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Them was rotten days

"Sir, Robert Skidelsky and Marcus Miller (Letters, February 27) consider that the Nobel Prize winner Friedrich Hayek offered a "counsel of despair" in the Great Depression. Next, we have the minatory clichés "writing on the wall" and a call for George Osborne to "change gear" or "let someone else take the wheel".

"By chance, having literally been chauffeur in 1975 to Hayek at a Mount Pèlerin conference and thus spending some hours with him, may I declare an interest. Hayek was a delightful passenger. His view of the self-adjusting powers of markets is in fact a counsel of well-founded optimism. Indeed, as we discussed, allegedly "austere" Britain recovered from the 1930s slump faster than "New Deal" America where, in H.L. Mencken's withering phrase, Roosevelt was "addicted to the spending arts".

"The real "hoax" is the neo-Keynesian delusion that sub-optimal capital projects and monetary manipulations led by the knowledge-poor mechanisms of the state can do a better job than the relatively better informed, risk-disciplined actions of players in properly constituted markets. The Skidelsky / Miller imagery of the economy as a single automobile – a fixed construct with all parts known to the manufacturer – precisely illustrates the misconception that centrally operated levers and controls are appropriate to outcomes in the social sciences, and would have been gently derided by the unfailingly polite Hayek as such.."

- Letter to the editor of The Financial Times from Mr Peter Smaill of Borthwick, Midlothian, UK.

"..But today we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. The result is that our possibilities of wealth may run to waste for a time — perhaps for a long time."

- John Maynard Keynes, "The Great Slump of 1930" in *Essays in Persuasion*.

In the long and colourful history of dispatches sent by us with an adolescently naïve hope to the letters editor of The Financial Times, here is one that made it through past enemy lines on November 23, 2011:

"Sir, In his article "Why we need to tax the crazy market speculators" (November 21) John Chapman presents a confused picture of financial market participants and their motives.

He seems to imply that hedge fund managers (for example) only ever make profits, and that those profits invariably accrue from evil speculation. Shorting stocks, just to take one strategy, carries extremely high risk as the potential losses are infinite. But most investors would concede that the process of shorting adds to market liquidity, price formation and transparency. Which is probably why most European politicians have banned it in connection with bank shares.

If Mr Chapman is unhappy that governments are regularly humiliated by financiers, perhaps those governments could stop borrowing money from markets that they (more accurately, their taxpayers) may never be able to repay.

As to the proposed financial transactions tax, which would only raise costs for end investors since so much financial activity is intermediated, President John F. Kennedy tried something similar in 1963 with his interest equalisation tax. That may or may not have helped the US balance its finances. But it certainly triggered the creation of the multi-trillion dollar offshore eurobond market which London now dominates. Not, perhaps, mission accomplished. The likes of Hong Kong or Singapore would doubtless applaud Europe's introduction of such a tax today.

I share Mr Chapman's disillusionment that the UK's banks appear largely unreconstructed, albeit perhaps better capitalised than some of their eurozone peers. But he seems to fixate on shooting the messenger. Governments should learn to live within their means, too – and this crisis may make them."

That was written in response to EU proposals to introduce a pan-European 'Tobin tax' on all financial transactions. Now the cretinocracy at the EU have gone one better, and pledged to introduce a bonus cap on banker earnings essentially fixed at one times salary. We despise bankers as much as the next man, but even we have to concede that this is a lousy and economically hugely detrimental policy driven by nothing more than political petulance. Mikko Arevuo of the European Business School in London makes the following valid criticisms:

"Europe keeps digging its economic and competitive grave, deeper and deeper, with the introduction of yet another anti-business law. The political commissars in Brussels passed a law on Wednesday that will restrict bankers' bonuses to the equivalent of their annual salary, or twice the annual salary with shareholder approval. The British mounted a spirited fight against this politically motivated legislation, but to no avail.

"Although the threat of bankers packing up their bags and moving to pastures new has to be taken with a pinch of salt, political intervention in private enterprise compensation levels will do nothing but harm. The immediate consequence of the restrictive law is to drive base salaries up. The removal of bonus compensation also restricts the ability of banks to claw back bonuses from their deal makers should their transactions result in losses. The threat of bonus claw backs can be used to incentivize better decision-making. The new law significantly weakens the behavioural carrot and stick of the bonus incentive.

"In the longer term, of course, there will be a gradual move of trading activities, or even bank headquarters, to more favourable tax locations, especially in the Far East, as this region increasingly becomes the centre of global economic activity. As the European economic decline accelerates, capital will seek new homes where returns can be made. The circulation of capital will promote economic growth and wealth creation in entrepreneurial and business-friendly economies. Conversely, over-regulated statist economies of Europe will become starved of capital resulting in a death spiral of reduced tax revenues, declining welfare state spending, increasing unemployment…and so on.

"Banker bashing is currently all the vogue among politicians as their two top priorities always are either to get elected, or re-elected. Any other problem that needs solving is far down the politicians' collective to-do list. The public hostility towards bankers, mainly based on ignorance, offers a platform for politicians to craft populist policies. The restrictive bonus law is good politics but bad economics, and as I said, in order to understand politics one needs to understand the politicians' two top priorities; who cares about the economic consequences of our policies, as long as we get to stay on the gravy train that comes with power!"

The other major political development of the week was the usual confused mess arising from the Italian elections, which now threatens a return to 'risk-off' panic throughout the euro zone and its debt markets. Unsurprisingly, few voters are keen on austerity. They seem to prefer clowns.

In sum, the reason why markets and economies throughout the west are in a hopeless funk comes down to a democratic deficit. Voters have learned that apparent economic privilege can be easily bought, albeit at the expense of future generations. In this rush for hand-outs, voter greed and short-termism is matched by the greed and short-termism of the politicians they end up electing. Unless and until we see the return of statesmen with vision and guts, as opposed to PR merchants with neither, there is no likelihood of righting the ship.

In the 1970s in the UK, under a Labour administration, the top rate of income tax ("temporarily" introduced in the early 19th Century) was 83%. Combined with a 15% surcharge on "unearned" income, this brought the marginal rate of income tax to 98%. Now, as then, we are overborrowed and increasingly desperate as a sovereign state, so it is little surprise to see our currency in freefall. Cometh the hour, cometh the man – or woman. Could these statesmen-in-waiting get a move on, though – this waiting is agonising. And the subtext is clear: the euro zone doesn't deserve your investment capital. Don't fight the trend – if Europe's politicians out of spite against the City want to drive profits and capital to Asia, might as well follow them there as investors.

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