Economic crisis and public services:

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1. Introduction

This paper attempts to identify some aspects of the relationship between the crisis and public services. Further updates will be produced during 2009.

It distinguishes three aspects of the economic crisis – the banking crisis, the credit squeeze, and the recession – and their different effects on high income countries and developing countries, and on the public and private sectors.

It then examines:

- the pattern of government responses, and the impact on public ownership, public spending;
- the implications for some selected public services;
- the effects on the private companies involved in public sector contracts, and
- some discussion of the role of the state in the Financial Times.

2. Three aspects of the crisis: banks, credit squeeze, and recession

2.1. Banking crisis: Concentrated in USA and western Europe

The banking crisis affects different groups of countries in different ways. The direct global impact of the banking crisis itself is concentrated in the USA and EU. Some other countries are affected by problems of government and trade deficits, and all countries are affected by the gathering global recession – both of which problems have been exacerbated by the banking crisis.

No Asian countries have had to support their banks, except Indonesia. There are problems because of withdrawal of foreign investment from many countries, including India and South Korea, but many Asian countries have substantial foreign exchange reserves: "Asia's capital flight problem looks both temporary and manageable". [1] In Indonesia, for example, HSBC has recently bought a local bank, as part of an expansion strategy not as a 'rescue' operation: it "demonstrates HSBC's belief in the potential of Indonesia" [2]

No Latin American countries so far have had to support their banks. In Brazil for example: "The total amount of credit in Brazil was equal to 38 per cent of gross domestic product in August… The government has paid down much of its foreign debt and is now a net creditor to the rest of the world. Less than 10 per cent of bank credit is raised overseas….. The banking system is solid following a state-sponsored restructuring in the 1990s…." [3] The falls in commodity prices may affect exports and lead to trade deficits for some Latin American countries such as Chile, Argentina and Venezuela. More generally, shippers and traders may be finding it harder to get credits necessary for trading.[4]

The World Bank chief economist for the region has stated that: "African banking systems are unlikely to experience the turbulence of the U.S. banking system." [5] There are no reports of African banks being supported or renationalised. The largest bank in Africa, Standard bank of South Africa, is now 20% owned by Industrial and Commercial Bank of China, which is: "examining potential targets in Africa's oil and gas, telecoms, base metals and power sectors." [6]

Banks in Lebanon, subject to conservative regulation, are doing well and enjoying an inflow of capital.[7]

2.2. Credit problems for companies, not governments

The crisis is not caused by excessive government borrowing, nor are governments finding it difficult to borrow money. Banks and investors continue to lend money to governments (with 5 or 6 exceptions, see below), and the cost of that borrowing has actually been falling in some countries. The USA, UK and some other EU countries are increasing their deficits substantially as a result of nationalisations and reflationary measures, but there is no sign that they will find it difficult to finance these deficits.

A small minority of countries have serious government deficits and problems financing them, including Pakistan, Hungary, Ukraine, Iceland and Turkey. However, there is not a general crisis of government

deficits in other developed countries, nor in developing countries. Many now have very low government deficits or even surpluses, as well as substantial reserves, and some own significant sovereign wealth funds.

Some developing countries also have problems arising from foreign investors withdrawing money, and from increased foreign debt of local banks and companies.[8] Because of foreign investors withdrawing money rather than investing it, some countries, including Ghana and Kenya, have postponed international issues of bonds[9] - but this does not imply problems with selling government bonds within those countries. The lower price of commodities may also worsen trade deficits for countries dependent on commodity exports.[10]

2.2.1. Credit squeeze on companies

However, there is a real and major global credit crisis for companies. Even the largest companies in the world are now finding it very difficult to borrow money to finance investment and operations. The reason is a general fear of default and collapse by companies, and a belief that it is only safe to lend to governments.

As a result, since August 2008, it has become far more expensive for companies to sell bonds. By contrast, it has actually become cheaper for governments to do so, so the gap – or 'spread' has become far larger than usual. This is true even for the biggest and best-rated companies:

> " That means the extra yield investors need before they will lend to investment grade companies [those with the best credit ratings] has gone from 2.7 to 5.9 percentage points in three months….According to Deutsche Bank, current spreads imply … an 'inconceivable' default rate for investment grade companies "[11]

The prospect of default by such companies, for example the car manufacturers, is expected to lead to significant government interventions to prevent bankruptcies and closures by companies which are large employers and crucial to national economies. For example, General Motors, Chrysler and Ford are hoping for $15billion from the current USA government.[12]

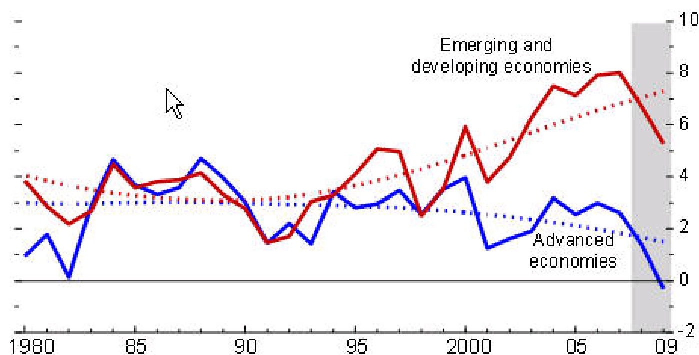
This loss of confidence in company performance is also reflected in the collapse of share prices. The value of shares in companies listed on stock markets around the world has halved in the last year. This fall has been remarkably uniform around the world – in the EU, USA, and Japan. The value of commodities such as oil and copper has also fallen sharply, because the recession means much lower demand for these commodities.

2.3. Recession: developing countries and north

The general global crisis is the developing recession, which is expected to affect all countries. Economic growth forecasts are reduced, for all countries. However, the revised IMF growth forecasts still suggest that most developing countries will continue to grow faster than OECD countries: "that is not to say that a prolonged slowdown in the US economy will not affect emerging markets, but the impact will be much less than would have been the case 10 years ago."[13] The effect of the crisis is to reinforce the gap in growth between high income countries and developing countries which has been apparent for some years (see chart).

Overall, the economies of high income countries are forecast to shrink by -0.3%, while developing countries are forecast to grow, on average, by 5.1% (see annexe, Table 2, for more details of IMF forecasts)

Figure 1. Real GDP Growth and Trend
(Percent change)



Source: IMF staff estimates.

3. Governments and public spending

3.1. Nationalisations and guarantees

The countries in which the banking crisis is concentrated - the USA, UK and the richer 'old' EU15 countries – have all taken action to support banks through partial nationalisations or guarantees. [14] The scale of this support is huge (see below). Some other OECD countries have acted to support banks through nationalisations or guarantees including Iceland, Norway, Switzerland, Japan, Australia and New Zealand; Russia has also had to provide guarantees to banks. [15] The only other non-OECD country which has taken action to support banks is Indonesia. [16]

As other major companies are threatened with default or bankruptcy, such as the car industry, governments are discussing offering similar support to these companies, both in the USA and the EU.

3.2. Reflationary policies

In all countries governments are using classic reflationary policies to counter the threat of recession and unemployment.

They include reductions in interest rates to extremely low levels. This is expected to have the effect of making it cheaper to borrow money, and thus reduce the pressures on companies. But the impact is unclear, because banks remain unwilling to lend to companies, and are not reducing the costs of borrowing in line with interest rate cuts.

Most governments are also introducing reflationary packages with some combination of higher government spending and/or tax cuts to boost consumer spending. These policies imply increasing government deficits, even if they involve stretching or breaking fiscal rules (see below). There are wide differences in policies between countries. The USA has agreed a large reflationary package. In Europe, while the UK and France have favoured significant increases in deficits, Germany has resisted introducing any large reflation by increasing deficits. In Italy, the government announced a small increase in state spending, which a professor of economics described as a "miserable third of a point of GDP". [17]

3.2.1. Infrastructure spending

Infrastructure spending is a key traditional form of reflation to maintain employment. It also establishes networks of lasting value for economic and social development. A wide range of governments are planning to increase such spending as a way of countering the recession. These plans are also having the effect of restoring confidence in the private sector: the stock exchange indices in the USA and India improved after announcements of plans for greater infrastructure spending. [18]

- The USA president-elect, Barack Obama, is preparing a recovery plan, which includes the biggest infrastructure investment in the US for half a century. [19] This is given greater priority than concerns about government deficits: Obama has said that: "we can't worry short term about the deficit. We've got to make sure that the economic stimulus plan is large enough to get the economy moving."[20]
- The EU is discussing proposals from Britain and France for a major programme of additional infrastructure investment [21]
- The newly elected government in New Zealand has announced its intention to make tax cuts and increase infrastructure investment including : "the development of new roads and public transport, improve schools and roll out an ultra-fast broadband network."[22]
- China, which is already spending as much as 14% of GDP on infrastructure, is "weighing plans to expand a massive stimulus package with higher spending on health and social programs" [23]
- The government of India has announced $60billion increase in state spending, including an additional $4 billion on infrastructure projects. [24]
- Mexico says it plans to spend 6.5% of GDP on infrastructure in 2009, the highest rate ever recorded, with a deficit of 1.8% of GDP.[25]
- South Korea is creating 50,000 jobs by the end of 2009 by spending over $3bn on infrastructure. [26]

The importance of infrastructure investment is demonstrated by the latest record 6.9% annual growth figures for Brazil in the third quarter of 2008, due to the government infrastructure investment policy adopted in 2006 [27]: "fixed investment soared 19.7%, pushed by several projects in the hydrocarbon sector as well as investment in infrastructure supported by the Program for Acceleration of Growth."[28]

In South Africa, investment grew by 24% in the third quarter of 2008, and, although there has been no major new programme for infrastructure: "much of the growth is coming from parastatals and the government itself, [showing] that the public sector infrastructure investment drive is, at last, starting to make the contribution it should to SA's productive capacity and its economy." [29] The public sector is increasingly the source of financing this investment as well.

In South Africa, infrastructure investment plans for airports and electricity are seeking finance from public sector development banks, including the Development Bank of South Africa, the World Bank, the EIB, and France's donor organisation, the Agence France de Developpement, rather than private banks. Financial commentators also suggest that "finance is likely to be raised increasingly from China, which has a 'huge investment appetite' and significant reserves to plough back into projects outside of its borders." China already owns 20% of Standard Chartered, the largest bank in South Africa. [30]

In India, the government is trying to avoid shortage of funds from the private financial sector by allowing a state-owned financial body, the India Infrastructure Company Limited (IIFCL), to raise $2 billion worth of tax-free bonds to provide re-finance to public sector banks for infrastructure lending. [31]

3.3. IMF and reforms

Countries which have had to ask for support from the IMF are finding that the IMF continues to impose conditions requiring cuts in deficits, thus imposing a reduction in demand additional to the general effect of recession. Many countries in Asia and Latin America are avoiding the IMF because of previous experience with these conditions.

The G20 group of countries has discussed reforming the international financial institutions, including the IMF and World Bank, to improve their role in such a crisis. However, the main demand from developing countries is that the institutions should become subject to far more democratic control, instead of being dominated by the richest countries, as at present. The China Daily carried an interview with a participant in the G20 meeting, who warned that:

> "It is not encouraging news, at least for Asian countries. If the economy of an Asian country is in trouble, very few of them, particularly East Asian countries, would be willing to go to the IMF for help. For any president in East Asian nations, such a choice would be a political suicide. For example, South Korea has put money into the Chiang Mai Initiative, an $80 billion currency swap line established by China, South Korea, Japan and 10 Southeast Asian nations. The initiative allows member nations to borrow foreign currency from each other to augment foreign exchange reserves." [32]

A number of countries in both Latin America and Asia have already deliberately paid off IMF loans to avoid conditionalities. [33]

3.4. Scale of rescues

About €645 billion has been spent so far by governments of the USA and European countries buying shares in banks and insurance companies, and nearly €6 trillion of bank debts have been guaranteed by governments. Details are given in table 3 in section 7. These figures do not include any estimates of the cost of guaranteeing deposits of bank customers, nor of increased liquidity provided by central banks, nor other general reflationary measures.

To indicate the scale of this, Table 1 below compares the amounts spent on these nationalisations by comparison with receipts from all the privatisations carried out worldwide in the last 30 years, the scale of the privatisations in eastern Europe following the collapse of the communist regimes, and the total amount of private finance invested in public services through all the PFI and PPP schemes ever signed in the UK and the rest of the EU combined.

Thus:

- the total value of the renationalisations of banks and insurance companies in the USA, UK and the rest of Europe is approximately equivalent to reversing about half of all the privatisations in the entire world over the last 30 years
- the USA renationalisation of the insurance company AIG is by itself equivalent to reversing all the privatisations that have taken place in the former communist states of central and eastern Europe since the collapse of communism.
- the UK government liability for the debts of Northern Rock alone is greater than the combined total value of all the private finance provided through PFI and PPP schemes in the UK and the rest of the EU over the last 17 years.

Another way of seeing the scale of the rescue is to note that the total cost of constructing sewers and water systems throughout the world's cities, to provide household connections for water and sewerage for over ¾ of the urban population in developing countries, would require only about €280billion – about 5% of the guarantees already given to the banks.

Table 1. Reversing 25 years of privatisation: the scale of nationalisation and state guarantees for private banks

	Privatisation 1977 -2007	Nationalisation 2008
Total global proceeds of privatisation 1980-2007	€1 300 bn.	
Nationalisation and recapitalisation of banks and insurance companies		€645 bn
Of which:		
Total proceeds of privatisation in new EU states of central and eastern Europe (PL,CZ,SK,SL,HU,EE,LV,LT)	€80bn.	
USA nationalisation of AIG		€90bn.
Total value of EU PPPs, inc UK PFI, 1990-2007	€108 bn.	
UK nationalisation of Northern Rock		€110 bn

Sources: Privatisation Barometer, Financial Times, UK NSO Sept 2008, PSIRU estimates
Figures based on conversion rates of £1= €1.3, $1= €0.75

3.5. EU fiscal and state aid rules

3.5.1. EU fiscal rules

The issue for all EU countries is the impact on EU fiscal rules, which require governments to keep deficits within 3% of GDP and debt within 60% of GDP. The impact of bank nationalisations under EU rules is not as significant as under UK rules (it is treated as a financial transaction and the debt of the banks is not treated as general government debt), but they will involve an increase in government debt to finance the nationalisations.

There are no clear rules on how to account for 'contingent liabilities' which arise from the widespread state guarantees, although they are very large and of great value to the companies which are guaranteed.

The use of public spending to maintain employment could be threatened unless the EU rules are relaxed. Ireland has already said it will breach the limits, and France has called for greater flexibility and deferred its target of a balanced budget. [34] According to forecasts by economists at Credit Suisse bank, countries that will run deficits above the EU's preferred limit of 3 per cent of gross domestic product next year include Ireland at 7 per cent, Spain at 4.5 per cent, France at 4.2 per cent, Greece and Portugal at 4 per cent and Italy at 3.8 per cent.[35]

> The German government, which has made strenuous efforts over recent years to bring its budget into balance, is concerned at the ballooning deficits predicted for many of its EU partners next year and worried about the implications for the stability of the euro and the 15-nation eurozone. [36]

The need for such adjustments could provide the opportunity for a renewed debate on the appropriateness of the EU rules and criteria, for example:

- a review of the limits themselves in light of 15 years experience, economic changes and tensions, and certain future problems
- to broaden the criteria for 'exceptions' to include social and developmental objectives as well as financial stability
- the broadening of the criteria to take account of changes in public sector net worth, for example (usually negatively affected by privatisation)
- a tightening of rules so that all PPPs or PFIs with explicit or implicit guarantees are included on public sector balance sheets

3.5.2. State aid

The European Commission is relaxing its interpretation of the EU rules on state aid to make it easier for governments to use public finance to help banks and others hit by the financial crisis. Formal relaxations were announced in December 2008, applicable for two years. Both Sweden and Germany had pressed the commission to "call off these legions of state aid bureaucrats". [37]

The rules were originally intended to stop governments giving state subsidies to their companies thus giving them an unfair advantage. The rules have been used to undermine direct public sector provision of public services, by making it harder for municipalities and others to fund their own operations if private companies want the business. [38]

3.5.3. UK rules

The UK rules, which it maintains in 'parallel' with the EU rules, create a very different impact, resulting in massive increases in both government deficit and debt. Sales of state companies are treated as revenue which reduces the current government deficit, and purchases of company shares – as has been done with the banks – also have to be treated as increasing public expenditure and thus increasing government deficits. Moreover, the debts of state-owned enterprises are treated as part of the Public Sector Debt, and so the net debts of the part-nationalised banks have to be recorded as an addition to public sector debt. The nationalisation of Northern Rock alone has led to an increase in the national debt of £87 billion. [39]

These rules could thus lead to a squeeze on public investment elsewhere, and even push for renewed privatisations, to compensate for the effect of including the banks' debts on the public sector balance sheet.

4. Services

4.1. Housing

The problem of 'sub-prime' mortgages has direct connections to public housing policies.

The provision of public sector housing at affordable rents was one of the major public services in the 20th century. In parallel, non-profit mutual savings banks and building societies enabled the middle classes to buy houses, with encouragement and support from governments. From the 1980s, public sector housing was cut back as part of the general reduction in the role of the state. At the same time, mutual building societies were converted into for-profit banks, with less restrictions on their lending policies. The policies were followed in some of the richest countries, such as the USA, countries in transition from communism, where large public housing stocks were privatised, and some of the least developed, such as Malawi, where a 2007 survey found that "Formal housing finance in Malawi is rudimentary … and less than 16 per cent [are] able to afford a conventional house…. no subsidies are available to the individual" [40]

In the USA, in particular, poorer families had to try to buy homes by taking out mortgages from banks which were trying to expand their business. The banks loosened credit requirements, as they rushed to sign more people to mortgages. Many people could then not afford the payments, and so these 'sub-prime' mortgages became bad debts for the banks, a major factor in the banking crisis. And many others were encouraged to refinance their houses, allowing them to borrow more against the equity of the 'unrealized' increase in the value of their houses. This additional borrowing fuelled the consumption spree in the USA, keeping the economy healthy, yet preparing the crisis in the housing sector. When home values fell, many people who had refinanced found they owed more than their houses were worth. They too became unable to pay the mortgages. The banks responded with repossessions which made hundreds of thousands homeless.

The global financial crisis has thus sharpened the need to rediscover social housing. The role of municipal housing services is being rediscovered, especially by UN agencies. The UN Economic Commission for Europe (UNECE) organised a conference in 2004 on housing problems in transition countries in central and eastern Europe, which concluded that:

> "the increasing reliance on market forces has not been sufficient to compensate for the decline of the role of the state in the housing sector. For this reason, the housing needs of the poor and vulnerable are often not adequately addressed. The availability of affordable housing, however, is crucial for an individual's well-being as well as for ensuring a social cohesive society. It is also an important factor for economic productivity: affordable housing is a prerequisite for labour mobility and an essential part of the creation of a policy environment conducive to enterprise formation and job creation. Realising this, countries are increasingly searching for ways to effectively and efficiently address the housing concerns of those most in need, and the provision of social housing is an important tool to achieve this." [41]

At the height of the crisis, in October 2008, the UN released a statement by its housing expert, Raquel Rolnik, arguing that the crisis shows markets alone cannot ensure housing for all, and demanded a re-appraisal of social housing policies:

> "The belief that markets will provide adequate housing for all has failed. The current crisis is a stark reminder of this reality,. ….A home is not a commodity – four walls and a roof. It is a place to live in security, peace and dignity, and a right for every human being. ….Excessive focus on homeownership as the one and single solution to ensure access to housing is part of the problem….. adequate housing for all is a public goal whose achievement requires a wide variety of arrangements, from tax advantages to buy a home to better legal protection for tenants and rent control areas; from direct subsidies to the poor to publicly owned housing and a range of tenure arrangements. Markets, even with appropriate regulation, cannot provide adequate housing for all." [42]

This was followed by a statement from the Executive Director of the United Nations Human Settlements Programme (UN-Habitat), Anna Tibaijuka, who told a UN-Habitat Committee meeting that:

> "Rapid, chaotic urbanization and the dearth of affordable housing were the underlying causes of the current financial crisis, and they could only be resolved through public financing and political will… housing was the repository of national wealth, as well as a market product and a social good." [43]

Public sector house building programmes can also form part of a programme of infrastructure spending which creates employment to counter the effects of the recession. In Nigeria, for example, the state of Borno has undertaken a large housing programme, using government funds: it not only provides homes for the poorest, but also provides employment in building and maintaining the houses. [44]

4.2. Postal services

The crisis has probably halted the privatisation and commercialisation of post offices in the EU. It has also re-established the importance of banking services through a state-owned institution, which the public can trust more than the commercial banks.

In the UK, the new trade secretary Mandelson expressed the view that the Post Office should keep a key contract, which was expected to have been awarded to a private contractor, in order to strengthen its role as a trusted bank. However this was followed in December 2008 by a proposal to sell part of the Post Office to a pre-selected private company. [45] Opposition in France to the privatisation of La Poste was strengthened by the crisis, with the French government postponing its privatisation plans: "Henri Guaino, one of President Nicolas Sarkozy's closest advisers, said there was no question of opening up the capital of La Poste for the moment given the current market turmoil" [46]. In Germany, the damaging effect of commercialisation was apparent, as the banking subsidiary of Deutsche Post, Postbank – the bank with most retail customers in Germany - recorded losses of €449 million in the third quarter of 2008, as a result of ill-judged investments with Lehmann Brothers [47]; while DHL, its express delivery service, pulled out of competing on express domestic deliveries in the USA (cutting 9,000 jobs in the process) , where it expects a loss of €1.5billion in 2008. [48]

4.3. Pensions

Pensions provided through employer-linked, funded schemes are badly affected. To the extent that the funds are invested in shares, the value of the investments has fallen, and so increased contributions will be needed to maintain the funds at a level necessary to match the pension liabilities. For public authorities in central and local government, these increased contributions squeeze the money available for spending on services.

'Pay-as-you-go' schemes, where pensions are simply paid out of current income (or tax or social insurance revenues), are not directly affected: the volume of pension liabilities remains the same.

5. Companies and privatisation

5.1. Privatised utilities

Stock market values of private utility companies appear to have fallen at about the same rate as other company shares over the last year. The recession means that they too experience falls in sales. Although the business is relatively secure, this depends on political decisions. And, like other companies, utility companies may have problems refinancing their debts.

All these issues can be seen in Italy and the Italian multinational power company Enel. Power consumption in Italy fell by 30% in 2 months to December 2008:

> "Italian industry has slashed its electricity consumption by almost a third in two months in a stark sign of the force of the recession and a serious blow to efforts by Silvio Berlusconi's centre-right government to play down the depth of the crisis. Terna, the company responsible for electricity transmission across the national grid, recorded a 30 per cent fall in October and November." [49]

Enel has debt of over €50 billion, which it claims it can reduce by the end of 2008 by using profits, but it has to refinance €14bn of debt by 2010 and probably find a further €11bn to buy out its co-owner of the Spanish

company Endesa. Its ability to deliver this was put in doubt in December due to uncertainty over an Italian government decree that would 'cap' utility bills. [50]

Even if private utilities succeed in refinancing their debts from the point of view of their shareholders, it will be at considerable extra expense to the public. As noted by Martin Wolf (see below) private companies were already an expensive way of financing investment in networks; the companies are now having to pay an even greater premium above what it would cost governments. This extra cost will be borne by consumers, through even higher prices, or workers (through cost-cutting), or governments (through subsidies).

5.2. Privatisations and PPPs

The nationalisations have reversed the privatisation pattern of previous decades. In addition, countries have been abandoning proposed privatisations and PPPs:

- Sweden has postponed its entire privatisation programme, principally because of the fall in stock markets, which has halved the revenue that might be expected from the sales. [51]
- In the USA, the publicly owned port of Portland abandoned plans to sell a lease for a private container terminal, citing difficult market conditions.[52]
- Mexico, for example, has announced that it will continue with major infrastructure spending plans, but has cancelled projects which were expected to be financed by PPPs. [53]
-

It is not clear whether PPPs will continue to be used as an instrument of investment in public services or infrastructure. While banks are still prepared to lend to governments at cheaper and cheaper rates, the rates of interest charged to companies has become higher and higher. The difference between the cost of borrowing by governments, and the cost of borrowing by companies – the 'spread' – has thus become higher than ever. This should make PPPs an extremely unattractive way of financing capital investment.

Companies may still want to obtain PPPs in high income countries, because they are seen as safe ways of making money, underpinned by government guarantees. The European employers federation, UNICE, issued a leaflet in November 2008 promoting PPPs, for example. But international companies have become generally reluctant to invest in developing countries: capital is being withdrawn, not injected. And private companies may be less interested if there is real competition involved in bidding for PPPs: when Brazil passed a new law providing for competitive tendering for private investments in new port facilities, companies reacted by complaining that the law would "would drive away investors by making the process too bureaucratic." [54]

6. Political issues and the role of the state

The crisis has generated more discussion around the role of governments and markets, including articles in the business press which have been more critical of companies, more sympathetic to state intervention, and more ready to acknowledge the possibility of public hostility to business practices, than in previous years. Some examples from the Financial Times (FT) include:

- a critical article in September on AIG's practices 'This greed was beyond irresponsible' by John Gapper, the FT's chief business commentator: "The word "irresponsible" does not begin to describe AIG's behaviour. Like Bear, Lehman and others, it saw a way to get in on the growing action in mortgage-backed derivatives. Its bankers were soon earning huge fees for themselves and AIG by piling up unimaginable risks. Call me a spoilsport, but I do not believe that AIG or any other capital markets institution should be allowed to play like that with my money (I am a US taxpayer) in future." http://www.ft.com/cms/s/9c0e75cc-84e1-11dd-b148-0000779fd18c.html

- an article in October 'Back in Business' discussing the possible need for a new 'social contract' in the USA, like the New Deal of the 1930s, in response to perceived changes in public perception, by Clive Crook, the FT Washington correspondent: "A new social contract – the New Deal – was the outcome of the Great Depression and it would be foolish to rule out another such convulsion. The present crisis is adding to demands for new government intervention….Rising unemployment and falling incomes will highlight gaps in the country's social insurance and will sharpen complaints

about social injustice. More than in the past, the nation's mood is likely to favour universal healthcare, for example, and higher taxes on the rich….astounding increases in the incomes of prominent financiers – private equity partners, hedge fund managers, chief executives of failing banks and so on – are widely reported and arouse incredulous rage. Furious popular resistance to the Treasury's initial financial rescue plan, widely perceived as providing a parachute for Wall Street fat cats, was a striking illustration of the strength of feeling." http://www.ft.com/cms/s/0/23210f82-9ae2-11dd-a653-000077b07658.html

- a FT leader on the UK/EU rescues of October 13th headlined 'Nationalise to save the free market' gratefully commented that : "Gordon Brown came to save capitalism, not to bury it….does this rescue mean the end of private financial capitalism? Of course not. ….. Nationally owned banks seem likely to be a reality in many countries for a decade. ….. But stakes in banks will, eventually, be sold back to private investors. Governments – rightly – will regulate to avoid further crises. They will fail, and then be forced to act to pick up the pieces. There is no alternative……These leaders are not putting capitalism to the sword in favour of the gentler rule of the state. They are using the state to defeat the marketplace's most dangerous historic enemy: widespread depression. And they are right to do so." http://www.ft.com/cms/s/0/2ec1ce0e-9951-11dd-9d48-000077b07658.html

- an article 'Britain's utility model is broken' by Martin Wolf, the FT chief economics commentator, in June criticised the costs and inefficient financing mechanisms of privatised infrastructure and utilities such as electricity, gas and water in the UK.: "…the transfer of monopolies into the hands of regulated companies that own, run and develop the assets is flawed. This is excessively costly to consumers. …Because the weighted average cost of capital is well above the cost of debt, investors have been able to buy the companies, replace the equity with debt and enjoy a licence to print money. Prof. Helm estimates that this financial arbitrage has been worth up to £1bn a year, at the expense of the customers, predominantly in water. This is, quite simply, a scandal…..When one looks at it this way, it seems obvious that the finance of assets is a suitable function for the public sector, which has one huge advantage – the ability to borrow cheaply". http://www.ft.com/cms/s/0/e7e5525a-3896-11dd-8aed-0000779fd2ac.html

7. Annex

Table 2. IMF growth forecasts for 2008 and 2009 (revised November 2008)

	2006	2007	**2008**	**2009**
			Forecast	**forecast**
World	**5.1**	**5.0**	**3.7**	**2.2**
Advanced economies	3.0	2.6	**1.4**	**-0.3**
Emerging & developing economies	7.9	8.0	**6.6**	**5.1**
USA	2.8	2.0	**1.4**	**-0.7**
Canada	3.1	2.7	**0.6**	**0.3**
Japan	2.4	2.1	**0.5**	**-0.2**
European Union	3.3	3.1	**1.5**	**-0.2**
United Kingdom	2.8	3.0	**0.8**	**-1.3**
Germany	3.0	2.5	**1.7**	**-0.8**
France	2.2	2.2	**0.8**	**-0.5**
Italy	1.8	1.5	**-0.2**	**-0.6**
Spain	3.9	3.7	**1.4**	**-0.7**
Central & eastern Europe	6.7	5.7	**4.2**	**2.5**
Russia	7.4	8.1	**6.8**	**3.5**
CIS excl. Russia	10.2	9.8	**6.9**	**1.6**
China	11.6	11.9	**9.7**	**8.5**
India	9.8	9.3	**7.8**	**6.3**
ASEAN-5	5.7	6.3	**5.4**	**4.2**
Brazil	3.8	5.4	**5.2**	**3.0**
Mexico	4.9	3.2	**1.9**	**0.9**

Africa	6.1	6.1	**5.2**	**4.7**
Middle East	5.7	6.0	**6.1**	**5.3**

Source: IMF World Economic Outlook Update 06 November 2008
http://www.imf.org/external/pubs/ft/weo/2008/update/03/index.htm

Table 3. Nationalisations and loan guarantees (as at end November 2008)

Country	Bank	Curr-ency	Pur-chase	Bank debt guar	**Pur-chases**	**Bank debt guarantee**
			bn.	bn.	**€bn.**	**€bn.**
USA	Recapitalisation of 9 banks (Citigroup$25bn,JP Morgan Chase $25bn, Bank of America$20bn, Merrill Lynch$5bn, Wells Fargo$25bn, Goldman Sachs$10bn, Morgan Stanley$10bn, Bank of New York Mellon$2-3bn, State Street$2-3bn)	$	125	125		
	Recapitalisation of AIG (80%)	$	85			
	Fannie Mae and Freddie Mac	$	200	5400		
TOTAL USA		$	410	5525	**308**	**4144**
UK	13 Oct (of which RBS, HBOS,Lloyds £37bn)	£	50	400		
UK	Northern Rock	£	27	87		
	Bradford and Bingley	£	18	45		
TOTAL UK		£	95	532	**123**	**692**
Be-Fr-Lux	Dexia	€	6.4			
Be-ne-lux	Fortis	€	11.2			
Germany	Hypo Real Estate	€	50			
Germany	13 Oct	€	70	400		
France	13 Oct (of which Credit Agricole 3.0, Paribas 2.55, Soc Gen 1.7, others 3.25bn.)	€	40	320		
Netherlands	13 Oct (of which ING €10bn.)	€	20	200		
Spain	13 Oct	€		100		
Italy	13 Oct	€				
Austria	13 Oct	€	15	85		
Switzerland	UBS	€	3.9			
TOTAL EU – UK + Switz		€	212	1105	**212**	**1105**
TOTAL ALL					**645**	**5941**

Sources: FT, Guardian. Final columns based on conversion at rates of £1= €1.3, $1= €0.75

8. Notes

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