Lobster 60

Well, how did we get here?

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Introduction

That I do this was suggested by Dan Hind and he made a number of useful comments on this text, some additions to it and suggested the title. Essentially I took parts of my 1999 *Prawn Cocktail Party,* pruned them and topped and tailed them, with a new intro and conclusion.

Here is an example of how being on-line changes things: were *Lobster* still a hard copy magazine I would never have thought it worth devoting ten pages of it to this. On-line, however, where space is not a major consideration, it looks useful to have this material available to anyone who wants it.

Where Are We Exactly?

The banks have ripped us off, screwed the economy, and taken billions in the taxpayers' name. They are not lending to the productive sector of the economy, they are still paying themselves huge bonuses, and there is barely a flicker of political protest. None of the three major parties are even *thinking* of doing anything serious to restrain or reform them. (And the same is true in the United States: the Obama administration's plans for the financial sector will not inhibit the global gambling.[1]) It's not that the banks are too big to fail, to quote the title of one of the books about the events of 2007/8: they have already failed. Rather, they are perceived in this country to be too big to tackle. (In America they have simply bought the politicians.)

This essay tries to explain how we got here. By which I don't mean the recent events leading up to the crash of 2008 – these are have been discussed in dozens of books. Instead I want to set out the older and specifically British back story, both economic and political. The crash of 2008 did not appear out of the blue. Yes, some of the key factors, notably the use of computers in the global gambling, are relatively recent. But many of the building blocks were in place long before the Internet enabled the global casino we now live in.

The story in outline is simple: we got here because we removed the controls placed on the financial sector. For sixty years the British banks struggled to escape the constraints imposed on them by the rest of society. And as they overcame each obstacle they proceeded to create and lend money on an ever larger scale. They lent money against property for the most part and left British industry to look after itself as best it could. The bankers in charge did this to make themselves rich. That's all there is to it. What follows is a very short account of how this happened. And almost no economics knowledge is required to understand it.

The City, 1945-70

Up to the mid 1980s the financial sector might have been described with reasonable accuracy as a nexus of interests

1 See, for example, Liam Halligan, 'Obama signs a bill that lets banks have US over a barrel once more', *Daily Telegraph*, 28 July 2010.

consisting of the Corporation of the City of London, the major banking and investment institutions, including the pension funds, the so-called merchant banks, and elements in the British state, including the Bank of England and the Foreign and Commonwealth Office. This post-imperial network mutated after the so-called 'big bang' of 1986, when American and Europeans bought up the British merchant banks and vastly expanded their operations away from the eyes of national regulators.[2] Since then London has hosted an almost unregulated, offshore centre for the world's financial institutions.

None of the terms currently in use is a satisfactory shorthand for this complex mixture, but in this essay I will refer mostly to 'the City', meaning the financial sector, and the overseas lobby [3] – that is, those whose main preoccupation is with investment opportunities outside the UK. For the domestic British economy, it matters little in which part of the globe 'British' investment is made or where the foreign banks in London have their head offices; what matters is that these interests are not in the UK. And what is good for the overseas lobby economy is often not good for, indeed is often antithetical to, the interests of the domestic economy.

Before the growth of London as the world's favourite barely regulated financial centre, the domestic-overseas conflict was simple to understand and widely discussed. On one side were those businesses and people whose welfare depended on the strength of the British economy. On the other were those who sought opportunities to invest abroad. Between the Second World War and 1980 successive governments tried to balance the demands of the overseas lobby with the interests of the domestic economy and the City

2 For a very brief account google <wiki + big bang>.

3 The term was first used in Roger Opie's 'The Making of Economic Policy' in Hugh Thomas (ed.) *Crisis in the Civil Service* (London: Anthony Blond, 1968).

was, to some extent, kept under control. Britain's decline from 10th in the OECD 'league tables' of economic performance to its present 19th began in 1980, the year that the Conservative Government scrapped the remaining controls on overseas investment of British-generated wealth.[4]

Although this issue no longer makes it onto the main agendum of this society, the conflict between the interests of the domestic economy and the overseas lobby is one of the major themes in British economic politics in the 20th century. From the rise of Tariff Reform League before the First World War, through the attempts by its domestic manufacturing-based successors, Patrick Hannon and the British Commonwealth Union, to create an 'industrial group' of MPs in the House of Commons in the 1920s, to the struggle over the reimposition of the gold standard in 1925 at too high a value for the pound, the conflict expressed the dominance of the interests of the overseas sector over the domestic, largely manufacturing economy.

In the 1930s economic crisis a kind of compromise was reached between domestic and overseas sectors: the overseas sector accepted some controls and was largely confined to the trading bloc of the Commonwealth, the so-called sterling area.

During the Second World War the state controlled everything: capital movements, production and trade. Of necessity a version of the producers' alliance sought by some sections of pre-war labour, capital and state, was formed. Co-operation rather than conflict was the model chosen for total war, a lesson not lost on the wartime generation of politicians and labour leaders.

The *de facto* 'producers' alliance' began to weaken after the fall of the Labour government in 1951; the controls on capital were slowly loosened.

4 OECD figures in the *Guardian* 15 July 1996.

Operation Robot

The overseas lobby made its first serious attempt to break free of these state controls a year after the Conservatives returned to government. A group of Treasury and Bank of England officials, with the support of R. A. (Rab) Butler, the Chancellor of the Exchequer, tried to con the Conservative government into making 'a dash for freedom': float the pound, remove the controls on access to sterling and put the pound – and the City of London – back as a player on the world financial stage. In its aims and in the methods used to try and implement it, Robot, as it was called, was the prototype for later attempts to free the overseas lobby from the constraints of civil society. In the infantile jargon of the British political system, it was an attempt to 'bounce' the proposals through Cabinet, having already primed prime minister Churchill (who, like many other prime ministers, knew little about economics).[5]

But after an intense struggle, described in detail by one ofthe participants, Donald Macdougall, the Robot proposals were rejected. Harold Macmillan, for example, called the proposals 'a bankers' ramp'. Undeterred, the same group tried to 'bounce' a slightly amended set of proposals through the Cabinet some months later and were again resisted.[6]

Robot was startling. It proposed that sterling leave the post-war international system of fixed exchange rates and float. This would have alienated not only the United States, but also the countries of Western Europe who were involved with the UK in a payments system. And the 'sterling balances' – money owed to foreigners held in London – would be blocked. What is striking now is that Robot's authors acknowledged that their proposals would lead to domestic instability, higher interest rates and increased unemployment

5 Donald Macdougall, *Don and Mandarin: Memoirs of an Economist* (London: John Murray, 1987) pp. 87-9. Churchill had been briefed about the plan by the Bank of England.
6 *Ibid*. p. 102-3.

at home. One of its opponents in Cabinet, Lord Cherwell, the Paymaster General, wrote to Churchill that, if implemented, Robot would keep the Conservatives out of office 'for a generation.' [7]

In his study of the Treasury, Henry Roseveare, former professor of history at King's College, London, commented on 'Robot' that:

> 'Parallels with 1925 [the return to the gold standard] are not too far-fetched. Here, it seems, was the same ruthless impatience on the part of the financial authorities to submit the British economy to the automatic disciplines of international monetary pressures.' [8]

After the failure to con the cabinet with Operation Robot, attempts to restore the City to its pre-war primacy were undertaken piecemeal and with caution, especially after Harold Macmillan became prime minister; but some of the old system was reintroduced – centrally the management of the domestic economy chiefly by using interest rates.[9] The results were as predicted by Robot's authors: a return to pre-war experience of domestic expansions and contractions, as speculation against the pound led the Conservative government of the 1950s to repeatedly raise interest rates and create unemployment, thus giving a higher return to the holders of sterling (and improving the balance of payments figures by reducing domestic consumption: the poor consume less). Economic historians Newton and Porter note:

> 'With the wartime and post-war control system

7 Scott Newton, *Operation "Robot" and the Political Economy of Sterling Convertability, 1951-52:* EU Working Paper no 86/256, (Florence: European University Institute, 1986) p. 31.

8 Henry Roseveare, *The Treasury* (London: Allen and Unwin, 1966) p. 327

9 This period is described in Scott Newton and Dilwyn Porter, *Modernisation Frustrated: the Politics of Industrial Decline in Britain since 1900* (London: Unwin Hyman, 1988) pp. 126-30.

> dismantled, the only way the government could prevent a large movement out of sterling was by making Britain a thoroughly attractive place for the owners of capital.'[10]

The cycle of speculation against the pound, followed by higher interest rates and higher domestic unemployment, which became derided as 'stop-go', reached its first climax in 1957 when interest rates were pushed up to the then extraordinary (for peace time) level of 7%. Samuel Brittan commented:

> '.... he [Chancellor Thorneycroft] was proclaiming....that production and employment would be held back whenever currency speculators decided to gamble against the pound.' [11]

Chancellor Thorneycroft, with two of his Treasury junior ministers, Enoch Powell and Nigel Birch, resigned in January 1958 because the Cabinet would not support their demand for larger cuts in public spending. Former Treasury economist Donald Macdougall noted that Thorneycroft 'felt his only consistent supporter near the top of the [Treasury] hierarchy was Sir Leslie Rowan, who was in charge of external finance.' [12] Rowan was one of those who had tried to 'bounce' Robot through the Cabinet six years earlier.

Starved of the investment which continued to go abroad, and repeatedly attacked by high interest rates and deflation – 'stop-go' – the British domestic economy was perceived to be not performing as well as its competitors and a long series of diagnoses of British economic failure were published in the late fifties and sixties, contributing to the climate which helped elect the Wilson government in 1964.[13] A feature of this

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10 *Ibid.* p. 130

11 Samuel Brittan, *Steering the Economy* (Harmondsworth: Penguin, 1971). p. 130

12 MacDougall, *Don and Mandarin*, (see note 5) p. 96

13 For example the Penguin Specials *British Economic Policy since the War* by Andrew Schonfield (1958), Michael Shanks' *The Stagnant Society* (1961), and Rex Malik's *What's Wrong with British Industry?* (1964).

debate was that, unlike today, there was some discussion of whether or not British capital should be *allowed* to go abroad: capital exports were seen to be linked with Britain's relative decline.[14] But by 1971 Susan Strange noted that 'none of the three main political parties in Britain has ever engaged in recent years in a serious debate on the ends or means of policy towards overseas investment'. This she attributed to 'a hidden bias in the political, economic and indeed social system, towards overseas investment'. [15] In the 1950s and 60s the British state clung to the pretensions of world power status, with all that entailed by way of overseas capital investment and expenditure on diplomatic, military and intelligence activities. The 'bias' in favour of the overseas lobby detected by Strange wasn't so much hidden as so taken for granted as to be invisible.

In the late fifties and early sixties the Conservatives began to think about ways of getting more growth out of the economy without impeding the overseas lobby. Economic planning, an idea largely imported from France, which was perceived to have outperformed the UK, began to be considered; but the framework had barely been put in place before the 'dash for growth' attempted by Conservative chancellor Reginald Maudling in 1962/3 resulted in too many imports being sucked into the economy, producing the large (by the standards of the time) balance of payments deficit inherited by the Wilson Government in 1964.

The Wilson story is well known and only needs the slightest of sketches here. The ambitious plans to side-step the Treasury's dominance of economic policy by the creation of Department of Economic Affairs (DEA) and the Ministry of Technology (MinTech) were frustrated because Wilson took

14 For example in Schonfield's 1958 *British Economic Policy since the War.*

15 Susan Strange, *Sterling and British Policy* (Oxford University Press, 1971) pp. 147 and 150

the political decision that Labour could not (politically) afford to be responsible for the second devaluation of the pound since the war. Wilson's desire to recreate the 'producers' alliance' of 1941-51 failed while, backed by the Americans, he borrowed and tried to fiddle his way out of the recurring balance of payments deficit, while keeping sterling at its fixed rate, and trying to maintain domestic consumption in order not to provoke unmanageable hostility from his party, the unions and the electorate.

In 1966, after Wilson faced down the governor of the Bank of England's presentation of the overseas lobby's request to put up interest rates and cut spending at home, the lobby began machinating, with *Daily Mirror* publisher Cecil King, then on the 'Court' of the Bank of England, as the focal point. This reached a climax – or anticlimax – in King's attempt to persuade Lord Mountbatten to front some sort of 'emergency government'. Though the origins of King's animus against Wilson are obscure, King, like his banker friends, wanted Wilson to cut back on domestic expenditure to 'defend the value of the pound' – the traditional rationale for sacrificing the domestic economy in the interests of the overseas lobby. One of King's allies in this was Sir George Bolton of the Bank of England who, as director in charge of overseas finance there, had been one of the architects of Operation Robot in 1952.

Wilson was finally forced to devalue the pound in 1967 and from then on the Labour Government pursued policies of financial orthodoxy: tight credit and cuts in public spending were the order of the day. It was in this period, as Chancellor of the Exchequer, that Roy Jenkins acquired the reputation for being 'sound' – i.e. doing what the overseas lobby wanted. In a sense, the Wilson-Jenkins austerity years paid off: by 1970 the balance of payments was in surplus. But they paid the price for domestic cutbacks, rising unemployment and the disillusionment of their political supporters: they lost the election in 1970.

The Rise of the City in the 1970s

Led by Edward Heath, the Conservatives returned in 1970. Heath had one overriding aim: British entry into the EEC.[16] Although he had studied economics at Oxford as part of his degree, events would show that he had little understanding of the British economy. In the first year and a half of his government he appeared to believe that the best way to prepare the British economy for EEC entry was a dose of competition and freedom – the traditional Tory Party ideas of getting the government off the backs of the producers, reducing taxation and so forth. In his innocence Heath seems to have believed that British capital was merely waiting for their cue from central government, and would rush to invest in the British economy. But they didn't and Heath took to berating those he thought should be investing. Head of the Confederation of British Industry (CBI), Sir Campbell Adamson, said:

> 'I couldn't count on the fingers of both hands the number of times that Mr Heath told us that everything had been put right that the government could put right, and still industry didn't invest enough.'[17]

And so 'two years as Prime Minister had quickly disillusioned him as to the energy and even the patriotism of British

16 'The centrality of Europe to the administration's agenda was reflected in the establishment of a European Secretariat in the Cabinet Office.' Stuart Ball and Anthony Seldon, *The Heath Government 1970-74* (London: Longman, 1996) p. 63.

17 Phillip Whitehead, *The Writing on the Wall: Britain in the Seventies* (London: Michael Joseph, 1985) p. 81. Similar anecdotal evidence is in John Campbell, *Edward Heath* (London: Cape, 1993) p. 526.

industrialists, who he felt had let him down.' [18] Heath concluded that, 'the government had no choice but to intervene directly to promote rapid growth – whatever ministers might have said previously about government getting off industry's back.' [19]

The economist and Treasury official at the time, Donald Macdougall – the Macdougall who opposed Robot – witnessed this change of tack, Heath's notorious 'U-turn', taking place.

> 'Then there was a sudden change in November 1972....Ted started by asking William [Armstrong] ... what he thought. He said that, coming down in the car, he had been brooding over the situation and thought we should think big, and try to build up our industry onto the Japanese scale. This would mean more public spending. We should ask companies what they needed in the way of financial and other help, and give it to them. To my surprise Ted warmed to this and said, "Fine, and of course we must give to only to the good firms, not the bad ones ..." This was the occasion when Heath was converted – or at least first announced his conversion in my hearing – from a "hands off industry" policy to one of selective intervention; and also to a major reflationary policy....'[20]

The 'brooding in the car' story was a fiction. Armstrong had been chairing a secret Whitehall economics committee, created by Heath, that had been in existence for a year.[21] The committee has been set up to devise a way of creating economic growth prior to EEC membership, if private

18 *Ibid*. p. 452

19 *Ibid*. p. 442

20 Donald Macdougall, *Don and Mandarin: Memoirs of an Economist* (London: John Murray, 1987) p. 188.

21 Senior civil servant, Leo Pliatzky, later said of this committee: 'The concept was that we must strengthen our industrial capacity to as to take advantage of membership of the Common Market.' Whitehead, *Writing on the Wall* (see note 17), p. 8.

enterprise didn't deliver the goods.

And it really was a *secret* committee. Even the Chief Secretary to the Treasury, Patrick Jenkin, was unaware of the committee's existence.[22] In the scale of its ambitions and the secrecy with which it functioned, this secret committee 'was an exercise of prime ministerial power comparable to Neville Chamberlain's conduct of foreign policy in 1937-9 or Eden's handling of the Suez crisis.' [23]

Although he never explicitly said this, Heath wanted to convert Britain into a European-style social democracy, similar to that sought by the Labour government he had succeeded.

> 'Heath had been very impressed, when visiting Germany, by Willy Brandt's regular round-table consultations with the unions and the German system of co-partnership; his mind began moving towards establishing a similar relationship in Britain by which the unions should be given an acknowledged role in the running of the economy.' [24]

Heath also wanted the British bankers to become more like their German counterparts, taking direct stakes in British manufacturing. In his diary, Cecil King reports in April 1973 on having lunch with Sir George Bolton, like King a member of the 'Court' of the Bank of England. Bolton – who had been a member of the group which tried to foist Operation Robot onto the government in 1952 – told him:

> 'Recently Ted addressed a party of bankers at No. 10. Tuke, Chairman-designate of Barclays Bank, told him Ted had lambasted them for not investing more in British

22 Ball and Seldon, *The Heath Government* (see note 1) p. 40. 'The free-marketeers among the ministers at the Department of Trade and Industry knew nothing about it [the committee] despite the detailed Industry Bill which was to emerge.' – Peter Hennessy, *Whitehall* (London: Secker and Warburg, 1989) p. 239.

23 Campbell, *Edward Heath*, (see note 17) p. 447.

24 *Ibid*. p. 444.

> industry. This went down very badly.'[25]

Heath's biographer tells us:

> 'During 1972 and 1973 Heath.....used to lecture the banks on their national responsibility, urging them to *invest directly in industry like German banks.....*'[26] (Emphasis added.)

Reading these accounts now, Heath seems astonishingly naive, apparently believing that British capital and the labour movement would simply abandon their previous positions and perceived self-interest and throw in with the prime minister on his great venture to transform Britain. But British capital was not impressed by these plans and one section of it in particular, the City of London, which Heath seems to have largely ignored, had other ideas.

Wheelbarrow days[27]

The City had been growing in another direction with the development of London as an offshore base for American money avoiding US taxes.[28] Cecil King, in communication with the UK overseas lobby, both as Britain's then major

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25 Cecil King, *The Cecil King Diary 1970-74* (London: Cape, 1975) p. 278

26 Campbell, *Edward Heath* (see note 17) p. 526.

27 'Just take your wheelbarrow to the banks and cart away the cash' – Edward Du Cann MP on the credit explosion after the introduction of the Bank of England's Competition and Credit Control proposals (discussed in this chapter) in 1971. Du Cann was then chair of the merchant bank Keysers. Edward DuCann, *Two Lives* (Upton on Severn: Images Publishing, 1995) p. 131.

28 This began during JFK's term in office. It is not widely understood that JFK was more or less a Rooseveltian Democrat who sought – rather like Harold Wilson – to rebuild the US manufacturing economy and rein in the US economy's tendency to invest abroad. He was hated by Wall Street, not for what he did – none of his radical proposals had got through Congress by the time of his assassination – but for what he intended. The only decent account of this appears to be Donald Gibson's *Battling Wall Street* (New York: Sheridan Square, 1994).

newspaper publisher and as a member of 'the Court' of the Bank of England, first mentions this in his diaries in July 1971. With banker and fellow member of the Bank of England Court, Gordon Richardson, he discussed 'the success of London as a financial centre in recent years. [Richardson] said it was remarkable and had drawn to London very numerous branches of foreign banks.....'[29]

Charles Gordon, part of the management of one of the so-called 'fringe banks' – finance companies, essentially licensed moneylenders – in London during this period, commented later:

> 'The colonial expansion of overseas banks into London in the 1960s and 70s created a near ring-fenced, onshore, unregulated lending activity, which was simply mind-boggling in its enormous size.' [30]

In the midst of this growth in the late 1960s the British domestic clearing banks, the major high street banks, were unhappy. Not only did they have to watch the growth of pension funds, unit trusts and building societies as rivals for domestic saving, the arrival of increasing numbers of foreign banks, and the rise of the so-called secondary or fringe banks, they were also

> '... unpaid agents of the state, bearing a great part of the considerable administrative burden of implementing exchange controls, in the post-war years their lending activities were almost constantly restricted by government, and they were the main agents through which the authorities tried to enforce periodic credit squeezes.' [31]

29 King, *Dairy,*(see note 25) 2 July 1974.
30 Charles Gordon, *The Cedar Story* (London: Sinclair-Stevenson, 1993) p. 152. Gordon was then running Cedar Trust, which became one of the first casualties of the secondary banking crisis of 1973/4.
31 Michael Moran, *The Politics of Banking* (London: Macmillan, 1986) p. 396.

The Bank of England was also under pressure, for much of this new financial activity was beyond its regulation; and, with the Treasury, the Bank set up a joint committee to come up with a solution to these difficulties.[32] But the Bank 'bounced' the Treasury and produced its own scheme in the autumn of 1970 while the committee was still deliberating, and the Bank's governor, O'Brien, put the plan to Chancellor Anthony Barber at a dinner in January 1971.[33]

In what were called the Competition and Credit Control proposals (C&CC hereafter), the Bank proposed that there would be no more physical or administrative controls on credit growth: market forces – i.e. interest rates; i.e. *interest rate rises* – would control the growth of credit. Another part of the 1952 'Robot' proposals was being introduced.

The C&CC proposals were adopted as government policy in September 1971, unnoticed by the major media or the Labour Opposition; and barely noticed by Heath himself.[34] Indeed, hardly anyone outside the higher echelons of the City seems to have known what was going on. Edward Du Cann, banker and MP, was at a meeting of the backbench 1922 Committee of the parliamentary Conservative Party at which the C&CC proposals were described:

> 'I looked round the room and wondered how many of the MPs present fully comprehended what he was talking about. I doubt whether more than half a dozen had the least idea.' [35]

The proposals were run through the House of Commons in chancellor Barber's budget speech. The *Economist* commented

32 A clear account of this is in Margaret Reid, *The Secondary Banking Crisis 1973-75* (London: Macmillan, 1982) chapter 3.

33 *Ibid*. p. 31

34 It is not mentioned by Heath in his 1998 memoir *The Course of My Life*. John Campbell, Heath's biographer, mentions C&CC briefly on p. 455 of his *Edward Heath*. The best discussion of C&CC is in Moran's *The Politics of Banking* (see note 31).

35 Du Cann, *Two Lives* (see note 27), p. 130

that they 'had not been the subject of a single clause of legislation. Parliament has barely discussed it. It has all been fixed up as a gentleman's agreement in private conclaves in the City.' [36]

A contemporaneous presentation of C&CC, playing to Heath's desire to see more direct involvement by the British banks in industry, appeared in *The Economist*, 'The Banking Revolution', which presented the consequences of C&CC as being a move towards:

> '... the German-Japanese system of largely bank-controlled industry.... a situation in which banking would have even greater control over British industry and the economy as a whole – that is, direct control through ownership and participation, rather than the indirect control it has exerted traditionally via government and the state.' [37]

This was pure disinformation. Nothing in the C&CC proposals could honestly produce this interpretation.

To the clearing banks the proposals meant 'the end to [lending] ceilings', government-imposed quantitative limits on lending.[38] As banker Du Cann put it, 'the brakes were well and truly off.' [39]

It was simply more of the old order being reimposed on the British economy. Under the new system the banks could lend what they liked and, when it was decided that they had lent too much, they would put the interest rates up. A truly wonderful racket!

Having persuaded the Tories to reintroduce 'freedom' into the banking business, the clearing banks began generating credit, but *not* lending it to, or investing it in British manufacturing, but to domestic consumers, the property

36 'The banking revolution', The *Economist* 18 September 1971.

37 *Ibid.*

38 Moran, *The Politics of Banking* (see note 31), p. 44

39 Du Cann, *Two Lives* (see note 27), p. 131

markets and the so-called 'fringe banks', which in turn lent it on again, largely into property speculation.

Charles Gordon, then with the 'fringe bank', Cedar Holdings, described the period:

> 'These immediate years after C&CC were wonderful shovelling times. The main thrust of the banks (there were a number of honourable exceptions) was to apply the shovel with gusto not with discretion, lip-service was mouthed to the authorities, consequences were ignored, and pious condemnations were made of those who were found out patently overdoing it. Old-fashioned lending practices were contaminated, most of the lending industry was embroiled – from the newly liberated primary banks to the reeking sewage level of the tertiary lenders.' [40]

According to the creator of Trafalgar House Investments, Nigel Broackes, who dined with Heath in January 1972, just after C&CC had been enacted, Heath said he 'wanted an investment boom with an abundance of cheap credit'.[41]

He certainly presided over the making of a boom, though largely of the consumer variety. Personal taxes were cut, and interest on some bank loans, including those for the purchase of homes, second homes and shares, was made offsetable against tax, encouraging 'the biggest credit binge in British post-war history.' [42] Heath's government also tripled the amount borrowed by the state to pay for its activities between 1971/2 and 1972/3. When the balance of payments began to deteriorate as a result of imports being sucked in by the

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40 Gordon, *The Cedar Story* (see note 30), p. 149

41 Reid, *The Secondary Banking Crisis* (see note 32), p. 71

42 William Keegan, *Mrs Thatcher's Economic Experiment* (Harmondsworth: Penguin, 1985) pp. 55 and 6.
'Between December 1971 and December 1974 the total assets of British banks rose from £36,865 million to £85,204 million – a rise of £48,339 million or 131 percent.' – Douglas Jay, *Sterling: a plea for moderation* (London: Sidgwick and Jackson, 1985) p. 147.

boom, Heath floated the pound rather than slow things down (another echo of the Robot proposals).[43] As late as September 1973, after the OPEC oil price rise, with inflation heading towards 20% a year, Heath told a meeting of the National Economic Development Council: 'This time I am determined to swim through the whirlpool'.[44]

Heath's gamble on a 'dash for growth' to kick-start Britain out of its stagnation failed for several reasons. Heath simply did not understand British capitalism. Given the right expansionist conditions, Heath believed, British banks and investors would pump funds into the domestic manufacturing economy. But they didn't. Why? The controllers of British capital had a duty – a legal duty – only to maximise the profits of their companies. Patriotic appeals from a prime minister, even a Tory one, were of little interest. Absent an activist state capable, on the French and German model, of strategic planning, the private sector didn't know how to invest while minimising risk. On the other hand, the relatively risk-free business of blowing financial bubbles beckoned. (Capitalists hate risk as much as they like being told that they are risk-takers.) There was also the fact that after twenty years of 'stop-go' in the British domestic economy, British capital was reluctant to act on the 'go' signals, (correctly) fearing another 'stop' round the corner.

Heath was also trying to go in contradictory directions. On the one hand he was trying to take the unions into a German-style tripartite management of the domestic economy; on the other – as they saw it – attacking them with his industrial relations legislation. On the one hand seeking an investment boom in Britain via cheap credit; on the other allowing the introduction of a system which explicitly promised

43 Nixon had already floated the dollar.

44 Geoffrey Howe quoted in Michael Kandiah (ed.), 'The Heath Government: a witness seminar', in *Contemporary Record*, vol. 9, no.1, 1995, p. 199.

increases in interest rates (and thus domestic contraction) to 'control' the supply of credit. This last contradiction was swiftly resolved in favour of expansion. Heath may have allowed the C&CC changes – apparently without understanding what they implied – but when push came to shove, politics (and prime ministerial power) prevailed over liberal orthodoxy; and Heath refused to allow the rates to rise as far and as fast as the Bank of England wanted.[45] The result was the worst of all possible worlds: banks printing money day and night with low interest rates. A former senior Bank of England official said, off the record:

> 'We little knew that Ted Heath would lose his head and bolt for wildly exorbitant expansion just as C and CC started. The system was meant to rely on interest rate movements and we were going to be allowed to use that instrument as required. Against the background of enormous expansion of the economy with the banks, just released from their shackles, bolting for business, the end result was very different from what we had hoped.' [46]

But blaming Heath fails to conceal the Bank of England's culpability. In their entertaining account of this, *Can You Trust Your Bank?*, Heller and Willatt noted:

> 'What had been created, under the eyes of the Bank of England, was a simulacrum of the lethally unbalanced Wall Street of the late and roaring twenties.....between mid 1970 and early 1974 M3 (currency, current bank accounts and deposit accounts) rose by the previously unthinkable amount of 270 per cent .... As for the property boom, which would have been impossible without the heavy financing from the banking system,

45 The fact that Heath refused to allow the C&CC proposals to be operated as intended is good evidence that he did not understand them in the first place.

46 Reid, *The Secondary Banking Crisis* (see note 32), p. 76

the Bank's sole reaction was a mild directive to the banks in the autumn of 1972, requesting them to make credit less freely available to property companies and for non-industrial purposes.'[47]

Massive expansion of debt and Bank of England regulatory policy still being done by 'a word from the governor'? Which had no effect: the pigs were in the trough by then. (In the current banker boom and bust, a Bank of England subcommittee did report on the dangers of the giant globalised debt pyramid in 2006; but still thought things might be OK......with care.... and nothing was done.[48])

Heath realised it had all gone wrong and reversed some of the changes over which he had presided. For a period, building societies were subsidised to try to prevent the interest rates paid by owner-occupiers from rising above 10%. Incomes policy was reintroduced. At the end of 1973, with the energy crisis in full swing, the balance of payments deep in deficit and inflation rising, government spending was cut, surtax was increased, hire purchase controls were reintroduced and the 1971 C&CC reforms were suspended.

After 'go' we returned to 'stop'.

Heath had failed to swim through the whirlpool.

But it was too late; and for the 'fringe' banking and property sectors, the tightening of credit was too much.[49] The edifice of speculation based on rising property and land prices, began to topple and the impending collapse of some of the 'fringe' banks led to the Bank of England's then secret launching of 'the lifeboat' bearing (suitably expensive) financial

47 Robert Heller and Norris Willatt, *Can You Trust Your Bank* (London: Weidenfeld and Nicolson, 1977) p. 102.

48 Edmund Conway, 'City faces meltdown if debt crisis hits', *Daily Telegraph*, 12 July 2006 <www.telegraph.co.uk/finance/2943149/City-faces-meltdown-if-debt-crisis-hits.html>

49 This view is expressed very strongly by Edward Du Cann, then Chairman of the banker Keyser Ullman, in his account of the crisis in his memoir, *Two Lives* (see note 27)

assistance to them.

The bankers had been given their heads and did what they always do: enriched themselves and their shareholders by expanding lending – and fuck the social consequences. It is one thing to con the prime minister into supporting legislation but another to get him to accept the consequences when it dawns on him what they are. The Bank of England managed the first but failed the second.

Free at last!

In 1974 Heath's government was replaced by that of Harold Wilson, who resigned in 1976, handing over to James Callaghan. The Labour government of 1974 inherited inflation at 20% and rising, and set about trying to bring it down without causing too much unemployment. In the conventional view of this period, the central event was the visit by a deputation from the IMF in 1976, after the government requested a large loan with which to defend the value of sterling against speculation. While the IMF visit was traumatic for the wider Labour movement, signalling cuts in social programmes, was used by the Labour left to attack the Callaghan government, and was portrayed by the government's political opponents on the right as an event of national humiliation, in retrospect it was of little consequence. Half the loan was never used and the rest was paid back without incident. With hindsight, rather more significant, was a decision taken about the North Sea oil revenues which were on the political horizon.

Reducing inflation and deciding what to do with the coming oil money were two big items on the economic agendum in late 1970s Britain. Let's take oil first. In the Labour Cabinet Tony Benn wanted to create an oil fund –

what would now be called a sovereign wealth fund – to be used for industrial investment. (This is what Norway did with its oil money; their oil fund is now worth roughly $450 *billion*.) But after a debate in Cabinet, the fund idea was rejected. Benn noted in his diary:

> 'So that is the end of the saga of oil revenues. They are now a part of general public expenditure.....we are going to give it away in tax cuts.'[50]

In the event Labour lost the 1979 election and the oil question fell into the Conservative Party's lap. The Tories in opposition, as well as the financial nexus - the City, Treasury and Bank of England - had been discussing the coming oil wealth in 1977-8 and had concluded that manufacturing would decline when North Sea oil came on-stream. The argument went thus:

1. As Britain produced oil it would need to import less and less oil. Assuming the British economy continued exporting as much as it had before oil, the result would be produce a growing trade *surplus*.

2. Such a surplus would push up the value of the pound.

3. A rising pound would make British exports more expensive, imports cheaper and British manufacturing would decline.

The overseas lobby offered as the solution to this problem the following: if exchange controls – i.e. government-imposed restrictions on the movement of capital out of the UK – were abolished with more capital leaving the UK, this old wealth going out would counterbalance the new coming in from the North Sea. Thus there would be no trade surplus and

50 Tony Benn, *Conflicts of Interest: Diaries 1977-80* (London: Hutchinson, 1990) pp. 280/1.

Edward Pearce's biography of Healey, *Denis Healey* (London: Little Brown, 2002) p. 508, attributes the decision to Healey supported by Treasury ministers Lever and Barnett; with the kicker that the fund notion was rejected in part simply because it was supported by Tony Benn who had become a pariah within the cabinet. Healey doesn't mention the event in his memoir.

no rising pound. *Complete freedom to move money* would solve the problem. *Complete freedom to move money* – what the City had always sought but never really expected to get. In 1977 this had been adopted by the Treasury and Bank of England, and was the message coming from financial journalists and the Conservative Party's spokesmen.[51]

Thus, when in 1977, with the IMF stamp of approval on the economy and the imminent prospect of the pound being a petrocurrency, the international value of the pound began to rise sharply, the Treasury tried to persuade the Labour government to scrap exchange controls. This Labour refused to do; but they were abolished by the Thatcher government in 1980. However, despite a rush of capital out of the UK, the value of the pound continued to rise, making British exports uncompetitive and eventually destroying nearly a quarter of British manufacturing industry.

Why did this theory fail (assuming it would have worked)? It ran into another theory held by the Thatcher government: that you reduce inflation by controlling the money supply; and you control the money supply by raising interest rates. (In reality: rising interest rates cause a recession, which reduces spending in the economy and so price rises are reduced and eventually eliminated.) This should now sound familiar.

When the idea of capital exports preventing a rising pound was adopted in the late 1970s, it had not occurred to the discussants that the government would also *raise* interest rates. The result was that *on top of* the rise in the pound's

51 The general tenor of the oil debate can be seen at a glance in *The Times* Index for 1977, especially p. 375, under Economic Situation and Policy.

For the most influential financial commentator of the period, Samuel Brittan, scrapping exchange controls was the 'only serious way of preventing North Sea oil from imposing a contraction in manufacturing.. ...' – The *Financial Times*, 3 July 1980. Brittan's piece was headed 'Deindustrialisation is good for the UK'.

value due to its status as a burgeoning 'petrocurrency', anti-inflationary interest rate rises made the pound even more attractive to foreign investors. Leo Pliatzky, who had been a senior Treasury official in the previous Labour administration, commented on this episode:

> 'It was a strange period to look back on. There appeared to be a great gulf between attitudes in much of the City and in industry throughout the country. In some quarters there was a Khomenei-like fanaticism about, a reluctance to see the connection between high interest rates and a crippling exchange rate. North Sea oil had made sterling a petrocurrency, it was alleged; the days of manufacturing were over.' [52]

Fronted by Mrs Thatcher, who knew little about economics, the City was in charge. Unconcerned by the mess created by partial deregulation of the financial sector during Heath's term, and in addition to abolishing exchange controls, between 1979 and 1982 the Thatcher government:

* ended some restrictions on building society lending – starting them off on the road to becoming banks – and thus beginning the great credit explosion of the later 1980s;

* abolished the restrictions on bank lending which had been introduced by the previous Labour government;

* abolished the Reserve Assets Ratio which made the banks hold at least 12.5% of their deposits in some specified range of liquid assets, thus enabling them to lend more;

* abolished hire-purchase restrictions.[53]

The British bankers had finally shed almost all state restrictions on their activities.

As the Thatcher recession deepened, North Sea oil

52 Leo Pliatsky, *Getting and Spending* (Oxford: Basil Blackwell, 1982) p. 128.

53 These measures are listed by Nigel Lawson in his memoir, *The View from No 11* (London: Corgi, 1992) p. 626.

production and revenues from it to the exchequer grew. But having become 'oil rich', much of Britain was getting poorer. Leo Pliatzky commented:

> 'It is understandable that people are frustrated that more primitive (sic) countries which produce oil have used the revenues from it to finance industrial and social development while in Britain *both have been cut back* since the North Sea oil came on stream.' (Emphasis added.)[54]

Where had the oil riches gone? The *Guardian's* Victor Keegan wrote in 1983:

> 'Most of it, in the *supreme irony of economic history*, has gone to pay out unemployment to those who would not have lost their jobs if we had not discovered [oil] in the first place.' (Emphasis added.)[55]

If British economic history since the 1920s shows one thing it is that these 'ironies' always benefit the financial and overseas sector and not domestic manufacturing.

The result of the 'dream conditions for London's financial apparatus in 1980 and 1981' [56] – high interest rates, a high pound and no restrictions on lending – was the shrinking manufacturing base accompanied by a booming City of London. As the manufacturing was mostly in seats held by the Labour Party, and a section of the Conservative Party, including Mrs Thatcher, believed that Labour (and unions) were in the grip of communists, the rising unemployment was more a suitable punishment for the working class for having the temerity to support Labour than a cause of great concern.

In his pre-election budget in 1987 the chancellor of the exchequer, Nigel Lawson cut personal taxes and, after the

54 Leo Pliatzky, *The Treasury Under Mrs Thatcher*, (Oxford: Basil Blackwell, 1989) p. 194.

55 *The Guardian*, 16 May 1983.

56 Tom Nairn, *The Break-up of Britain* (London: Verso, 1981) p. 392.

stock market crash in October that year, kept interest rates low to head off recession, when his own theories said they should rise. Cue the great house price inflation of 1987-90 and what became known as the Lawson boom, fuelled in large part by people borrowing against the rising values of their houses. Which boom, with accompanying inflation, after another Conservative election victory in 1992, was followed by the second big recession since 1979 – again triggered by raising interest rates to reduce inflation. It was a return to stop-go, the familiar sequence.

Along the way the City's commentariat changed the story. It wasn't that we had to lose manufacturing to make room for oil [57] but that Britain was on a natural evolutionary path towards a post-manufacturing, service economy. It did not matter that Britain was making fewer and fewer products: they would be replaced by 'financial products' – a term which came into use in the mid-1980s as the language followed the money. This became the received wisdom within the Treasury. Political journalist Edward Pearce recounts how a 'Treasury knight' – i.e. one of the very senior civil servants in the Treasury – said to him of John Major's period in office (1992-97):

> '....that though very fond of Mr Major, we worried a little at his anxiety about manufacturers. He wasn't very happy with the analogies we made about Switzerland, *so prosperous entirely from service industries*, so it was necessary to let him make friendly things (sic) to the manufacturing people.' (Emphasis added.)[58]

Britain as Switzerland? Oil revenues would pay the dole for the shrinking manufacturing sector outside the London travel

57 'As the energy sector grows, something has to shrink' – Hamish MacRae in the *The Guardian*, 13 October 1981. In this curious universe it is unclear how countries ever get richer, for as one sector grows, another, apparently, has to shrink.

58 *The Guardian* 8 January 1992.

to work distance, while the City – avatars of our post-industrial destiny – showed us the way.

Uncle Sam's New Labour

Fifteen years after they first appeared in financial circles, these ideas were adopted by New Labour. Talk of the service economy became talk of the 'knowledge economy', a mishmash of the City, computers, film production, rock music and the Internet. There was a supplement about 'the knowledge economy' in the *New Statesman* 27 September 1999. In his contribution James Dyson, the inventor, wrote:

> '......I've had an argument with the governor of the Bank of England about this, *who thinks that software is replacing the need to make goods.*'(Emphasis added.)

In the late 1970s and 1980s the bankers first thought oil would replace manufacturing; then it was the growth of the City of London and the financial services sector; finally the governor of the Bank of England thought it would be computer software.

Historically, geographically and institutionally the Labour Party was the party of the domestic economy and the response of its leaders in the early 1980s was to resist all this drift away from manufacturing. The idea that there was a basic conflict between the City – with the South benefiting from it – and industry was quite widely understood in the party. It wasn't a hard sell: the City was booming but the industrial North, Scotland and Wales were deep in recession induced by the high interest rate, high pound policy.

In 1982 the Labour Party's national executive committee published a report by its Financial Institutions Study Group, *The City: A Socialist Approach*, which recommended a raft of new legislation to regulate the City more closely. Neil Kinnock, who replaced Michael Foot as leader after the election loss in

1983, was influenced by a version of the City-versus-industry thesis by the Cambridge economist John Eatwell. In 1982, in the depths of the first Thatcher recession, Eatwell had written a TV series which argued that the recovery of the British economy centred on the reconstruction of manufacturing, and that this needed something like the German or French relationship between manufacturing, finance capital and the state: i.e. ending the City's dominance of British economic policy. These views were reflected in Labour leader Neil Kinnock's 1986 book *Making Our Way.*

But after the election defeat of 1987 (the third) the Labour leadership abandoned any thought of challenging the economic status quo and began accommodating the perceived power and electoral popularity of a Thatcherised, privatised Britain.[59]

Tony Blair and Gordon Brown, who had acquired safe Labour seats in the 1983 general election, were part of this shift. By the end of their first parliament in 1987 both had been noticed as rising stars and had been given shadow cabinet roles, Brown as number two to the late John Smith, who was shadowing the Department of Trade and Industry.

The US government was also paying attention: in 1985 – only two years after Blair became an MP – an official in US embassy in London described him as 'one of the brightest and most ambitious of recent Labor intake';[60] and the next year

59 See Eric Shaw *The Labour Party Since 1979*, (London: Routledge, 1994) pp. 46-50, for an account of the policy shifts in this period. The one member of the Labour leadership who really understood this subject, Bryan Gould, eventually resigned his seat and went to back to New Zealand in disgust. A recent essay by Gould is in this issue of *Lobster*.

60 Giles Scott-Smith, 'Searching for the Successor Generation: Public Diplomacy, the US Embassy's International Visitor Program and the Labour Party in the 1980s', in *British Journal of Politics and International Relations*, 2006, Vol. 8, pp. 214–23. Using declassified US files, Scott-Smith shows that virtually the entire cast of 'New Labour' went on US government-sponsored trips to America in the 1980s and 90s.

Blair took the first of his freebie trips to America.

Brown and Blair were 'modernisers' and that had a specific meaning in this period: accept the power of the City and American global hegemony and give up all this nonsense about economic independence (let alone socialism).[61] John Smith, another 'moderniser' in the Labour leadership, was on the steering committee of the Bilderberg group, one of the key elite forums promoting globalisation, from 1989 to 1992.[62] In June 1991 Smith took his then understudy, Gordon Brown, to the Bilderberg meeting at Baden Baden. There Brown met the then obscure governor of Arkansas, Bill Clinton. Blair attended the 1993 Bilderberg Conference in Athens.

After the 1993 American presidential election Brown and Blair went out to America to meet the new Democratic government. In Washington Brown and Blair met Clinton's people; and also Larry Summers, a Harvard academic who had been with the World Bank, Robert Reich, Clinton's newly-appointed Labor Secretary and Alan Greenspan, chair of the Federal Reserve. These meetings were arranged by a young *Financial Times* journalist called Ed Balls who had studied under Summers at Harvard. Like other Labour personnel, including Yvette Cooper, whom Balls later married, and David Miliband, head of Blair's policy unit, Balls had spent a year in America as a Kennedy Scholar.[63]

By 1994 the long-delayed implementation of the 1952 Robot plan – the British economy open to the world and controlled solely by interest rates – had caused the second

61 Neil Lawson, former aide to Gordon Brown, said of this period: 'Labour got to the stage in the early 1990s where we'd give up virtually anything to get elected.' Quoted in Francis Wheen, 'Social justice - that's so old Labour' in *The Guardian*, 7 February 2001.

62 Letter from Maja Banck, Executive Secretary of Bilderberg Meetings, to the author, 13 April 1999.

63 New Labour's wider American links are detailed in Robin Ramsay, 'Uncle Sam's New Labour' at <www.variant.org.uk/6texts/Robin_Ramsay.html>.

major recession since Mrs Thatcher's election in 1979 and it was likely that the Tories would lose the next general election.

There had already been speculation in the media that Tony Blair would succeed John Smith as Labour leader. Three months before John Smith's death in 1994, the then shadow home secretary Tony Blair went on a trip to Israel at the Israeli government's expense. Blair was sympathetic to Israel, had shared chambers with the president of the Board of Deputies of British Jews, Eldred Tabachnik,[64] and had joined the Labour Friends of Israel on becoming an MP. On Blair's return from Israel, Gideon Meir, from the Israeli embassy in London, introduced him to Michael Levy, a retired businessman who had become a major fund-raiser for Jewish charities. Levy was 'dazzled by Blair's drive and religious commitment' and the two men became friends.[65] A month later the leader of the Labour Party, John Smith, died, and Blair became leader. Michael Levy then set about raising money for his new friend, Tony Blair.

The Israeli government had spotted Blair as a very pro-Israeli politician and probable leader of the Labour Party and steered him towards one of the leading Jewish fund-raisers in London.

With the Levy-raised money in his 'blind trust', Blair achieved financial independence from the trade unions and the Labour Party and could really get down to 'modernisation'.[66]

NuLab duly won the 1997 election and the rest is probably familiar. They set about implementing what they had learned about 'the Washington consensus' on their trips to

64 See the profile of Michael Levy in the *Daily Express* 26 June 2000.
65 Geoffrey Alderman, 'Playing Tennis with Blair' in *The Jewish Quarterly*, Autumn 1997.
66 John Lloyd, 'Labour falls for the Big Gift' in *New Statesman* 27 February 1998. A number of reports stated the Levy raised £7 million for Blair's office. Alastair Campbell, in his diaries of the period, *Prelude to Power* (2010) p. 156, quoting Levy, puts it at £1.3 million.

America in the early 1990s. The moneymen were given their heads; regulation would be 'light touch'. Chancellor Brown surrendered the power to set interest rates to a committee under the aegis of the Bank of England. Following his American mentors, Brown believed – I think really did believe – that globalisation, the City's role in the world economy and the absence of government regulation, was Britain's future. (Though how this would work for – say – Brown's constituents in Fife was never explained.) Interest rates and the value of the pound rose. The champagne flowed in the City. Manufacturing continued to shrink.[67]

British banks had worked to get rid of state supervision from 1945 to Brown's final surrender of the control of interest rates in 1997. But the game had changed. By 1997 very little of the City was actually British-owned. London had become the location of choice for corporations and individuals seeking to avoid taxes and regulation in their home jurisdictions. London had become the most important offshore centre in the world – a washing machine for criminal entrepreneurs, politicians, and the big winner in the shell games of globalisation.

By 2001 the British and American economies were running huge trade deficits and facing recession. The Americans began stimulating their flagging economy by cutting interest rates. This encouraged house price inflation and private consumption as millions borrowed money against rising house values. Mortgages were offered to almost anyone. Ninja mortgages – no income, no job, no assets – appeared. Nulab followed suit. Cue the enormous expansion of debt on both sides of the Atlantic, bringing great times for the money-movers, followed by the collapse in 2007/8. The governor of

67 'Manufacturing accounted for more than 20 per cent of the economy in 1997, when Labour came to power critical of the country having too narrow an industrial base. But by 2007, that share had declined to 12.4 per cent.' Chris Giles, 'Manufacturing fades under Labour', *Financial Times*, 2 December 2009.

the Bank of England at the time, Eddie George, told the House of Commons Treasury Committee:

> 'In the environment of global economic weakness at the beginning of this decade.......... external demand was declining and related to that business investment was declining. We only had two alternative ways of sustaining demand and keeping the economy moving forward: one was public spending and the other was consumption..... But we knew that we were having to stimulate consumer spending; we knew we had pushed it up to levels which couldn't possibly be sustained into the medium and long term. But for the time being, if we had not done that the UK economy would have gone into recession just as had the United States. That pushed up house prices, it increased household debt.'

Like his American counterparts, Eddie George thought he was postponing a recession. Like his American counterparts, George had not grasped that the clever people in the globalised finance world would use this credit expansion to create another, immeasurably enormous pile of debts, derivatives and financial trades on top of it; and that while the world-wide spreading of financial risk was supposed to mean its dilution and diminution, in fact it meant that the entire rickety structure was only as strong as its weakest part. The breaking point was all those mortgages given to people who couldn't afford them. When the sub-prime loans went bad and repossessions rose, the housing market in America turned down and the whole thing collapsed.

It was the same old story: give the bankers freedom and they will lend too much (enriching themselves and their shareholders) and screw things up. The new factor this time was the enormous power of modern computers which enabled them to screw things up on a truly epic scale.

As the British economic commentators surveyed the wreckage of the world economy in 2009, those who had formerly seen financial services as the future of the British economy discovered this was the delusion the likes of Dan Atkinson, Larry Elliott and Will Hutton always said it was. They also discovered that even after 30 years of economic policies hostile to it, manufacturing was still a bigger section of the British economy than the financial sector: roughly, manufacturing is 13% and financial services 7% of the UK's GDP.

> *Telegraph* economics editor Edmund Conway:
>
> 'One dangerous misconception perpetuated by financial lobbyists is that without the City, we are nothing. Financial engineering [sic], they argued, was something Britain was well placed to do, while mechanical engineering could be carried out far more cheaply by the Chinese, or with far greater quality by the Germans. While it is a compelling narrative, and fits nicely with the British propensity for defeatism, it is balderdash.' [68]

That the importance of manufacturing for Britain is now being written about again is a welcome change of tack. But it is terribly late in the day, and thus far neither government nor opposition show any signs of understanding how to rebuild manufacturing or an interest in so doing. This is not surprising. In economic history no country has built, let alone rebuilt, its manufacturing sector in open market conditions. The industrial success stories of the post WW2 era have followed the same pattern: extensive state intervention in the domestic economy, accompanied by protection from the products of other economies and/or the maintenance of an artificially low exchange rate. But none of our major political parties would be willing to contemplate this – not least because doing so

68 Edmund Conway, 'Shock news – Britain still makes things. Our much-mocked manufacturing sector is stronger than we think', *Daily Telegraph* 26 November 2009.

would certainly mean leaving the EU and possibly the World Trade Organisation. So manufacturing may acquire a slightly louder voice in Whitehall but nothing substantial will happen.

The present government appears to believe that they are reliving the 1980s and that they can embark on a large programme of cuts in public services and the economists' warnings about this course of action can be ignored, just as the Thatcher government ignored them in 1981. They also appear to believe that in this climate of cuts and recession the private sector will spring to life, creating hundreds of thousands of jobs, in time for the coalition (if it survives) to present themselves before the next general election as having done a dirty but necessary job. (Let us not forget that these are politicians and getting elected is top of every one of their lists.)

But this isn't the 1980s. Most of the oil in the North Sea has gone, ditto coal-mining, shipbuilding and steel-making. Manufacturing is a third of the size it was then. Cuts in public spending will create private sector cuts, creating more unemployment. This, in turn, will create further demands on the welfare system; and, certainly in the short run, *higher* public spending. None of this is mysterious; this is economics 101.

Why are they doing it? They are in the grip of a theory about the deficit. They have been persuaded that the UK is on the verge of being another Greece, an economy collapsing under its public debt. To prevent this they need to be 'tough' on deficit reduction to head off the 'bond vultures'. They believe that it is in the national interest to engineer a big recession rather than risk a full-blown economics crisis à la grèque.

This theory is nonsense. The present ballooning deficit has been caused by a combination of rising unemployment (so falling tax revenues and increased welfare payments to the unemployed) and lending to the banks – both of which are the result of the financial crisis caused *by* the banks. Though large by recent British standards, at 68·5% the UK's public debt as a percentage of GDP in 2009 was lower than France (79·70) German (77·20), Canada (72·30), Belgium, Italy and Japan, among the industrialised countries.[69]

The historical evidence is also clear that government deficits reduce when the economy is doing well. Economics 101 again: as employment rises, tax revenues increase and welfare payments fall. [70]

Meanwhile the domestic banks are rebuilding their reserves with government loans (taxes), increased charges for their services and by the devaluation of their individual depositors' savings (the interest they are paying on deposits is lower than the rate of inflation). The banks' customers are helping to pay for the bankers' mistakes. Normal life is returning to the City (and Wall Street). The bankers have seen off the politicians so far and no significant restraints have been placed on the global casino.

When Operation Robot was proposed in 1952 its *advocates* predicted that it would cause instability – i.e. booms and slumps – and unemployment.[71] We've had it working since 1980 and they were right: we're now at the beginning of the third major recession since then. Lord Cherwell, one of

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69 According to the CIA's *World Fact Book*, quoted in <www.economicshelp.org/blog/economics/list-of-national-debt-by-country/> Another version of the same data, a eurostat news release, 22 April 2010, gave government debt ratios as % of GDP in 2009: Italy (115.8%), France (77.6%), Germany (73.2%), the UK (68.1%). For more EU details see the table under the subhead 'Economies of member states' at <http://en.wikipedia.org/wiki/Economy_of_the_European_Union>.

70 Explained in fairly simple terms by Anne Pettifor and Professor Victoria Chick in their 'The Economic Consequences of Mr Osbourne' at <www.debtonation.org/>.

71 Donald Macdougal, *Don and Mandarin* (London: John Murray, 1987) p. 91.

Robot's opponents, told prime minister Winston Churchill that Robot would be so unpopular it might keep the Tories out of office 'for a generation'.[72] In April this year, Bank of England governor, Mervyn King, was quoted as saying 'whoever wins this election will be out of power for a whole generation because of how tough the fiscal austerity will have to be'.[73]

Yes, there are echoes of 1931 and the formation of the national government then to implement the cuts required by this economic orthodoxy and the City, whose interests it embodies. But these policies failed in 1931 and will fail again. If it holds together, the coalition – this would-be national government – will lose the next election. The Liberal-Democrat part of it will be decimated by its association with the recession and Labour will return, once again to try and repair the economic damage created by the Conservatives. The central question that arises is, as always, what kind of Labour Party, and with which policies, will take office after the next election?

72 Something Macdougal also attributes to one of the plan's major advocates, Chancellor of the Exchequer Rab Butler. *Ibid* p. 90
73 Larry Elliott, 'Mervyn King warned that election victor will be out of power for a generation, claims economist', *The Guardian*, 29 April 2010.