and Growth Pact should be replaced by an agreement on the coordination of member state budgetary policies. Coordination and centralisation are to some extent alternatives here – the greater and more reliable the coordination, the smaller the central budget could be – but between them the two measures must make possible some control over

aggregate tax and spending policies in the EU, comparable to that in the US or Japan.

Reform to institutional structures or in strategies has for a long time been rejected by EU leaders, who always insist that whatever has been done in the past is set in stone. It is a frame of mind which is completely wrong for the management of a huge integrated economic system. Compromise along the lines suggested would improve both the design of European economic policies and their implementation. No country would be harmed and the eurozone as a whole would be strengthened by the reduction of internal tensions.

What is stopping change?

Many of the weaknesses of the European Union – such as the complete subordination of social policy to economic policy, the failure to recognise public goods, the increasingly open attempt to deregulate labour markets and the democratic deficit which makes all these possible – derive from its domination by corporate interests.[2] However, the actual barrier to reform of the macroeconomic regime in the EU results from the entrenched positions of Germany and the UK.

German political leaders are wedded to a very conservative and restrictive position, and are hostile both to government deficits and to current account deficits. Since German households also, and very sensibly, save a large part of their incomes, and since there are no longer wide opportunities for corporate investment, the country relies upon exports to maintain employment and economic activity. This is not a particularly advantageous situation for Germany itself – it reinforces downward pressure on wages and employment in order to bring about the exaggerated international competitiveness needed for the huge trade surplus. Many households respond to the consequent uncertainties by saving even harder, thus intensifying the problem, while continuous pressure in labour markets,

deliberately intended to bring a low-wage sector into existence, is piling up social problems for the future.

Higher government spending, together with more secure employment and higher wages at the lower end of the spectrum, would provide domestic demand to replace some of Germany's exports; it would at the same time reduce the imbalances in eurozone trade and bring some relief to the crisis-struck economies of Ireland, Portugal and Greece. The failure to act in this way testifies to a refusal to recognise that the way German economic power is exercised has a big impact on other countries, and that this should be taken into account.

If the German position is one of power without responsibility, the British stance is essentially the reverse. Although the rhetoric surrounding British policy formation sometimes suggests a conservative preoccupation with suppressing inflation and restricting public expenditure, and although the mandate of the Bank of England puts price stability before everything else, the British establishment is actually pervaded by a pragmatic, Keynesian, concern to avoid disruption. The very influence of the City of London pushes in this direction: the financial sector favours a strong currency, but also realises that a drastic weakening of employment and of real economic activity are as dangerous to financial interests as is unchecked inflation. This pragmatism is an additional reason why, in principle, British entry into the eurozone would tend to strengthen the monetary union: it would militate against damaging policies inspired by unrealistic doctrines of rapid adjustment through market forces alone.

The failing in British thinking is not so much a simplistic approach to economics, but rather a romantic conception of politics. Since the Schuman Plan in 1950, British reticence towards the European project has expressed a reluctance to compromise British sovereignty. The difference between then and now is that in 1950 that sovereignty had some substance; today it is largely a fantasy. One aspect of this lack of realism is the fetish of the Westminster Parliament; even more important is the fetish of the

pound. The British opt-out from EMU depends on the continuing feasibility of sterling as an independent currency.

Already this is a limping independence – partial and impaired by the relative decline of the British economy. When sterling is compared to the two leading currencies – the dollar and the euro (with the D-mark as its predecessor) – it can be seen that a price has to be paid for maintaining sterling. Sterling is a wasting asset. If it is voluntarily given up today or tomorrow, a price could be obtained for it. In the longer term, that price will fall to zero.

When Britain joined the European Monetary System in 1990 it was a crisis measure. Without protection from the EMS – in effect from Germany – British interest rates would have had to be sky-high to avoid a drastic depreciation. But in the case of the EMS, British monetary subordination to Europe was temporary, largely because the extremism of German policy itself broke up the system.

In a future crisis, if Britain joins the EMU and accepts the euro, it will be a permanent subordination, and sterling will disappear for ever. And if it joined in a state of emergency, Britain would have had no chance to have influenced the design or the functioning of the EMU. Everyone would lose, because necessary, and in the long run unavoidable, reforms to the eurozone would be long delayed by a reinforced German hegemony.

The two main parties hold to their entrenched positions: the British cling to sterling, and the fantasy of sovereignty – until the pressures of the global economy make it impossible to continue. The Germans go on deepening the imbalances of eurozone, blaming the damage which results on the failure of their weaker partners to 'stabilise', at the cost of their public services, wage levels and social models – until crisis in the eurozone as a whole breaks it up or compels reform. A more prescient strategy could avoid such outcomes, but prescience has not been in great supply in Europe.

The full-length version of this article will be published in Soundings *42.*

John Grahl is Professor of Human Resources Management at Middlesex University. He is a member of European Economists for an Alternative Economic Policy in Europe and author of *European Monetary Union: Problems of Legitimacy, Development and Stability*, Kogan Page 2001. For the latest EuroMemorandum commentary go to www.lwbooks.co.uk/ebooks/euromemorandum.html.

Notes

1. The 'Growth and Stability Pact' is useless in this respect. Its rules may inhibit the adoption of necessary expansionary policies in some member states, but they contribute nothing to the definition of a common budgetary stance. In the present crisis many member states have had to breach these rules.
2. See John Grahl, 'A Dead End for the EU?', *Soundings*, 39, 2008 Summer, pp44-55.

The Green New Deal

Colin Hines

A green strategy for tackling the economic and credit crisis.

The Green New Deal is a strategic initative that seeks to tackle problems of climate change and the economy in an interdependent way. It can perhaps be seen as a modern version of the politics of hope and pragmatism shown by Roosevelt in the 1930s, offering a programme that is practical but innovative, and with a breadth of vision that recognises the magnitude of the problems we face and thus the need for a solution on a similar scale.

It proposes steps that, taken together, can address the problems of rising joblessness and severe economic slowdown while at the same time taking on climate change and improving energy security. It calls for the re-regulation of finance, and fairer and greener taxation, but its central plank is a call for a massive £50 billion-a-year public and private spending programme in order to bring about a dramatic reduction in fossil fuel use, and an increase in renewables use and energy efficiency, in every building in the country.

This will open up a huge range of new business opportunities in places where people actually live and will require the raising of a carbon army to fill the countless new green-collar jobs that will be created. This all-encompassing programme, focusing initially on the goal of 'every building a power station', will involve traditional energy-saving measures such as insulation, major projects such as large-scale combined heat and power systems, and a greatly accelerated uptake of renewable technology. The investment will thus both create jobs and address issues of climate change.

The programme will generate high skilled jobs in energy analysis, the design and production of hi-tech renewable alternatives, and large-scale engineering projects such as combined heat and power and offshore wind. For more practical workers it will provide jobs in areas such as loft-lagging, draft-stripping and the fitting of more efficient energy systems in all the UK's homes, offices and factories. City types can be retrained for the carbon finance sector that will be needed to publicise, advise and put into practice the range of funding packages proposed in the Green New Deal.

This hugely ambitious and transformational programme will of course require a legislative framework, backed up by price signals adequate to the task of accelerating the shift to a low-carbon economy. Germany has already started down this path. It provides low-interest loans for older properties to reach new-build energy standards; and its feed-in tariff programme ensures that anyone generating electricity from solar photovoltaics, wind or hydro gets a guaranteed payment of four times the market rate. This has created 250,000 jobs, and demand is such that Bavarian farmers – with large barn roofs and fields – are, incredibly, the biggest customer group for solar PV in the world.

In the UK, a Green New Deal would include rising carbon taxes (with adequate compensation for those in fuel poverty) and a price for traded carbon that is high enough to cause a dramatic drop in carbon emissions. Even more important will be a huge increase in investment in energy infrastructure.

Public funding must be augmented by the encouragement of investment in a government-backed Green New Deal from money saved by individuals, pension funds, banks and other savings vehicles. The guarantees currently available for savings in banks and building societies could be extended to Green New Deal investment. This would carry the proviso that such funds would be earmarked solely for investments that reduce carbon use. Savers could also be let off taxes on gains from investment in carbon-

reducing infrastructure, as is the case for infrastructural investment in the US municipal bonds market.

Other avenues for citizens and institutional investors to provide funding for the Green New Deal would include investment in 'green gilts' (government bonds), which would be guaranteed not just in terms of an interest rate, but also in terms of their use to reduce carbon. Kiddies Go Green/Families Go Green/ Grandparents Go Green bonds could be introduced to help revitalise the fusty national savings industry.

Local authority bonds could be the major vehicle for the funds raised for this programme. In the USA there is a $2trillion municipal bond market; but, apart from Transport for London's (TfL's) recent successful £600million bond issues, such an approach is virtually non-existent in the UK. Yet this source of funding – and local democracy – could be promoted relatively easily if the returns on the money saved from the low-carbon investments (minus their cost) were used to repay such bonds. There are no legal constraints on local authorities raising funds through issuing their own bonds, but it is not something that has been encouraged by governments since the 1980s.

But, I hear you ask, what could induce Gordon Brown to show the kind of political courage that Roosevelt displayed when introducing the original New Deal. The answer is simple – events, dear boy, events. The credit crisis and the imminent likely peak in global oil supplies means that demand will fall, and unemployment will rise, at a time when energy prices will remain high. Government intervention is crucial not just in the financial system but also in energy policy and the economy more widely.

Front-bench automatons until very recently were continuing to intone that 'Britain is uniquely well placed to weather this storm'. We are, in fact, uniquely well placed for a hammering: we have a housing bubble bigger than that in the US, a massive over-dependence on the City-slicker sector, North Sea Oil production that is falling off a cliff, and a high population density, which makes

us more dependent on the import of expensive food than any other European Country.

The Green New Deal offers a route map for tackling the triple crunch of the credit slump, rising fossil fuel energy prices and the need to urgently tackle climate change. It can transform today's reality of energy insecurity, rising joblessness and economic decline into a future of increased environmental and economic security and energy self-sufficiency. We call on Gordon Brown to demonstrate the courage of which he has elsewhere written so eloquently, and to take on the challenge of this new deal.

The full-length version of this article is published in Soundings *41.*

Colin Hines is a founder of the Green New Deal Group and Director of Finance for the Future.

The Green New Deal *is published by the new economics foundation on behalf of the Green New Deal Group. Its authors are Andrew Simms, Anne Pettifor, Caroline Lucas, Charles Secrett, Colin Hines, Jeremy Leggett, Larry Elliott, Richard Murphy and Tony Jupiter. To read in full go to* www.neweconomics.org/gen/z_sys_publicationdetail.aspx?pid=258#

A people's Post Bank

Lindsay Mackie

The Post Bank will be an important part of recreating resilient local communities.

When we launched our Post Bank manifesto earlier this year at the House of Commons with all party support, there were moments when the members of the coalition looked across at each other and jaws dropped in various degrees of astonishment. What seemed to be happening in Committee Room 14 was the tangible re-shaping of old political leanings around the issue of public need; the role of government in departing from the credo that the state must be rolled back; and the need to imagine and create a society of more humanity, more care and even of more tradition.

Jon Cruddas described the vision of Post Bank as a profoundly important moment – a democratic bank, localised, part of the process of creating resilient local economic infrastructures: it would help to protect us in our communities from the economic squalls that were going to continue. Philip Blond, the 'red Tory', was also in favour of localisation, raising the idea of local bonds and re-capitalising local economies through local investment trusts, based on the hub of the Post Office network. Vince Cable put the Lib Dems firmly behind the idea: it would give 'powerful purpose' to the existing Post Office network, rather than simply being part of a defensive war against the depredations of government over the years. He went further than many critics of the banking system when he said that Post Bank was an attempt to clean up banking, where 'the corruption of the system has spread across the branches'.

Roger Gale, Tory MP for North Thanet, gave a passionate speech in favour of a community based, local, socially valued Post Office and Post Bank. He was also very much against the privatisation of Royal Mail – selling off the family silver – and suspicious of financial experts who warned against setting up a state owned bank.

The disruption to received thinking caused by the current crisis is not – yet – as momentous as the disruptions that have taken place in the financial system. But the daily devastating bulletins charting the commercial banking world's descent into madness has greatly helped radical ideas, including the idea of Post Bank. Who wouldn't now want a bank without toxic debt, that will have no shareholder-driven short-termism and no bonuses, and will not play the market, instead wanting to serve its local communities?

It turned out at the Post Bank launch that nobody wanted to say no to it – except maybe the government; even Business, Enterprise & Regulatory Reform Minister Pat McFadden acknowledged that the idea had 'potential'.

The idea of Post Bank is not actually new. Girobank was an early model and countries such as Italy, France, Germany and New Zealand all now have one. But we – the Post Bank Coalition, formed of the Communications Workers Union, the Federation of Small Businesses, the new economics foundation, the National Pensioners Convention, Unite the Union and the Public Interest Research Centre – believe that at this time in Britain the Post Bank idea is the only progressive and potentially healing scheme to have been put forward since the crisis started. It is an alternative to the onward march of the corporate, amoral, social model that has been responsible for much of the grim environment in which we find ourselves.

The Royal Mail and the Post Office are part of the fabric of British society. They provide a universal service to all. Postal workers deliver to every door, regardless of the wealth that lies behind it. In its queues we are all equal citizens. Businesses of every

size and shape rely on it. For the elderly, the disabled, parents, and people living in rural communities, its services are essential. It works well, and could work a lot better if it was modernised and properly invested in. Safeguarding that vision is as much a part of Post Bank's function as is the injection of trust into the banking system that it would provide.

The truth is that the Post Office and its parent organisation Royal Mail are bulwarks – both symbolic and actual – against a dystopian society in which value means money and community means nothing.

The coalition started with a clear view of the post office as a great national institution, and the Post Office network as a unique national resource. Communities, businesses and individuals all depend on it. We therefore believe that it should be both be protected and grown, and that a Post Bank based on the Post Office is the best way of strengthening it – securing its future through building up and extending its current financial services. But as well as playing a role in maintaining the viability of the Post Office, Post Bank can also contribute to a wider re-design of the banking system.

One of Post Bank's roles would be to help combat financial exclusion and create rights to a fair, accessible and trusted banking system. We believe that the over-arching principle of a clean banking system must be a Universal Banking Obligation. It is unacceptable that the commercial banks have been deciding who shall and who shall not be able to access reputable sources of finance. And while it is the government's job to get their nationalised banks to offer decent services, there is a need for a diverse and plural range of banking provision. The Post Bank would be well placed to assist in improving financial inclusion. The government has made moves to extend financial services through the Post Office, and these are welcome; but they are no substitute for a new People's Bank based on the Post Office network.

Post Bank will not – most importantly – be shareholder-driven.

Profits will be re-invested in the network. The current plans by BERR to extend the Bank of Ireland contractual work with the Post Office would mean that 50 per cent of the profit of every transaction would go to the Bank of Ireland, thereby taking the money out of local communities and the Post Office network. It is therefore the wrong route to take.

Post Bank and the local economy

The aims of Post Bank are twofold. The first is to secure the Post Office network – currently around 11,500 post offices after the mostly disastrous culling of the last two years. A Post Bank would strengthen the network, would use it to its full capacity, would attract many more customers and would help modernise the Post Office. A local network also makes sense environmentally; and it is important socially – a local post office will continue to be a hub, a social centre and an information centre.

The second aim is to create a bank which will actually be useful and productive – helping end financial exclusion while also contributing to local businesses. The Post Bank will make a large-scale intervention on financial exclusion – an area where the commercial banks have failed miserably. They have withdrawn branches and services from large swathes of the country that are deemed not profitable; and, partly as a consequence, there are now 3 million people without a bank account. This makes them prey to loan sharks and doorstep lenders charging larcenous interest repayments.

In 2005/06, 13 million people in the UK – roughly one-fifth of the population – lived in households that were below the low-income threshold. And among the many factors contributing to the decline of disadvantaged neighbourhoods are limited access to finance and lack of appropriate financial training and business support. Poverty is now concentrated in specific geographic areas, and in areas that have lost banks local people have also become excluded from the banking system. The Post Office already provides

a known and trusted face in such areas, and a Post Bank would strengthen this support.

The commercial banking system also fails to support local enterprise and small business. Yet this sector employs 59 per cent of the private-sector workforce. Small and medium-sized enterprises currently employ an estimated 13.5 million people, and have an estimated combined annual turnover of £1,440 billion. Furthermore, the ability to finance new ideas and enterprising individuals to fill gaps in provision during recessions is one of the ways that economies eventually pull themselves into better economic times. If the banking infrastructure is inadequate for small enterprise, recovery is likely to be delayed. And access to 'patient' or long-term capital, to see small businesses through the crisis, would also be provided by Post Bank – a service that the large commercial banks do not provide.

Small businesses rely heavily on their local post offices for mail services. A Federation of Small Businesses survey showed that 79 per cent of respondents use the Post Office for their mail services and 88 per cent use stamped mail rather than metered mail. If small businesses could also access a wider range of financial services at the post office, they could deal with a large number of errands in one visit, thus saving them valuable time.

In other words a Post Bank would reconnect with the real economy of business and local enterprise.

The Post Bank as a new financial institution

Post Bank would break the model of risk-taking by being publicly owned and locally based, helping to serve local communities and economies though building on the foundations that already exist in organisations such as credit unions and community development finance institutions; these could support the Post Bank in developing better ways of delivering complementary community-based financial services.

The Post Bank would be set up with government financing (and would be a much safer bet than the billions it has already paid out to cover banking insanity: capitalising the Post Bank would not be used to finance existing debt but to serve real local economies). The bank could also be capitalised through the issue of local bonds, giving local investors a stake in a local financial provider. The bank should cover its costs eventually, but there will be certain products and services – loans, debt advice – that could be funded from government programmes directed at poverty reduction and social inclusion. There is already a huge sum of money in NSI savings, transferred from commercial banks during the present crisis. In the year 2007/8 (the period in which Northern Rock failed) NSI inflows grew by 9.9 per cent, to take annual inflow to £15.5bn. It seems safe to say the 'flight to quality' will only have intensified since then.

Post offices are well suited to banking. Post Office staff already conduct financial services in an 'FSA compliant' manner, and recruiting staff with financial expertise should not be a problem, given all the redundancies in the banking sector. The Post Office has the single biggest computer-linked system in Europe, and it is the third biggest UK cash carrier in terms of employees and vans. The Bank of England has recognised the Post Office as a cash storing institution.

The Post Bank will not have the very high – and random – charges that commercial banks have developed. It could offer free banking, or at least charges that are lower than those of commercial banks (another advantage of not being shareholder-driven). Any charges could become part of the Bank's investment back into its communities.

Successive governments have disgracefully neglected the Post Office; they have failed to see its vital social nature; they have been too blinkered to consider its future as a communications web linking us together; and they have omitted to notice that the diverse population of Britain has a range of needs (and skills) which should

be met by a diversity of social and economic institutions. Post Bank would help meet these needs and utilise these skills, and would give this government in particular a chance to demonstrate its commitment to the public realm.

Lindsay Mackie is a campaigns consultant for the New Economics Foundation, where she is working on the campaign for a Post Bank: www.neweconomics.org.

UK food security: from U-boats to climate change

Robin Maynard

Peak oil, climate change and unstable commodity prices mean that British agriculture is in need of a radical transformation.

Until recently anyone raising concerns about the UK's food security was likely to be dismissed as an anti 'free-trade' xenophobic crank, harking back to the days of the last war, when German U-boats threatened to cut off our supplies of food and fuel. It was the U-boat torpedoes that focused public and political attention on the need for maintaining a significant strategic resource of home-grown production, but it remained a concern after the war. Public subsidies and research and development funding were poured into agriculture. Farmers were encouraged to modernise, mechanise and become specialised arable or livestock producers, and to shift away from what was seen as inefficient, sentimentalist 'Old McDonald-style' farming – where each farm ran a mix of different enterprises. In tandem with this increased specialisation went a much greater reliance on off-farm inputs of chemical fertilisers, pesticides and pharmaceuticals for livestock. Yields and overall productivity were boosted, and the proportion of foodstuffs consumed in Britain that were home-grown rose dramatically. And alongside this production-focused push, the agri-businesses also boomed – supplying the agrochemicals and other inputs that farmers could afford because of public subsidy.

Superficially, this policy-driven farming renaissance was a triumph of technological achievement, with greater quantities of food being produced at affordable prices for the British public. And for the

past sixty-years ensuring a supply of plentiful 'cheap food' has remained the goal of successive governments, whatever their political leanings. But this single-minded focus on squeezing out maximum tonnes of grain or head of livestock per hectare has not been without controversy or cost – for wildlife, animal welfare and the livelihoods of rural people. And over the past couple of years, several factors have come together to call into question the long-term sustainability of this system, forcing the issue of food security higher up the agenda.

From 2006 to 2008 global food prices rose rapidly, fuelling social and political unrest in fourteen countries worldwide – causing 'tortilla riots' in Mexico and protests over the price of pasta in Italy. For the UK, food inflation has been running at 13.7 per cent since June 2008, up on the previous three months' rate of 10.6 per cent. After years of ignoring food security, growing public and media interest has at last provoked some welcome activity from government. Indeed, the first review Gordon Brown commissioned on becoming prime minister was a Cabinet Office Strategy Unit analysis of food issues generally. Their initial report, circulated in January 2008, concluded that 'existing patterns of food production are not fit for a low-carbon, more resource-constrained future'; and that 'existing patterns of food consumption will result in our society being loaded with a heavy burden of obesity and diet-related ill health'.

Strangely, those strong statements were air-brushed out of the final report published later that same year and the Strategy Unit's analysis appears to have become a 'minority report'. It seems that the hand of the Treasury and its 'free-market' inclinations have been the major steer over policy. The government's dominant view remains that expressed by Defra Minister Margaret Beckett in March 2006:

> We do not take the view that food security is synonymous with self-sufficiency … It is freer trade in agriculture which is key to ensuring security of supply in an integrating world. It allows producers to respond to global supply and demand signals, and enables countries to source food from the global market in the

> event of climatic disaster or animal disease in a particular part of the world … it is trade liberalisation which will bring the prosperity and economic interdependency that underpins genuine long term global security.

Such faith in the capacity of the 'global market' and 'trade liberalisation' to meet our food needs pervades Defra's later 2008 report, *Ensuring the UK's Food Security in a Changing World*, as evidenced in its statement that 'because the UK is a developed economy, we are able to access the food we need on the global market'.

Global food markets under stress

But the world has changed dramatically since that statement was written, and over-reliance on the global food commodity market is now as imprudent as reliance on global financial markets. Indeed, global food and finance markets are prey to the same self-serving interests. Some of the rise in global food prices stems from speculators moving out of dodgy derivatives and into more substantial, less toxic, food commodities. But there's a wider range of more enduring factors that are destabilising the world food market. These include the diversion by the US – once the world's major exporter of grains – of nearly 20 per cent of its cereal harvest into biofuel.

Such factors may seem distant and irrelevant to UK shoppers and politicians, who see no apparent shortages on supermarket shelves. But there are indications that our food system's links into the global food market are showing signs of stress. Take this comment from a leading UK retailer in response to a recent food-chain stakeholder survey on UK food security:

> A sense across the global supply chain that, whereas in the past, as a retailer, we have been able to shift very rapidly between countries if there was a problem … there is now a recognition that the ability to hop between countries is being constrained, as

> climate change and other issues, such as the price of oil, kick in … a growing awareness in the food industry that things aren't going to be the same in the future.

That uneasiness hasn't yet filtered through to government. Simply based on the statistics, UK food security seems robust, with the country in a stronger position than it was sixty years ago, when only 30 to 40 per cent of all food eaten here was grown in UK soils. According to Defra's statistics, the UK is currently 74 per cent self-sufficient in indigenous foodstuffs, and 60 per cent self sufficient for all foods. Elsewhere the 'official self-sufficiency figure' given for the UK is 49 per cent, however, implying that less than half of food consumed in the UK originates here, while another Defra study states that overall UK self-sufficiency has fallen by 10 to 15 per cent over the past twenty years.

Furthermore, government statistics reveal not just a widening trade gap, but also a disparity between policies. Healthy-eating guidelines urge consumers to eat more fruit and vegetables, yet 90 per cent of fruit eaten in the UK is produced overseas, and the area of UK land put down to vegetables has declined by nearly 25 per cent over the past ten years. In 2005 the UK had the largest deficit of any EU country in trade with countries outside the EU (5.35 million). Defra's response to any food security concerns raised about this trade gap is that the majority (68 per cent) of our imports come from other EU member states, which it considers 'low-risk, stable trading partners'.

Defra dismisses any suggestions that a greater proportion of UK home-grown food might be wise by describing self-sufficiency as 'an illusion' – because it doesn't take into account the extent to which goods produced in the UK depend on imported inputs, notably oil and gas, fertiliser, pesticides, feed and machinery. In a 2005 paper, the government estimated that 69 per cent of pesticides and 63 per cent of primary energy used in the UK for agriculture were imported; and a 2006 paper put the import figure for fertiliser at 37 per cent, up from around 10 per cent in the 1970s. But this is a self-defeating argument:

those alleged ‘low-risk’ EU exporting countries are also producing food via unsustainable systems similar to our own, predominantly depending on imported, oil-based and finite mineral inputs.

And that fact – given the ‘new fundamentals’ of climate change and its cousin peak oil – unravels any claim that the UK and the EU are removed from global food security concerns. Farming and food production in the UK, as well as globally, are simultaneously contributors to climate change and vulnerable to its impacts. Ironically, the richer countries that have pursued the path of industrial agriculture and its associated more centralised food distribution and retail systems may well be more vulnerable in the long term than the countries in the South that are popularly associated with food insecurity, poverty and famine.

Nitrogen fertiliser – agriculture's Achilles heel

‘Westernised’ agriculture’s increased productivity over the past sixty years has been due to a greater reliance on artificial inputs (particularly nitrogen fertilisers) and machinery, rather than on fertility-building crop rotations and livestock manure (and this has also conveniently displaced human labour). Use of fertiliser on its own is believed to have boosted crop yields by 30 to 50 per cent. There have long been concerns over fertiliser polluting water sources, with both ecological and human health impacts, but the overall sustainability of its use has not been widely questioned to date. Now, as agriculture’s main source of greenhouse gases, it is coming under much greater scrutiny.

Unlike other sectors of the UK economy, only 13 per cent of agriculture’s greenhouse gas emissions are in the form of carbon dioxide. Instead the majority are made up of nitrous oxide and methane – nitrous oxide represents the larger part of this, at around 50 per cent, while methane emissions make up 36 per cent. The main source of nitrous oxide is artificial nitrogen fertiliser, upon which non-organic farming in the UK is dependent – using over 1

million tonnes annually. Nitrous oxide is 310 times more damaging than carbon dioxide. And the manufacture of nitrogen fertiliser also accounts for the biggest portion of energy used in agriculture, amounting to over 40 per cent of all UK farming's energy requirement. To make a single tonne of nitrogen fertiliser takes a tonne of oil and 108 tonnes of water – in the process giving off over 7 tonnes of carbon-dioxide equivalent greenhouse gases. Emissions from the manufacture and delivery of nitrogen fertilisers aren't included in farming's official carbon footprint, however; they are allocated instead to 'industrial sources'. Yet modern industrial farming couldn't function without them. Adding them to the total boosts agriculture's total greenhouse gas emissions by 14 per cent.

In October 2008, Ed Miliband, the new Energy and Climate Minister, accepted the recommendation of the Committee on Climate Change to set the higher target of 80 per cent cuts in greenhouse gas emissions by 2050 – and that this target should include all greenhouse gases, not just carbon dioxide. That policy decision alone questions the resilience of our current food and farming system: it would necessitate a radical change in how we grow, source and distribute our food. Getting anywhere near achieving 80 per cent cuts on agriculture's greenhouse gas emissions must mean radically cutting artificial fertiliser use, as well as generally reducing dependency on oil.

This is not simply an issue of helping to curb climate change: in the long-term, global resources of oil are going to become scarcer and more costly to extract. With oil prices collapsing, along with the global economy – falling to under \$40 a barrel from last summer's high of \$140 – the shock of peak oil seems to have receded into the distant future. But the respected think-tank Chatham House predicts prices rising again to £200 a barrel over the next two decades. Our food is steeped in oil. The average American's annual food needs require 400 gallons of diesel to produce, process and distribute – and a similar figure applies here. As the era of 'cheap oil' comes to an end so too will the era of 'cheap food'.

The illusion of endlessly available fossil-fuel inputs like fertiliser has masked the fundamental link between good soil husbandry and sustained food security. The European Agricultural Conservation Foundation estimates that soil erosion and degradation affect approximately 157 million hectares of land in Europe (16 per cent) – roughly three times the total land area of France. And along with tonnes of precious soil, we have also lost hundreds of thousands of people from the land, and with them the skills to work it, displaced by chemicals and machinery. UK agriculture has seen a long, steady decline in employment. In 1900 around 40 per cent of the UK population was still employed in agriculture; by the start of the Second World War that had fallen to some 15 per cent; and today it's less than 2 per cent. Any form of lower-carbon farming, less reliant on climate-change-boosting fertilisers and fossil-fuels, will certainly need more people to be involved again in food production.

Major social, cultural, dietary change

The social, cultural and dietary changes required if Britain is to move to a more sustainable agriculture system are enormous. Take London alone. An analysis of London's overall 'footprint' by the Greater London Authority in 2003 estimated that to supply all of Londoners' needs the city's total 'footprint' was 48,868,000 global hectares (gha), or 6.63 gha per capita. The capital's true global 'fairshare'– i.e. its share if it reflected London's portion of the world's 'biocapacity' – would be a total footprint of 1,210,000 gha or 0.16 gha per capita. To achieve this would require all Londoners to consume 70 per cent less meat, eat more than 40 per cent local, seasonal unprocessed food, and cut their food waste by one tonne a year. This is indicative of the challenge of a wholesale switch to a more resilient, climate-friendly system.

Given the challenges of changing people's eating habits, perhaps Defra's strategy of basing our food security on a significant portion of imports is justified? And indeed the Soil Association isn't

proposing that the UK should become 100 per cent self-sufficient in all the food we consume. Even if we took advantage of the much wider range of fruit and vegetables that can be grown here (but is rarely seen in the shops), our diet would be duller and lacking in some key additional nutrients. Tea, coffee, chocolate and bananas have become staples in many people's shopping baskets, and when fairly-traded these provide vital income and livelihoods to farmers in poorer countries. And other imported foods that can't be grown in the UK form a central part of the diets of the diverse ethnic groups that now make up British society. From a food security perspective, importing a certain proportion of our food needs is a sensible hedge against crop failures caused by unanticipated weather events or disease outbreaks. But it makes strategic sense to maintain a resource of UK farmland capable of growing a significant proportion of our food, whilst also sustaining the numbers of people with appropriate farming skills.

So, has our government understood the enormity of the food crunch heading our way? Do they have an adequate strategic plan? Given our recent experience of the collapse of the financial markets and the consequent credit crunch – I fear not … That's why the Soil Association's main campaign efforts are directed at achieving 'A Secure Food Future – Organic by 2050'.

The full-length version of this article, which also includes pointers to some positive and available solutions, will be published in Soundings *42. The Soil Association's fuller report on the issues,* An Inconvenient Truth about our food - neither secure, nor resilient *is available at http://www.soilassociation.org/*

Robin Maynard has worked for more than twenty years in the environment movement, including posts as FOE's Countryside & Agriculture campaigner and later as Director of Local Campaigns; with FARM; and as Campaigns Director at the Soil Association.

Climate change needs social change

Michael Prior

Tackling the recession must not mean forgetting the environment.

Action to avert climate change must be the key priority for policy even in times of economic recession. There is an overwhelming scientific consensus that if the present level of greenhouse gas emissions (GHG) continues, let alone rises, there will be major changes in the world's climate. The only controversy is just how catastrophic for human life these changes will be and how soon the shifts will happen.

The Labour government, together with the serried ranks of business, is clear that various combinations of carbon trading, 'green consumerism' and new technology can provide a mechanism whereby a low-carbon future can be achieved without any essential changes in personal lifestyles or social activity. Individual consumers will have the choice of reducing their carbon footprint or buying carbon credits from others. New 'eco-towns' will house an expanding population and the sale of inefficient appliances will be eliminated. Business will have the same choice of reducing carbon emissions or buying them from overseas. Government policy with respect to household and transport emissions is a good deal vaguer. It emphasises measures relating to consumer action such as enhanced insulation and fuel-efficient cars, whilst holding out the possibility of personal carbon-credit cards for buying and selling carbon.

Some necessary statistics

It may be uncharitable to interrupt this Panglossian view of how the transition to a low-carbon life will disturb neither economic growth nor personal consumption, but the government's record to date hardly supports such optimism. Although the UK is just on track to meet its obligations under the Kyoto treaties, virtually all the required decline came before 1997, the year Labour was first elected. Since then carbon dioxide emissions have actually increased, balanced only by small reductions in other GHGs, notably methane. The main reason for the decline in the first part of the 1990s was a switch from domestic coal into gas, mainly in power generation but also in industry. On Labour's watch – which precisely matches the time since Kyoto was signed – less than nothing has been achieved to avert climate change. There have been plenty of targets but no substantive action.

The overall message for the future is that the Labour government's blithe optimism about how market forces will produce the changes necessary to avert climate change has no basis in Britain's record since 1997. Thus Britain has the worst record in the EU (apart from Malta and Luxembourg) for installing the renewable energy sources which all agree are a key component of any action to reduce GHG emissions. In 2007, for example, just 270 photovoltaic systems were installed on houses, compared with 130,000 in Germany, whilst, overall, just 2 per cent of our energy came from renewables, leaving the modest target of 15 per cent by 2020 as only a vague dream.

This is not to suggest that Europe as a whole has been particularly successful in reducing GHG emissions. The UK has been saved by mine closures. Elsewhere in Europe, where such an option has been unavailable, the Kyoto targets have, in the main, been ignored. EU15 emissions in 2005 were almost the same as in 1990, with only the UK and Sweden showing any sign of meeting their Kyoto obligations inside their territory.[1] And the fact that

Canada and Japan are also missing their obligations does nothing to mitigate the EU15 failure.

Happily for the green reputations of all these countries, however, a mechanism is at hand to rescue them. The Kyoto baseline date of 1990 is exactly the high-point of energy use in then-Communist countries. Economic decline and the associated drop in fuel consumption began immediately after this as communist systems collapsed. Thus these countries are meeting their Kyoto targets, some by large margins. In particular, Russia and Ukraine have Kyoto surpluses which exceed the combined deficits of all other Annex I countries.[2] These surpluses will be available to be traded to deficit countries.[3] In the EU, as in the UK on a smaller scale, environmental blushes will have been saved, this time by the massive chaos created by the collapse of communism (and each case has involved a transfer of social hardship from the rich to the poor).

Judged by this standard, the Kyoto Treaty has proved something of a fiasco, even leaving aside the refusal by the USA to ratify its provisions. Since 1997, the wealthy nations of the world have done little to reduce carbon emissions; the introduction of some renewable energy technologies has been more than balanced by growing consumption, particularly in transport. Meanwhile, the later industrialising countries, notably China and India, have undergone a period of rapid economic growth, fuelled largely by coal-based energy economies. There has been considerable hand-wringing over the impossibility of making any major inroads on carbon emissions unless these two countries reduce their growth in emissions. Politicians put less emphasis on the fact that it has been the failure of the wealthy nations over the past ten years to make any impact on their own emissions which has left so little room for manoeuvre in negotiating new reduction targets. They also place little emphasis on the fact that a significant element of China's growth in GHG emissions comes from provision of manufactured products to the west, products which once they made themselves.

The outcome of the international process begun in Bali at the end of 1997 is unclear, though most environmentalists believe that the conference produced little agreement other than to continue talking. However, one thing is clear. This time there will be no repeat of the localised economic collapse which has so fortuitously saved the face of the wealthy nations after Kyoto, no convenient mechanism to transfer the social pain. Recession may cause some global stagnation in emissions, but it is more likely to provide an excuse for inaction than to become an automatic consumption regulator.

Social action

The New Labour government, despite extensive rhetoric, has been a disaster for any action to stop climate change. The overall picture, that CO_2 emissions have actually increased on their watch, has already been illustrated; but the situation is actually worse when seen in detail, for there is no sign that any active policy is in place to reverse the trend. Despite having the largest potential wind, tidal and wave resource in the EU, Britain lags well behind all large EU countries in the installation of devices to utilise these. The schemes to promote household energy efficiency have largely collapsed even from their previously under-funded situation. Why is this? After all, other EU governments have hardly covered themselves in glory in preventing GHG emissions. The nub of my argument is that the market-based policies for GHG reduction to which the Labour government appears wedded are not only ineffectual but can be actually counter-productive. There are essentially three reasons for this.

The first is that in many situations, direct state intervention is simply more effective than any market-based alternative. An immediate example of this is the imposition of so-called 'feed-in tariffs' (FIT) for renewable electricity sources – as against incentives based upon emissions-trading. The generation of electricity is a crucial part of any GHG reduction programme, and there is now

almost universal acceptance that FIT (under which government-set guaranteed tariffs for electricity from renewable sources are paid to producers by electricity suppliers) work much better than the current UK market-based scheme, whereby electricity suppliers are give tradeable quotas for renewable electricity production. Yet in its 2007 Energy White Paper, the government treated FIT almost contemptuously, stating that it was 'hard to draw firm conclusions as to the effectiveness of these mechanisms', in the face of overwhelming contradictory evidence. The government has recently drawn back from outright opposition to FIT, but only for very small installations which will limit their effectiveness.

The second reason for the ineffectiveness of market-based policies is that their development often requires complex or bureaucratic mechanisms which take years to design, and which are always susceptible to insider lobbying. An historical example of this is the US sulphur-emissions trading scheme, which took years to negotiate and implement as compared with the European route of simply requiring that all installations above a certain size fit sulphur-removal kit. There is no evidence that the US approach ultimately saved any money in terms of investment, whilst it prolonged by years the physical damage caused by acid rain. The personal carbon-trading 'credit card', much promoted by David Miliband when environment minister, is a good example of how the market approach still dominates British government thinking. Apparently based on his perception of a Tesco loyalty card, the ramifications of this scheme, both technically and socially, almost defy belief. And it has had the effect of effectively stalling other policy routes which could be pursued with immediate impact.

The third reason for not relying on market-based policies is that a 90 per cent reduction in GHG emissions can only be attained by altering the social basis of our lives, a shift that requires developing a social consensus about the need for such change. The simple political fact is that governments will not push policies that will be rejected by an electorate who do not accept the need for such change, or which

can be changed by any new regime. At present, the Labour government appears to believe that a kind of 'green' consumerism by individual households will be enough to shift how we live to the extent required to achieve the necessary change. The facts of carbon emissions in the last ten years should be enough to show that this will not work. One simple reason for this is that individual consumers can hardly be expected to understand all the complex factors which go into reducing their own carbon emissions in any meaningful way.

However, information is only part of the problem. The society we live in alters our lifestyles in many different ways, many of which are almost impossible to resist and most of which are geared to increase consumption. The social changes required to reduce GHG emissions run counter to many of the pressures of a market-based consumer society, and it is only by achieving a different social consensus that they will be achieved. There are numerous examples of such consensual shifts – though possibly none as complex and far-reaching as those required to combat climate change. Attitudes towards drink-driving and smoking are recent examples. Although state intervention in various forms has been a factor, the key influence in both cases was a social shift towards regarding both as socially undesirable.

Although relatively muted, in both these cases there was also opposition to the changes, based upon grumbles that it was limiting human freedom; that the alleged damage was over-stated; and that it was all got-up by interfering do-gooders and busy-bodies. It is already possible to see the same complaints emerging over action to limit carbon emissions, and with much greater effect, given the diffuse nature of the problem and its lack of any obvious and immediate personal impact. There have been suggestions that the recession means that action to cut GHG emissions will have to be given a lower priority. In fact, the necessary abandonment of many aspects of the consumer society can give such action the point of departure, provided it is socially based.

The huge reductions in GHG emissions required to avert climate change cannot simply be achieved by government

intervention, but nor should all market instruments be rejected. Change will require extensive local cooperation and social agreement, of a kind that will be impossible based upon centralised authority. It will require the involvement of local authorities prepared to work with local residents in a truly democratic way to develop carbon reduction programmes. It is obvious that the place to start is with social housing, as these have often been some of the worst insulated structures, as well as with all the buildings operated by various branches of councils and the health service. The reduction in heating and power bills which will come from radical insulation and local power generation will thus benefit the poorest first, and will serve to diminish the huge gap which has developed between social housing and owner-occupation.

Action to reduce – ultimately to effectively eliminate – GHG emissions needs to begin now, not just with minor changes but immediately, with radical measures. The severity of the danger requires no less. The need to reduce the impact of unemployment by direct job creation provides opportunities for just such radical changes. What is required is political will.

The full-length version of this article will be published in Soundings *42.*

Michael Prior is author of *Beyond Feelbad Britain* available at www.hegemonics.co.uk/docs/beyond-feelbad-britain.pdf

Notes

1. Recent entrants to the EU such as Poland are not included as the collapse in energy consumption in most of these countries immediately after 1990 means that their Kyoto targets are secure.
2. The Annex I countries are all the industrialised nations that signed up to the Kyoto agreement.
3. The period in which Kyoto targets are legally binding is 2008-2012 after which a new treaty is required.

Why economics can no longer be left to economists

Clive Dilnot

The bankruptcy of dominant economics is an opportunity for rethinking.

Here, as a reminder, are three of the ways that professional economists responded to the financial crisis in autumn 2008.

The first comes from late September, just as the initial agreement for the $700bn bail-out of the banks was being settled in Washington. 166 US economists (including three Nobel prizewinners) sent an open letter to Congress. While the letter made a nod to taxpayer interests, its core proposition was contained in the following sentence: 'For all their recent troubles, America's dynamic and innovative private capital markets have brought the nation unparalleled prosperity. Fundamentally weakening those markets in order to calm short-run disruptions is desperately short-sighted'.

The second came in October, when 16 British economists signed an open letter to the *Sunday Telegraph*. Their contribution was to deny that this was a crisis at all. 'Occasional economic slowdowns are natural and necessary features of a market economy', they wrote. There was little to be alarmed about – and no need at all for any change in policy. 'Insofar as [slowdowns] are to be managed at all, the best tool is monetary.' Any 'additional state spending' would only 'stunt the private sector's recovery once recession is past'.

The third comes from Edward Phelps – a 2006 Nobel prize winner and Director of the Center on Capitalism and Society at Columbia University – who in the *Financial Times* of 5 November

argued that whatever else should occur in terms of resolving the crisis, one principle above all must be preserved: 'Owners of financial and business enterprises', he said, should 'be accountable to no-one (except their own consciences) – thus free to use their own intuition.'

We need to understand the all-but absolute blindness of economics in respect of the financial crisis; and we need to understand why it was that the discipline which, in theory at least, assigns to itself the responsibility for thinking the economy, so spectacularly failed in its mission. This is particularly crucial to understanding future decision-making. And here we face a particular problem. For when we ask who will make these economic choices, we face some uncomfortable truths. While circumstances have changed massively over the last few months, structures – and their principal players – have not. Those who manifestly failed to anticipate the crisis, who patently failed to understand its dynamic or apprehend its consequences as it unfolded around them, are the ones to whom we are still handing responsibility for putting the pieces back together. Thus, for example, Obama's 'new' economic team are almost all, to one degree or another, previous players in the crisis, whether on Wall Street, in government, or in regulatory authorities. The problem here is of course not just about personalities: the question is whether the *mentalities* of current economics can encompass what is demanded.

Confusing the market with accumulation

A large part of the problem here (evident in all three of the quotes with which I began) is what economics puts up front – which is the market, pure and simple. If we think of an economy as principally a site for private accumulation, and if we see it operationally as a series of efficient markets, all of which work best without regulation; if we think that these markets can be self-regulating; if we think that they will tend, over time, towards equilibrium (and will never therefore,

under their own volition, come to crisis or collapse); if we think that prosperity is dependent on giving these markets the freest possible reign and if, finally, we think that those who operate those markets require (as incentive) and deserve (as reward) colossal payments for their labour, then we will create (or we will accept) an economy very like the one that has just spectacularly fallen about our ears.

This kind of (mis)understanding of economics outlined above is what has enabled the economy to develop in the way that it has. For the crisis we now find ourselves in is not only – though it is – a crisis of a (privatised) mode of accumulation gone awry. It is also the product of a failure to properly understand what was happening in this economy.

More than thirty years ago Edward Nell memorably and critically summarised that economics as we know it 'made its main business the *demonstration* that a well-oiled market mechanism will produce the most efficient allocation of scarce resources among competing ends.' The language of that sentence is precise – and telling. Demonstrations are analytical only within the terms of their presuppositions. The market-mechanism presupposes the essential wealth-creating potential of markets. Economics thought in this way necessarily becomes the analytical (and rhetorical) *defence* of market efficiency and possibility. The corollary of this presupposition is that, while there may be externally induced and temporary slow-downs, even disruptions, in market operations, it is scarcely possible for properly run (i.e., 'free') markets to *destroy* wealth – on the contrary, markets are *always* productive of wealth, and they are on this basis (here is Adam Smith) *essentially* virtuous.

One problem is that this approach confuses markets and capitalism. What was operatively at work in this crisis was not markets, but accumulation pure and simple; specifically accumulation based on money capital treated as if it were a private source of accumulative possibility. Accumulation of this kind is the reverse of the efficient market hypothesis. Profits are made not through exchange in a transparent market but by trading on

asymmetries of information. In these markets accumulation happens through the willed uncertainty and extreme risk of de-regulated 'informal' exchange: volatility, the lack of transparency, asymmetry, all are essential to its operation. Capitalism, as a force of accumulation, knows no laws of operation. Furthermore, accumulation requires a differential gradient. Lacking one, it creates it, if necessary by force. Thus accumulation does not end in equilibrium: on the contrary, inequity is its point. Finally, the drive for accumulation is congenitally incapable of registering the costs and consequences of economic activity; accumulation will always run the risk of crisis, and in any case crises too are opportunity for profit, no matter how personally or systemically risky the crisis may be.

Accumulation therefore is not 'the market'. It would be better to say, accumulation makes use of markets. This was the gap between the reality of what was happening in the City and Wall Street, and what economics and economists were telling themselves about what was happening.

The paradox here is that although economics is the cheer-leader for capitalism – and one of its principal legitimating agencies – it displays in its thought and teaching a fastidious distaste for the brute realities of accumulation. Following Hayek (rather than the great realists of the nineteenth century) it ever wants to cleanse and make ideal flawed capitalist reality. But in drawing a veil over what is unseemly, and in eliding and hiding uncomfortable truths – in giving us a sanitised capitalism, a capitalism without costs – economics covers-over reality. The dynamics of the situation are lost sight of. The realms of practice that the discipline seeks to grasp retreat from view. The concept that promised economic enlightenment ('the market') becomes the unquestioned canon that *blocks* understanding.

Certainly it was disconcerting for regular readers of the *New York Times* to see Paul Krugman, in the weeks before his autumn award of the 2008 Nobel Prize for economics, struggling to make sense of

what was happening. One felt his shock at his inability to grasp or explain satisfactorily the debacle around him. What one realises is that orthodox economics, even at the high-end, has no adequate explanation for what was happening. The 'efficient market hypothesis' cannot account for the crisis – above all it cannot account for a crisis that was wholly internal, a crisis engendered in and of the markets; a crisis in which 'external' factors play an insignificant role.

The most obvious example of what was missed, or what did not come to view in the weeks and months that the crisis unfolded, was the role of debt. A set of markets and institutions dependent on ever-increasing levels of debt could not but fail. The only question was when, and what would trigger a fall. Debt was by no means the only factor in the crisis but it was the indispensable condition. In particular, without the tolerance and acceptance of previously unprecedented levels of inter-bank debt, the triad of asset-inflation, speculation in mortgage-backed securities and other forms of structured investment vehicles would have been impossible. Debt – meaning excessive debt – was the precondition on which the whole edifice was built. All this was visible to a professional view but it was (largely) not noted. Why?

We come back to the assumptions that guide a discipline. If you believe in efficient markets then, if they are delivering astonishing levels of return, you scarcely doubt the basis on which those returns are being effected. In line with the thesis that one's job is to demonstrate that 'well-oiled' market mechanisms will always produce the most efficient allocation of resources, and in love with the concept of dynamic and innovative capital markets, you ignore or downplay the consequences of the *total* subordination of the *public* dimensions of the credit system to private interest. Above all, you cannot see that the relentless expansion of private money-capital is both unsustainable and in the end not productive of wealth at all but only extractive, and – as we now know – destructive.

Economics has been abject in relation to the crisis. It has revealed itself as, at best, a minor technical footnote to the operations of markets – providing that these markets play by the rules that economics has itself stipulated. It has proved completely incapable of grasping the dynamics and the implications of relentless capital accumulation based on privatized credit markets. Indeed the nature and pre-conditions for success (and failure) lie outside of its understanding, because it cannot bring itself to face what in truth it should be dealing with. Markets 'become' capitalism and replace it in thought. This allows the destructive force of private accumulation to be presented as an objective good.

The privatised accumulation of the social

All this is bad enough. But it doesn't end there. For the converse of failure to engage with the forces of accumulation is the relentless colonisation, on behalf of markets and privatised accumulation, of the social. What in truth belongs to social exchange, what is *not* identical to the market, is understood as having reality only in relation to the market. Market forces – not social exchange – now determine value.

We have allowed this to happen to such an extent in the last thirty years that it takes an effort today to recall that credit and banking systems are not reducible to private interest in accumulation; that they have by necessity a public dimension, since they facilitate public exchange. We forget too that money is a complex medium of social exchange that is *not* reducible to pure 'monetary' relations; that labour is not reducible to paid work; that land (nature) is not reducible to rent or the monetarised costs of doing business; that motivation (to work) is not reducible to accumulation; that innovation is not reducible to purely monetary incentive; and, above all, that the 'common-good' is not reducible to privatised accumulation.

These kinds of reductionism obscure the dependency of economic accumulation on the social institutions and social

relations that keep it in being. Unable to understand the relations that sustain economic activity, economics has become a deeply dangerous field: because in practice it extends into every field of the social, its own 'autonomy' is increasingly a threat. It is inadequate to the thinking about the economy that we now need.

The crisis tells us that it is essential that we are able to fully grasp the consequences of privatised accumulation – and to assess, much more objectively than at present, the true costs and implications of doing business in the way it has been done over the last thirty years: to look hard at the costs of the extractive or dis-possessive or diversionary economy – both as 'financialisation' and as the unsustainable exploitation and 'using-up' of what-is.

We also need a mode of thought capable of reflecting on the character of economic life in relation to the complex aspirations we have for the common good. We require an acutely sensitive and intelligent political economy capable of discerning economic life not (only) through the peculiar and flattening (and inverted) prism of the market, but also in its social dimensions, for the benefit of all. We need a political economy that allows for the exploration of those aspects of the social that make possible economic relations, and that are themselves the goal of productive activity considered not as private interest but as the building of social wealth.

Causes for optimism?

What are the prospects, if any, for such an economics? There are two small reasons for hope. The first is that, especially in its extreme Chicago form (the form which unfortunately has become in large part the global norm), the crisis has at least dented (if only a little) the authority of economics. One must not exaggerate, nor wait for the mea culpa. But the failure – the abject intellectual failure – of the discipline cannot quite be washed away.

The second reason for hope stems directly from the first. It is that, in the wake of the double failure of the market and of

economics, the field becomes once again what it must be – a dialogue around political economy, and above all around the question of the kind of social economy we need *and would wish to identify ourselves with over the longer term*. And there are some signs of this emerging.

Economics, especially alternate views of the economy, has very quickly become in the last few months a key topic, meaning a topic, in the strong sense, of conversation. This is what happened with political economy in the nineteenth century. The creation of a space of wide debate, while no substitute for the gradual development of a new, and much more adequate, kind of professional economics, is nonetheless an indispensable precondition for it. For what we need now is not another version of a 'pure' economics, but exactly the opposite: an economics of social and ecological negotiation, and an economics that can think beyond extraction. In a word, an economics for a society that is learning that it must become capable of contending and accounting, adequately, with the costs – and possibilities – of its actions.

Clive Dilnot teaches at The New School in New York, where he is professor of design studies: dilnotc@newschool.edu.

The killing fields of inequality

Göran Therborn

What is inequality?

There are (at least) three fundamentally different kinds of inequality, and they are all destructive of human lives and of human societies. There is inequality of health and death, which we may call vital inequality: hard evidence is piling up that health and longevity are distributed with a clearly discernible social regularity. Children in poor countries and poor classes die more often before the age of one, and between the age of one and five, than children in rich countries and rich classes. Low-status people in Britain die more often before retirement age than high-status people. Vital inequality, which we can measure relatively easily through life expectancy and survival rates, is literally destroying millions of human lives in the world every year.

Second, there is existential inequality, which hits you as a person. This kind of inequality restricts the freedom of action of certain categories of persons, for instance that of women in public spaces and spheres, as is the case in many countries around the world today. Existential inequality means denial of (equal) recognition and respect, and is a potent generator of humiliations – for black people, for (Amer-)Indians, for women in patriarchal societies, for poor immigrants, for those of low caste, and for stigmatised ethnic groups. It is important to note here that existential inequality does not only take the form of blatant discrimination; it also operates effectively through more subtle status hierarchies.

Thirdly, there is material or resource inequality, meaning that human actors have very different resources to draw upon. We can

distinguish two aspects here. The first is access to education, to career tracks, to social contacts, to what is called 'social capital'. In conventional mainstream discussions, this aspect is often referred to as 'inequality of opportunity'. Secondly there is inequality of rewards, often referred to as inequality of outcome. It is the most frequently used measure of inequality – the distribution of income, and sometimes also of wealth.

The production of inequality

Inequality can be produced in four basic ways. The first can be described as distantiation – meaning that some people are running ahead and/or others are falling behind. Exclusion is a second mechanism – through which a barrier has been erected making it impossible, or at least more difficult, for certain categories of people to access a good life. Thirdly, the institutions of hierarchy mean that societies and organisations are constituted as ladders, with some people perched on top and others below. Finally, there is exploitation, in which the riches of the rich derive from the toil and the subjection of the poor and the disadvantaged.

The historical importance of these mechanisms in generating the configuration of the modern world is still hotly disputed. Exploitation, the most repulsive generator of inequality, is a significant feature of today's world, but it is not the major force. Rather, organisations and societies are permeated by subtle hierarchies of social status. Through their unequal allocation of recognition and respect, through the limitations they impose on freedom to act, and through their impact on self-respect and self-confidence, these appear to be a major reason behind persistent inequalities of health and life expectancy. And social hierarchies produce existential inequality, which in turn has serious psycho-somatic consequences.

In the course of the twentieth century there was a substantial income equalization in most western countries, including in the UK,

but class differentials of life expectancy widened, particularly among men. In 1910-12 an unskilled manual worker in England or Wales had a 61 per cent bigger risk of dying between the ages of 20 and 44 than a professional man. In 1991-93 the extra risk of early adult death had risen to 186 per cent.[1] The hardest evidence for the lethal effects of status hierarchies is probably Sir Michael Marmot's twenty-five year study of 18,000 Whitehall civil servants.[2] The risk of early death closely followed the office hierarchy. When age, smoking, blood pressure, cholesterol concentration, and a few other such factors had been controlled for, those at the bottom of the hierarchy died from coronary heart disease 50 per cent more often than those at the top.

Barriers of exclusion have been generally lowered in the world over the last century. The exclusion of women from public space, from labour markets, and career ladders has declined. Racism has become widely discredited, and the late twentieth-century return to the mass migration of a hundred years earlier is also consistent with more inclusion. Regaining national sovereignty in the postwar period removed some of the barriers for the formerly colonised countries, and for China and India in particular it opened up possibilities of development. Between 1913 and 1950 the rate of economic growth in China and India was approximately zero. But between 1950 and 1973 Chinese growth was 4.9 per cent a year, and India's 3.5 per cent.[3] Though lower than before, however, exclusion is still a major feature of the contemporary world, which is divided into exclusive nation-states, each with its specific rights for citizens only. There are also other excluding processes at work – for example American cotton protectionism, which hits poorer countries of the African savannah.

The paradox of distance

Finally we come to the mechanism of distantiation, and here we are facing a paradox of our times. In a territorial sense, distances have shrunk enormously. On the other hand, income and vital distances

are increasing, within the world and within many, if not all, countries. In the first half of the 1970s, the distance in life expectancy at birth between sub-Saharan Africa and high-income countries was 25.5 years; thirty years later it was 30 years.[4] In the UK the life expectancy gap between the rich and the poor has been increasing by 0.15 years annually since the 1980s.[5] Within metropolitan Glasgow the gap between males in Calton and in Lenzie is 28 years, larger than that between the UK and Africa in the 1970s. Capitalist Russia and the rest of countries of the former Soviet Union are also falling behind in life prospects.

In 1973 GDP per capita in sub-Saharan Africa was about 8 per cent of America's. In 2005 it had dropped to 5 per cent, measured in terms of domestic purchasing power.[6] Within the US, the share of total household income appropriated by the richest one per cent was 8 per cent in 1980 and 17 per cent in 2000. In the UK, the richest 1 per cent leapt from receiving six per cent of all income in 1980 to taking about 12.5 per cent in 2000.[7] The gap between the income of the richest and that of average workers is now much wider than in pre-modern times.

Another angle from which to view the new economic distance is the current world distribution of wealth. Last year, before the bubble burst, Forbes magazine (March 2008) listed 1125 billionaires in the world. Together they then owned $4.4 trillion. That was almost the whole national income of 128 million Japanese. In March 2009 the billionaires number 793, owning only $2.4 trillion – which is equal to the national income of France.[8]

Distantiation is the main road to increasing inequality today. It is the most subtle of mechanisms, the one most difficult to pin down morally and politically. Though its effects are highly visible in ostentatious consumption, it operates more through stealth than through assailable principles or blatant violations of human rights. But distantiation is a mechanism, or channel, of inequality; it is not a causal force. So what drives it?

Global vital distances have grown because some countries have

fallen behind. Russia and the former Soviet Union are victims of a ruthless restoration of capitalism, causing massive unemployment, economic insecurity, impoverishment and existential humiliation. The leading British epidemiologist Sir Michael Marmot has estimated the death toll of capitalist restoration in Russia in the 1990s to about four million people.[9]

The global income gap increase is also an effect of Africa falling behind. There is not the space here to go into the complex reasons for this, but the long period of colonialism and neo-colonialism it suffered is a key factor, as are the continuing unequal terms of trade between the continent and most of the rest of the world.

The widening gap in intra-national income, on the other hand, is driven mainly by increases at the top, although in the US (but not in the UK), the soaring of the highest incomes during the last decade was also accompanied by a slow decline of the income for the poorest fifth of the population. That the top is now running ahead rather than the poor falling behind means that competition from low-wage countries is a minor component of the gap. Interestingly, the u-turn in income inequality is primarily an Anglo-Saxon phenomenon, most pronounced in the US, but also marked in Canada, UK, Australia, and New Zealand. It has not been so much of a trend in Germany, France, Netherlands, and Switzerland.[10]

Why is economic distance widening?

There seem to be two major processes at work. One is the extension of solvent markets, which has increased both the pool of rewards and the competition for star talent. The lifting of controls on capital movements in the 1980s, the expansion of transnational investment, and the emergence of a global executive and professional market, have catapulted a small business elite upwards, surfing on soaring stock markets. A similar phenomenon has occurred in sports and entertainments, and this is increasingly referred to by apologists of inequality.

The second process is the increasing autonomy of financial capitalism from what is still called 'the real economy', a process particularly pronounced in Wall Street and the City and their other Anglo-Saxon emulators. In the last ten years this has turned capitalist finance into a gigantic casino, trading in currencies, 'securities', and 'derivatives'. The amount of nominal money involved has become astronomical. In early March 2009 the Asian Development Bank estimated that by then the value of financial assets in the world could have fallen in the current crisis by $50,000bn, which is equal to the total value of the world product in 2007.[11]

Inequality, so what?

OK, inequality is a fact, and increasing, so what? Inequality is a violation of human rights. Few people are likely to argue that a society which awards 28 fewer years of life to people in the most disadvantaged neighbourhood (Glasgow Calton) than to those in the most privileged ones (Glasgow Lenzie, London Kensington and Chelsea) is a decent society. Is it a vindication of the superiority of capitalism that male life expectancy in capitalist Russia is now seventeen years shorter than in Cuba?[12] Social status hierarchies are literally lethal. The richest country on earth, and the most unequal of the rich countries, the USA, has the third highest rate of relative poverty among the 30 OECD countries (after Mexico and Turkey). The poorest tenth of the US population has an income well below the OECD average poor, lower than the poorest tenth in Greece.[13]

The turn of capitalist finance into a huge global casino has created the current economic crisis, and put hundreds of thousands out of employment, and is now demanding billions of pounds of taxpayers' money. In the South the world crisis is bringing more poverty, hunger, and death.

Growing social distance diminishes social cohesion, which in turn means more collective problems, like crime and violence, and

fewer resources for solving problems like global warming. Western Europe – east of the British Isles, west of Poland, and north of the Alps – is still the world's least inegalitarian area. For an experience of the full power of inequalities, you should look at the violence and the fear of most South African and Latin American cities.

What is to be done?

Global inequality is to a large extent class and intra-state ethnic inequality. While overall income inequality is still governed by nation-state divisions, class and ethnic demarcations are cutting through them. 'Globalisation' is not a convincing excuse for inequality. Global equalisation requires that the popular, disadvantaged forces of the inegalitarian countries are strengthened.

Inclusion is a means of promoting equality that has brought women into public space and labour markets in many parts of the globe. Recently it has changed the Creole coloniality of some of the Amerindian republics of Latin America, particularly in Bolivia and Ecuador – though the issue of how to include the 'First Nations' into the polity of the twenty-first century remains on the agenda, from Chile to Canada. The European Union has also made a contribution, through the recent inclusion of an impoverished Eastern Europe into its area of prosperity.

Redistribution and recompensation are also powerful tools for addressing inequality. Denmark and Sweden are the least income unequal countries of the world.[14] The Danish welfare state spends 28 per cent of GDP on social expenditure, the Swedish 31 per cent – while the UK spends 20 per cent.[15] Both Denmark and Sweden are heavily dependent on the world market: merchandise export makes up 35 per cent of Danish Gross National Income and 40 per cent of Swedish – compared to 17 per cent of the UK. Pro-marketeers will perhaps ask whether this equality and generosity is sustainable in the context of the world market.

The irrefutable answer is yes. For many years, the Davos World

Economic Forum Global Competitiveness Reports have put the Scandinavian countries at the very top (together with USA and Switzerland). In the 2006-2008 editions, Denmark was ranked no. 3 in global competitiveness, with Sweden as no. 4 in 2007-8. New Labour Britain was no. 9, down from no. 2 in 2006-7.[16]

While these composite rankings should always be taken with a pinch of salt, the recurrent success of the Nordic welfare states – with Finland ranked 6 and oil-rich Norway 16 out of 131 countries on a world capitalist list – certainly does mean that generous, relatively egalitarian welfare states are neither utopias nor protected enclaves, but highly competitive participants in the world market. In other words, even within the parameters of global capitalism there are many degrees of freedom for radical social alternatives. And the literally lethal effects of inequality make searching for them imperative.

The full-length version of this article will be published in Soundings *42.*

Goran Therborn is Professor of Sociology at Cambridge University. His latest books include (as editor and co-author) *Inequalities of the World* (Verso), and *Between Sex and Power. Family in the World 1900-2000* (Routledge).

Notes

1. Calculated from R. Fitzpatrick and T. Charandola, 'Health', in A.H. Halsey and J. Webb (eds), *Twentieth-Century British Social Trends*, Basingstoke, Macmillan, table 3.8.
2. M. Marmot, *The Status Syndrome*, London, Bloomsbury, 2004, p45.
3. A. Maddison, *Contours of the World Economy, 1-2030 AD*, Oxford, Oxford University Press, 2007, table A5.
4. UNDP, *Human Development Report 2007/8*, Geneva 2007, table 10.
5. Joint Bristol and Sheffield University study, reported on the BBC News 29.4.05.
6. Maddison, op cit, Table A5; UNDP 2007, op cit, table 14.
7. T. Piketty, 'Top Incomes Over the Twentieth Century: A Summary of Main Findings', in A.B. Atkinson and T. Piketty (eds), *Top Incomes over the Twentieth Century*, Oxford, Oxford University Press, 2007, p12.

8. www.forbes.com/forbes/2009, accessed 12.3.09.
9. Marmott 2004, op cit, p196.
10. Atkinson and Piketty, op cit.
11. G. Tett, 'Lost through destructive creation', *Financial Times*, 10.3.09, p11.
12. UNDP 2007, op cit, table 28.
13. OECD, *Growing Unequal?,* Paris, OECD, 2008, p37.
14. OECD 2008, op cit, p52.
15. OECD, *Society at a Glance*, Paris, OECD, 2007.
16. K. Schwab and M. Porter, *The Global Competitiveness Report 2007-2008*, Geneva, World Economic Forum, 2007, table 4.

Constructing a left politics

Bryan Gould

Neoliberalism has had its day. It is time to reassert the values of the left.

As the global economic crisis gathers force, it not only sweeps before it the flotsam of discredited economic doctrines; it also demands a complete reappraisal of how economies and societies work. It poses again the great questions that underlie all political debate, and it poses them in the certain knowledge that the answers given over the past thirty years – and so widely accepted – must now be rejected.

This is, in other words, one of those rare moments when it is not only possible but positively essential to go back to first principles. We must ask again, what is the purpose of politics, what is the role of government, does democracy matter, and – for those who see the need and seek the opportunity for reform – what does it mean to be on the left in politics.

Those questions must be asked, of course, at a time when – in Britain at least – left politics has run into the buffers. The concessions and subterfuges that were thought to be necessary to win power and then to hold it are now unmasked not just as craven but as totally destructive of anything that could have been legitimately regarded as the true purpose of left politics. If there is one incontrovertible lesson to be learned, it is that a left politics that is disconnected from principle and analysis will lead to failure and defeat.

The opportunity is, then, to think again about that body of principle and structured analysis that should underpin any left approach to politics. Our starting-point for such an inquiry must surely be a recognition that, since the late 1970s, and with the often

unstated acquiescence of the left, the political agenda has been dominated by neo-liberal thinking.

The dominance of this self-serving doctrine has been a huge achievement for those who already exercised great economic power, but felt their privilege threatened by the political power of democratic electorates. They feared, correctly, that elected governments, accountable to the widest range of interests, would not tolerate a system which unfairly favoured the rich and powerful by allowing them to rig the contest for power in their favour.

The rise of neoliberal hegemony

The powerful responded to this threat by bringing about changes, around the end of the 1970s, which negated the power of democracy – changes whose significance was hardly recognised at the time. They made elected governments irrelevant, by acquiring a degree of economic power that would allow them to face down and blackmail all but the most powerful democratic governments – and to bend even the most powerful governments to their will, by using their economic power and invulnerability to political pressure.

The individual steps by which this was achieved need be only briefly rehearsed here. One of the earliest of these masqueraded as a purely technical change that would help international trade and investment, and that was sold to the ordinary citizen as a welcome reduction in bureaucracy. That change, of course, was the removal of exchange controls by Reagan and Thatcher so that international capital was free to roam the world in search of the most favourable investment opportunities. In one step, the rules of the game had changed hugely. Investors no longer had to comply with the requirements of elected governments. Instead, governments found themselves played off against each other by investors who commanded greater and greater resources as the now global economy was funnelled into fewer and fewer hands.

It was governments that now had to sue for terms; they would

lose out in the competition for investment if they did not comply with the demands of the multinationals. The investors, on the other hand, now understood that they could exercise their power quite irresponsibly. It was, after all, governments – not the investors – that had to answer to their electorates. The investors answered to no one but their shareholders. And most costs could be 'externalised', or passed on to taxpayers who no longer had a voice. A further consequence was that voters began to understand that their governments could no longer protect them, and confidence in the democratic process began to weaken.

At around the same time, monetarism became the accepted wisdom, on the left as well as the right – the doctrine that managing the economy was a more or less technical exercise in controlling inflation (the only goal, it was said, that mattered) by regulating the price of money. This technical task could safely be entrusted to unaccountable officials – bankers no less – so that, in one simple step, democratic government was excluded from perhaps the central function for which it was elected.

These ground-breaking changes were reinforced by re-shaping political structures in the image of international capital. Multinational investors found it increasingly irksome to have to deal with national governments, each with its own set of requirements, each reflecting the particular interests and priorities of their own voters. They insisted that economies would function more efficiently if those controlling investment capital could deal with authorities (such as the European Union) that matched their own multinational structure and scale – unelected multinational bureaucracies whose goals coincided with their own. So powerful was the momentum towards the integration of national economies in the name of greater economic efficiency that no one seemed to notice that the long-term consequence was not only an actual reduction in economic efficiency but also a political loss of a most serious kind – the replacement of democratic governments as the ultimate authority by multinational capital.

The ability of multinational capital to set the political agenda meant that a doctrine that could never have been directly sold to voters in individual countries became the dominant driver of the world economy – the view that markets are infallible, that they must not be regulated or interfered with in any way, that the interests of shareholders and the bottom line are all that matters, and that governments must step aside while market forces have their way.

Few seem to have understood – not even politicians supposedly of the left – that an 'infallible' market and democracy cannot co-exist. The whole point of democracy, after all, is that ordinary people can use the political power of democratic legitimacy to offset what would otherwise be the overwhelming economic power of the privileged minority. If even democratic politicians accept that they are powerless to intervene in the market, and that it would be literally improper and counter-productive for them to do so, then the powerful are unconstrained in their ability to impose their will on the rest of society.

We can now see the inevitable consequences of that extraordinary concession by democratic politicians – one that is even more incredible when made by politicians of the left. Unrestrained markets will always threaten a conspiracy against the general interest – as indeed Adam Smith pointed out. They will always lead to excesses. They will always, as a consequence, in the end destroy themselves. The global recession was the direct and inevitable consequence.

We can also see how and why the New Labour government lost its way. Its fascination with the rich and powerful, its acceptance that the unregulated market must always prevail, its belief that market solutions will always be best, and its embrace of a global economy dominated by international capital, all meant that it opted out of the role that most of its supporters expected it to fill – the diffusion of power in society so that the less powerful were protected and treated fairly.

Markets and government

None of this means that the left should dispense with the market. At its best, the market allocates scarce resources, empowers consumers (through what might be described as economic democracy), stimulates efficiency and innovation, and rewards the most productive and creative. It is, however, a valuable servant but a dangerous master. It is the elevation of the market to the status of a moral force that cannot be challenged that enables the powerful to by-pass democracy. That view must be contested. If democracy is to mean anything, government must be ready to intervene in the market so that its outcomes are acceptable and sustainable, both politically and economically. The deliberate aim of a left government must be to utilise the market so as to optimise its great strengths, but to make sure as well that the market does not prejudice the wider goal of diffusing power as widely and as fairly as possible throughout society – through entrenching and extending the power of the privileged.

In other words, good government also matters. It is the means by which the market is restrained, so that the full resources of the whole of society are deployed to the widest advantage; by which essential services are provided; by which the economy is managed and directed for the general good; by which the benefits of citizenship are fairly and productively shared; by which the cohesion of society is effectively developed.

This is of course at odds with the right-wing doctrine that government should limit itself to a minimal responsibility for maintaining the value of assets – and particularly the currency – and should otherwise merely hold the ring while market operators are allowed to get on with it. The left has always taken the view that governments are inevitably major players in the economy. They are the most important investors, customers and employers. They influence events and behaviour through policy decisions. As a result, they should accept responsibility for the overall context in

which economic activity takes place. They should properly be concerned with the appropriate level of demand, the provision of gainful employment opportunities for all citizens, and the fair distribution of the fruits of economic activity. It was the abandonment of these responsibilities, particularly by the left, that contributed so greatly to the global crisis.

A proper balance between the roles of the market and the government, between economics and democracy, is essential. And it need not – as is often argued – require a sacrifice of economic efficiency for the sake of social outcomes or political principle. The lesson of the last thirty years is that 'free- market' economics do not lead to efficiency – great riches for a tiny minority, yes, but sustained and equitable economic progress for all, no.

The case for diffusing power throughout society is as much economic as it is social. We make the most efficient use of our resources, and particularly of our human resources, if everyone has the chance to make their most appropriate contribution to wealth-creation; if that contribution is fairly recognised and rewarded; if everyone's potential is properly recognised and not suppressed; and if we understand that no individual is so talented as to merit rewards hugely greater than those enjoyed by others, since it is the cumulative effort of the whole of society that is overwhelmingly responsible for the progress we have made.

A similar argument can be made concerning the proper use of our natural resources and the sustainability of our environment. If decisions on these matters are taken by democratic agencies answerable to the widest possible constituencies, rather than by a handful of self-interested operators in a short-term market which they dominate, we have a better chance of managing our natural resources to the greatest possible advantage for all of us and of our planet.

These economic and environmental arguments reinforce the great social case for a wider diffusion of power. Freedom in society is not to be measured by the level enjoyed by that powerful

minority that benefits from the greatest freedom of choice. Freedom exercised by denying freedom to others – even indirectly, through the supposedly value-free operation of the market – is not the mark of a free society. Only by diffusing power, by breaking down concentrations of power, can we optimise freedom for everyone. The supposed antithesis between freedom and social justice dissolves away when the goal is to allow everyone the maximum level of freedom that is commensurate with a similar level for others.

These principles of democracy, social justice, and community – and the analysis by which those principles are derived – provide us with the basis for deciding an appropriate left political agenda. We should be clear what the touchstones are on issues such as who owns, controls and benefits from the economic process; the appropriate level of guaranteed provision for the basic requirements of a civilised life; what attention should be paid to the interests of others beyond our shores and beyond our lifetimes; and the importance we attach to a sense of fairness for the maintenance of social cohesion and unity.

Some signposts for change

In economic terms, we should reclaim economic policy (including monetary policy) as the proper responsibility of democratic government rather than of bankers, and as a proper subject for public debate. We should recognise that economics is a behavioural science and does not lend itself to mechanistic solutions. In particular, we should re-examine the role of the privately owned banks in the light of the current debacle and question whether they should ever again be allowed a virtual monopoly of credit creation. In view of the burden that bank failure has imposed on the taxpayer, should the banking function not be seen as essentially a public responsibility?

The roles of limited liability and the joint-stock company should

be re-examined, in view of the irresponsibility and disregard for the public interest that they have demonstrated. New models of industrial ownership and control should be explored, including those that would give working people a stake in their own enterprises.

A left government should take the lead in negotiating new agreements to reform international financial and economic arrangements so that multinational capital takes a more responsible attitude to the communities in which it is invested, the volatility of foreign exchange markets and flows of 'hot money' are restrained; and global imbalances between rich and poor, and between debtor and creditor nations, are addressed effectively.

In social terms, a left government should recognise the over-arching importance of making whole again a society that has been fractured by class, economic circumstance, ethnicity and religion. An inclusive society based on fairness and tolerance, and one that placed a value on all its citizens, would be the most effective antidote to crime and other anti-social behaviour, and would also provide the conditions for improved economic performance. Making full employment once more the prime goal would also be important. An attack on economic inequality through a combination of integrated tax and income support policies would produce a more cohesive society. Health and education services that reflected the public service ethic rather than the profit motive and the market mechanism would also be helpful.

The demands of practical politics will inevitably require compromise and trade-offs. But each policy, each new initiative, should meet a sort of health check provided by the touchstones that were outlined earlier. The alarm bells should ring if the policy agenda is seen to fly in the face of the basic principles. If only New Labour had heard them toll!

The full-length version of this article will be published in Soundings *42.*

Bryan Gould was elected as Labour MP for Dagenham in 1983 and joined the Shadow Cabinet in 1986. He directed Labour's election campaign in 1987, and contested the Labour Party leadership in 1992. In 1994 he returned to New Zealand as Vice-Chancellor of Waikato University. He is currently a director of Television New Zealand. In 2005, he was made a Companion of the New Zealand Order of Merit. His website is http://www.bryangould.net/.

Soundings

'Soundings is defining the new politics – spread the word'

Jon Cruddas MP

Subscribe to Soundings
online or by standing order

Soundings is thinking ahead

Compass is the UK's most influential centre-left pressure group, with over 3000 members and 15,000 supporters. We campaign for a more equal, sustainable and democratic world.

This is a call to mobilise for the real change and the new politics our country now desperately needs by joining our mailing list, taking action and getting more involved.

The Observer

Brown faces party revolt over energy windfall tax

To join our supporters list, or become a member please visit

www.compassonline.org.uk

email: info@compassonline.org.uk or write to 'FREEPOST COMPASS' (no stamp or address required)