



6th August 2012

The Mess We're In

“The genius of our ruling class is that it has kept a majority of the people from ever questioning the inequity of a system where most people drudge along, paying heavy taxes for which they get nothing in return.”

- The late Gore Vidal.

“**It’s a mess**, ain’t it, Sheriff ?” suggests the deputy in the Coen brothers’ ‘No Country For Old Men’ as they survey the body-strewn aftermath of a West Texas gunfight. “If it ain’t,” replies Tommy Lee Jones’ laconic lawman, “It’ll do till the mess gets here.” And our mess is already here, albeit with the likelihood of plenty more mess to follow. The latest offering¹ in the increasingly crowded pantheon of financial crisis porn stands apart from its competitors for at least three very specific reasons:

- It doesn’t focus myopically on the mess in banking, but instead puts our giant international banking mess in the context of a wider analysis of budget deficits; the slow collapse of occupational pension provision; fears for economic recovery; and as its subtitle indicates, whether our political systems are even remotely fit for purpose in attempting to resolve these various crises.
- It offers a much broader overview of the sad history of politicians in their various dealings with the economy and financial markets. (The word has already been coined: “Omnishambles.”)
- It dares to offer some practical solutions and a way out of the swamp.

We are now five years into this crisis and there is no tangible sign of improvement. Having thrown everything at banks including the kitchen sink, governments are now starting to appreciate that all they have achieved is the loss of a kitchen sink. Which may be why the Financial Times last week reported that the full nationalisation of RBS was back on the agenda. Barclays’ discredited former CEO, Bob Diamond, was obviously ridiculously premature when he suggested that a period of banking remorse and apology needed to be over. On the contrary, given the scale of the mess, and its cost to the taxpayer and to the economy, that requisite period of remorse and apology may yet outlive us. But bashing the bankers gives only the least satisfying form of relief. As we have frequently suggested, no account of the crisis can be complete without a comparable assessment of the role played by our politicians – not just in the run-up to the events of 2007 and 2008, but in the years and decades that preceded them.

'The Mess..' begins its analysis of political involvement with markets and money with the 1919 Treaty of Versailles. Enter John Maynard Keynes, in whose name all sorts of monetary high jinks are now being perpetrated². Keynes recognised, after the Allied victory,

"..that a government running a budget deficit for any length of time must itself be inflationary, and the longer and more significant the deficit then the greater this effect would be. For even a government can only borrow so much money, after which it will resort to printing more money, and with more money in circulation its value must surely fall..

"Keynes [also] realised that, once heavily indebted, a country could slip into a vicious inflationary spiral. If it borrowed in its own currency, then it would need to print more money with which to pay it back and, if it was running a budget deficit, perhaps even to service the interest. If it borrowed in foreign currency, then again it faced the prospect of having to print much more of its own money with which to purchase the foreign currency with which to repay the loan..

"It was the danger of widespread economic hardship leading to social unrest, or even revolution such as the communist uprisings that Germany had already witnessed, to which Keynes was attempting to alert the French and British governments. Incidentally, Keynes is widely credited with saying that the easiest way to undermine a capitalist society is to 'debauch the currency', but in fact he was quoting Lenin, albeit only to agree with him."

Versailles, of course, begets the Weimar hyperinflation, which in its own way begets Hitler. There are good reasons for the Bundesbank to be wary of letting the ECB print money without restraint. But this brings us to the essentially political problem of our time. Politicians "all have a vested interest in the system remaining exactly as it is – and it is that system which lies at the root of our problems. It encourages politicians to make decisions only on their likely short-term outcomes and it gives them far too much scope within which to make such decisions, with far too little democratic mandate." In tune with our own scepticism, the author takes up arms against the central banks, including our own Bank of England:

"The Bank sees its role as 'promoting and maintaining financial and monetary stability and its contribution to a healthy economy.' If so, then the astute observer may spot that it must surely rank as one of the most unsuccessful organisations in human history, since we currently have neither financial nor monetary stability, nor a healthy economy. Perhaps wisely, the Bank's website does not elaborate on how these things might be defined, nor does it mention its failure to keep inflation under control."

Perhaps the finest story in economics is Frédéric Bastiat's fable of the broken window. A shopkeeper's son breaks a pane of glass. A crowd gathers. The spectators soon conclude that while the broken window is bad news for the shopkeeper, it will be great news for the glazier. Perhaps more windows should be broken, to enable the money stimulus spent on mending broken windows to trickle down through the economy. The crowd see the window. What the crowd misses is what goes unseen. Any money spent by the shopkeeper on repairs will not, and cannot, be spent on anything else. Britain's politicians today see the Olympic village (for example) and a host of vanity projects paid for by the taxpayer. What they cannot see is what that now spent money cannot be spent on instead. Politicians, like the members of Bastiat's crowd, see only what they want to see.

But politicians, like their appointees in the central banks, believe that they must be seen to be doing something. Visible action, of whatever form, is deemed to be superior to thought. This is a

workable definition of fascism. So ECB President Mario Draghi pledges to do whatever it takes to save the euro. But what if the euro is the problem, rather than the solution ?

'The Mess We're In' provides a thorough analysis of the motley interplay between feckless politicians and clueless economists through the ages. The reputation of Keynes is largely restored. The growing reputation of the Austrians is rightly reinforced. And the author doesn't pull punches in advocating policy measures that might correct the state's automatic tendency to inflate, or move government budgets toward a more manageable balance. What is missing from the current debate between the various economic schools and between the electorate and the political classes is a sense of fundamental humanity: an appreciation that we are in a desperate fix, that genuinely hard choices will need to be made by all, and that a fiendishly complex sequence of crises cannot be resolved by overly simplistic economic dogma. In acknowledging that there are severe and possibly fundamental limits to the capabilities of politicians to resolve the sort of crisis we now inhabit, 'The Mess We're In' will help to manage expectations by voters and investors alike.

¹ **'The Mess We're In: Why Politicians Can't Fix Financial Crises'** by Guy Fraser-Sampson, published by Elliott and Thompson. Available from all good bookshops, and some thoroughly disreputable ones as well, perhaps.

² As the author points out, 1930s governments believed in balanced budgets. "Keynes himself called any period of budget deficit 'abnormal spending'. This is a crucially important point, frequently overlooked by present-day politicians eager to pick out the bits of a theory that they like but leave the rest behind. For it was to represent a vital building-block in what was to become known as Keynesian economics, a system of thought that would revolutionise the way in which people looked at the world. The key word here is 'system'. Keynes did not intend parts of his thinking to be applied in isolation while the rest of it, the less politically convenient part, was ignored."

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