PRACTICAL POLITICS

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OUTLOOK

A key issue is "financing government deficits in countries where the markets will no longer lend to the government" or will not do so on affordable terms. A second problem lies within the eurozone where "peripheral countries are so uncompetitive with the core countries" that measures to "regain competitiveness…appear unachievable". Around the world, the level of "debt within the global economy adds to the risk picture. The US and European governments have to issue total debt of around $5 trillion over 2011, to rollover existing debt that is maturing and to pay for this year's deficits. This amounts to $20 billion every trading day of the year." [a]. It is not smart to have to be borrowing to be in a position to pay the interest on earlier borrowings – hence the pressure to cut deficits. "Deficit reduction is a vital building block for sustained economic growth…Self-imposed fiscal austerity will always be politically very difficult, but it is far preferable to the austerity likely to be imposed by others – markets and the IMF – if action is ducked. Growth sustained today is only growth stolen from tomorrow" [b].

The International Monetary Fund (the IMF) has issued two warnings. The first is international debt, not only government deficits but also private sector indebtedness in the developed world. "Household debt has fallen by less than a 10th in the US and UK…Europeans are as in the red as ever. Gearing [*i.e.* the ratio of borrowing to equity capital – ed.] at western companies also remains near record highs", suggesting dire difficulties when interest rates rise. The second risk highlighted by the IMF is a rapid unwinding of carry trades [a carry trade involves borrowing money in a country with low interest rates and depositing it in a country with relatively high rates – ed.]. "The repercussions of hot money suddenly pouring out of emerging market assets are anyone's guess but they won't be pretty" [c].

As we noted in our Issue No. 184 (November 2010), our policymakers have thrown away the vital key – the abatement and eventual replacement of current taxes on work, goods, services, trade, spending, and saving, by the capture of the annual rental value of land for public revenue purposes – the policy known historically in this country as land value taxation (LVT). The rôle played by land in the economy is crucial. Ignoring it brought on this crisis, as it had done that of 1992. The ultimate cure for an economic depression is not to have one in the first place. Only full and proper LVT ensures that.

CONTRADICTIONS

The Government and the Opposition both want U.K. banks to offer more loans, especially to businesses and homeseekers. **(i)** Is the country not already supposed to be suffering from over-borrowing? Are the banks not busily repairing their damaged balance sheets (some of them in preparation for de-nationalisation)? **(ii)** Most of the larger U.K. companies operate internationally. Foreign earnings are worth more when converted to sterling now that the pound is effectively devalued by 20% or so. They are not in need of cash. They want something worth investing in at a time of high uncertainty and risk. They want less red tape (of all sorts) and reduced taxes. **(iii)** Private individuals and the owners of smaller companies share some of the views of the big companies, and are aware also of the dangers of more borrowing at a time of widely forecast interest rate rises. **(iv)** Policymakers must surely be aware that banks' basic interest rates are currently below the rate of inflation. In theory, this is a great time to borrow! For lenders it is a great time to lend at variable interest! Where is the evidence of a desire by the fully solvent to borrow for well planned investment? Could it be that few schemes currently look robust enough to withstand the slings and arrows of outrageous fortune? **(v)** Put simply, the slump came about as a result of frothy land speculation. Customers offered the banks the security of unrealistically swollen land value as collateral, and the banks, scenting profits, eagerly accepted it. The Government should be letting land prices fall back further now and be doing nothing to maintain or raise them. **(vi)** What possible good can come from urging lenders to loosen their criteria for couples seeking to become first-time home owners? The number of homes is static in the short term. Putting money in people's wallets can only boost competition, not availability. This will raise prices – the opposite of what commonsense tells us ought to happen. Before the year is out, a job loss and/or rising interest rates could see the new owners in deep despair and leave the lender with a bad loan on the books. **(vii)** A sensible housing policy would start with a Government announcement that a Bill for a National Land-Rent Charge (*i.e.* LVT) is to be introduced, and that relevant aspects of the planning system are for review. LVT would penalise land hoarding (of unused and poorly developed land) and instead stimulate new building.

EUROPE

"The reflex of the EMU elites is to blame this mess on lack of statesmanship…but is today's crisis really a failure of leadership? Was EMU not dysfunctional from day one?...Has it not left victim states trapped in slumps from which there is no escape on terms acceptable to Germany? If the project itself is rotten, what the eurozone needs most is an undertaker" [d]

Three months ago the European Parliament passed a budget costing the U.K. a total of £9.2 thousand million (£884 million more this year than last). "Included in the EU assembly's budget demands is a staffing increase of 388 posts to swell the ranks of the 6,166 civil servants who assist the work of 736 MEPs" [e]. There is more cash for assistants and researchers, a new EU diplomatic service, and three new EU offices in the U.S.A., China, and Russia. In the real world, governments are making efficiency savings, and cutting back on activities and staff, but in the sealed atmosphere of Brussels the fat cats of Europe order even more cream. Crisis? What crisis?

The recent report by the Court of Auditors "into the discharge of the EU's £102 billion 2009 budget declared the Brussels accounts to be 'true and fair' but highlighted 'material errors' that affected 92 per cent of spending, with particular concern over farm subsidy payments and shoddy public procurement rules…Court officials have growing concerns that farm subsidies are being paid to companies, such as golf clubs, property developers or speculators, who engage in no farming activity except for 'maintaining land in good condition' under rules that are badly policed. 'People can get high value subsidies by renting low value land. This problem is bigger than it seems,' said an auditor…Nine out of 10 audited road-building projects...went ahead despite breaches of funding rules being detected" [e]. Notwithstanding these seemingly forthright revelations, a member of the Court of Auditors, just retired, has alleged that the auditing bodies' reports have in fact been watered down, and that auditors have caved in under pressure from commissioners and from countries "including France and Italy", preventing "the true extent of fraud from being disclosed" [e].

Back in the real world, "**Spain** has set in motion a partial nationalisation of its crippled savings banks or *cajas* but stopped short of the giant rescue deemed necessary by some experts to contain the country's festering crisis… Spain remains caught in a vice of tightening fiscal policy and a deepening property slump that may culminate in a 40pc fall in house prices, eroding the solvency of the *cajas*" [d]. A firm of Madrid consultants estimates the overhang of unsold homes at 1.2 million. Meanwhile, **Estonia** has become the 17th. member of the EMU. The essential reason for adopting the euro is strategic rather than monetary. Together with having already joined NATO and the EU, Estonia is locking itself closely to the West. After rejecting Russification, Estonia's economy first picked up then boomed, "until all went wrong in the property bubble…a classical boom-bust story". **Latvia** has had an even tougher time: "debt is higher…and [the country] has required an EU-IMF bail-out" [d]. There is a different story coming out of **Iceland**. "Nobel economist Paul Krugman said Iceland has been able to eke out recovery sooner because it never joined the euro" [d] or indeed the EU. It let "its currency plunge…with inflation that devalues debt" and allowed the banks to fail without pumping money into them – tough, but it seems to be working!

ENERGY POLICY TANGLE

(i) "In the misguided belief that ethanol and biodiesel can help solve the problem of energy security…Europe and the US are piling on subsidy like it is going out of fashion." Existing subsidies of some $12bn annually would have to double to achieve the targets set. This "is incubating its own environmental catastrophe, from deforestation to excessive use of fertilisers and pesticides" [b]. Apart from the effect on food prices, inevitably "Pressure to grow crops for biofuels reduces land available for growing food. The grain needed to produce enough biofuel to fill the tank of a 4x4 could feed a person for a year" [f].

"Offshore wind farms produce electricity at twice the cost of gas and coal-fired power stations, and will need subsidies for at least 20 years…The cost of building and running the farms has risen rapidly" owing to "the spiralling price of steel and the drop in the value of the pound. Research by…a government think-tank found that the cost of all forms of generation was rising, but offshore wind farms remained by far the most expensive – 90 per cent more than fossil fuel generators and 50 per cent more than nuclear" [g].

(ii) "Shares in Heritage Oil unexpectedly dropped by 28pc on the news it has made Iraq's biggest gas discovery for 30 years. The frontier explorer…had been hoping to strike oil in Iraq's semi-autonomous northern region, Kurdistan" but the news prompted investors to fret that "Kurdistan does not have the infrastructure to export gas…The discovery is likely to have to rely on the extension of a planned new pipeline…to take gas supply to Europe…Heritage was one of the first foreign oil companies to enter Kurdistan. But the area has been avoided by the energy majors, despite its stability, because its independence as an oil province has been disputed by the Iraqi state" [h]. Petroleum products from discovery to customer, are fraught with risk, troubles, national and international politics, costs, delays, and anxieties. They are clobbered with taxes (which the consumer has to pay). Compare this with the mollycoddled wind farmers and the growers of crops for fuel who queue for dollops of subsidy (which the consumer has to pay). Have our governments been spending as sensibly as we are being asked to believe?

[a] Kleinwort Benson Quarterly Review, December 2010 [b] Jeremy Warner, "Daily Telegraph", 27th. January, 28th. October [c] Lex Column, "Financial Times", 29th. January [d] Ambrose Evans-Pritchard, "Daily Telegraph", 13th. December, 25th. January, 4th. January [e] Bruno Waterfield, "Daily Telegraph", 21st. October, 10th. November, 12th. January [f] David Hope, letter dated November 2010, citing "Biofuels: the Promise and the Risks" (World Bank, 2008), "The Fund Holder", Winter 2011 (published by The Share Centre) [g] "Daily Telegraph", 28th. September [h] Rowena Mason, "Daily Telegraph", 27th. January

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