

## “I’m Your Worst Nightmare”

**B**ILL CLINTON’S winning election slogan made its mark on the minds of American voters:

*“It’s the Economy, Stupid!”*

As a guilt shifter, that was a shrewd piece of political hyperbole. A gift for politicians who need to direct people’s anger at a faceless target. The truth, however, is that our major social and economic problems are almost entirely the result of bad governance.

*It’s the Politics, Stupid!*

If I am correct, we need forensic examination of the politicians who exercise the

power of the state, if we want to understand why and how Britain – and the rest of the world – fell into the severest economic crisis since the Great Depression of the 1930s.

As I write, in February 2010, Britain has suffered 18 months of negative growth. A recession is defined at six months of declining national income. The pain of that downturn was felt not just by those who lost their jobs and homes. Even the people who managed to cling onto employment suffered a reduction in wages, as the price of continuing to receive pay packets. And those who managed to get back into work, after a gut-wrenching spell in the dole queue, suffered an average pay cut of 28%.<sup>1</sup>

Britain was on a life support system as New Year fireworks flared over London at midnight on December 31, to celebrate the arrival of 2010. Banks, car dealers and retailers were receiving financial support from taxpayers, in the desperate bid to resuscitate the economy.

It need not have happened. Because, as far back as 1997, I alerted Tony Blair and

1 The estimate is by the Chartered Institute of Personnel and Development. Monaghan (2010).

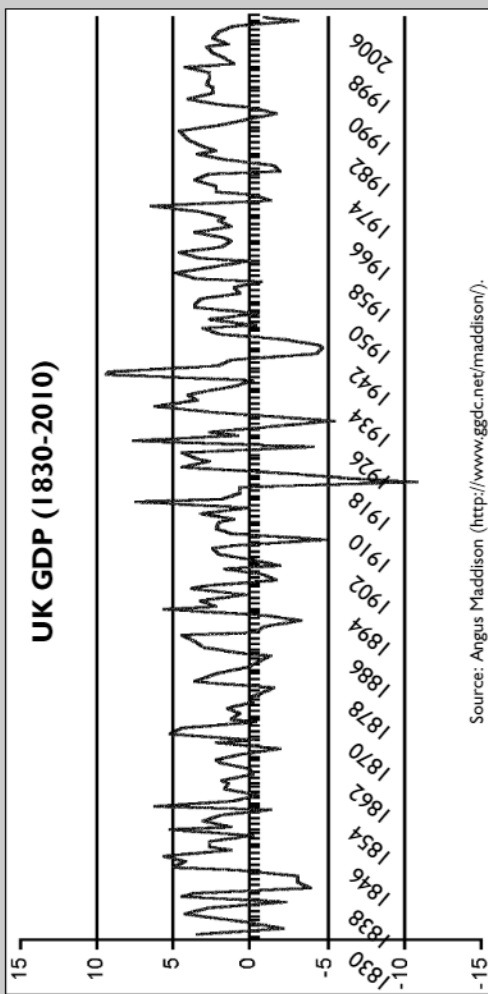
his New Labour government to the fact that they had a full 10 years to prepare for the next catastrophe.

I had lived through three recessions, beginning with the Barber boom/bust of 1972/74. That was when I embarked on my autopsy: I wanted to know why the people of Britain were forced to suffer these repeated bouts of mass unemployment. I published my findings in 1983: *The Power in the Land*. This explained why the capitalist economy was subject to violent swings, and what could be done about it. And I explained that it was simple arithmetic to work out that Britain would go into recession at the end of the 1980s (what would turn out to be the Lawson boom/bust), hitting the bottom in 1992.

The economic engine of Britain – the first industrialised country in the world – has suffered such cardiac arrests on a regular basis. Graph 1:I below registers the movement in national income back to 1830.

The fluctuations appear to be random. And unstoppable. So how could I know, ten years in advance, that the economy would suffer one of its worst crises for a hundred

**Graph I:1**



Source: Angus Maddison (<http://www.ggdc.net/maddison/>).

years? And how could I be so sure that it could be prevented?

My warnings were specific. In *The Chaos Makers*, published immediately after New Labour's election victory, I described the economic trajectory that was pushing Britain towards the following crunch points.

- Property prices would peak in 2007: they did.
- The crisis would be triggered by breakdown in the housing market: it was.
- The economy would hit the bottom in 2010. Output of national income went negative in the second quarter of 2008, and flattened out in the three months running up to Christmas 2009. Anaemic growth restarted with the Christmas sales that were dragged out into February 2010.

The historical evidence on which I based my forecast is overwhelming. But there was something unique about the cycle that ended in 2010. *The real estate sector of every country in the world was integrated into the same timetable.* That meant one – terrible – prospect: a freefall in the global

economy of depression proportions. And so, I predicted that prospect in 2005, in *Boom Bust*. Through newsletters and personal communications, I kept the Treasury and Downing Street fully briefed on the terrible events that were on the horizon. Those warnings went back to November 1997.

## Boom Bust: The Alert

TONY BLAIR reincarnated the Labour Party as New Labour, in a bid to come out of the political wilderness. Labour's politicians had been in opposition for 18 years. The suave, slick-talking barrister from the back benches took control and ditched his party's constitutional commitment to nationalise the means of production. He won the election in May 1997 by not only reforming his party, but promising to rejuvenate Britain.

I also had an agenda. I was determined that the Blair government would be held accountable, if it failed to guide the UK through the implosion of the global economy at the end of the first decade of the 21st century.

I wrote to the Prime Minister on November 4, leaving him in no doubt about the primary source of Britain's problems. I wrote: "With every passing month, Britain loses more than £10bn in goods and services, money that could be shared between the public and private sectors to finally solve all the problems that will otherwise be with us when you seek re-election in 2002."

My letter to the Chancellor of the Exchequer, Gordon Brown, was dated November 1. I supplied him with a briefing paper which explained how the tax system he had inherited was undermining people's ability to produce their incomes. I added: "The bad news is this. Under existing strategies, There will be a mini boom/bust in the lifetime of this Parliament, ... followed by the cyclical Big One after the next general election. Britain is preserving the features that nurture and drive the business cycle ... there is nothing in the policies of New Labour that would obviate this outcome."

The dot.com bubble clocked in on time. And, sure enough, what I called the Big One did emerge on the appointed date. But

at the time of writing to the Chancellor, there was ample opportunity to head-off these crises.

But prime ministers and finance ministers are busy people. They surround themselves with advisors and confidantes who work at the political coal face, making sure that their masters are properly briefed. So I made sure that the inner circles were alerted.

I wrote to Alistair Darling on November 13. He was the Treasury Secretary under Gordon Brown. But there were two other players who were key to the fortunes of New Labour.

On November 4, I wrote to Alistair Campbell, recalling that he had asked me to supply information on tax policies. I reminded him that New Labour had declined my offer to assist in developing a new fiscal strategy. And in supplying him with a copy of *The Chaos Makers*, I took the opportunity to offer a forecast on the value of Gordon Brown's first big initiative – relieving himself of responsibility of setting interest rates by rendering the Bank of England independent in the administration of monetary policy. I told Campbell:



The result is an economic strategy that will fail. There will be a housing boom and bust in the life of this Parliament, and an even greater one in the following Parliament. There is one policy only for avoiding that outcome, and it has nothing to do with the independence of the Bank of England or any other tools which are currently at the disposal of the Treasury.

The second key operator was Peter Mandelson. He was special *not* because he was the acclaimed architect of New Labour's election victory, but because he was the grandson of a pre-war Labour politician who knew how to reform the economy. Herbert Morrison proposed a law that would boost incomes in the nation's capital and deliver both fairness (for individuals) and efficiency (in the way the economy used its resources). To try and rescue London from the damage inflicted by taxation, in 1939 Morrison's Bill went before Parliament. If enacted, that law would begin to place the finances of the capital on a growth path that would be sustained.

Parliament found the excuse to throw out the Bill that would begin to shift taxes off people's wages and on to the rental income of land. But the knowledge

of how to re-fashion the tax system was deeply embedded in the Morrison family's political history. My hopes were high that little Peter had grown up to understand the principles of good governance. So it was with some expectation of a meaningful dialogue that I wrote to Mandelson on November 4. I supplied him with a briefing paper that quoted his grandfather's words.

New Labour now has the opportunity to retrieve the wisdom of its roots to make sure that the 21st century is not a re-run of the 20th century. The economic consequences of failing to do so can now be measured. In Britain, since May 1 [date of the general election], we have lost more than £50bn in goods and services which would have been produced under the fiscal system advocated by Herbert Morrison. My colleagues and I estimate that, annually, Britain loses in excess of £115bn in defence of a tax structure that destroys entrepreneurship and hard work.

I reminded Mandelson that his Prime Minister's declaration of zero tolerance to teachers and local civil servants who fail in their responsibilities was a standard that would have to be applied to his government. And so I concluded my letter in these terms:

I am your worst nightmare. I know exactly why New Labour will fail, if that is indeed to be the outcome, and I will be obliged to chronicle the developments in order that the voters will know how to apportion responsibility ... I am sure that you would expect no less, given the *zero tolerance of failure* standard which New Labour insists upon for others.

I spent the next 10 years monitoring the performance of the Treasury. I read the speeches of the key Cabinet ministers, which were full of promises about how they would rejuvenate Britain. And, in particular, I tracked the number of times Gordon Brown reiterated the promise: *No More Housing Boom/Busts!*

The Blair/Brown partnership failed abjectly to erect safety barriers around the nation's economy. After moving into their security protected homes in Downing Street, Blair and Brown watched the homes of working people being exposed to the vicious storms that were gathering in the property market.

And so, now, the inquest. This book is in fulfilment of the promise I made to Peter Mandelson: I would hold to account his lordship (he has now been elevated as one of Her Majesty's peers of the

realm, occupying a seat in the House of Lords).

Under Gordon Brown's premiership, he became Business Minister. While enjoying the trappings of a cabinet minister who pontificated on the need of others to work harder and better, Mandelson presided over an enterprise economy in collapse.

But we will not just name the names of the politicians who failed their nation. There is an even more challenging question that must be addressed: *why* do governments repeatedly abuse the interests of the people they are supposed to serve? We need an answer to *this* question because, otherwise, by default we will allow politicians to repeat the boom/bust cycle. That became obvious during New Labour's regime, when economists betrayed their obligation to provide honest guidance to government. An example of how the lawmakers were misled by their experts was revealed early in 2003, when I wrote to Tony Blair's No 10 spin doctor, Alistair Campbell. I had worked with him on the *Today* newspaper, and we had both previously worked for the Mirror Group newspapers. I left him in no doubt that

government's policies were "a shambles". He replied on February 5 :

I'm a little bemused as to why you believe this country's economic policy is 'a shambles'. These are difficult times for the global economy but pretty well every independent expert believes this country is in better shape to weather these storms than our competitors. That's surely in large part a result of the economic policies followed by this government.

I was in a minority of one, and the unfolding events would determine whether the independent experts on whom Campbell relied were right or wrong.

## The Pledge

GORDON BROWN had ample time to put in place the counter-cyclical measures to defend people's welfare. That was his responsibility, as the steward of the nation's economy. But we can all make mistakes. In the end, what matters is how we behave after we have been exposed. When the UK housing market started to turn down in October 2007, Brown was in a position to reassess his policy failures. At that point, he could have come clean with

the public, so that a viable rescue mission could be launched. Instead, Brown did not behave in an manner becoming of a Right Honourable Gentleman.

As the credit crisis struck down the mighty Masters of the Universe on Wall Street and the City of London, Brown tried to cover up his tracks. He splashed out hogwash by the bucketful, all calculated to save his political skin. But in doing so, he declared his intention: to bend our minds away from the truth.

As Tony Blair's successor as Prime Minister, Brown flew to the United Nations in New York, in September 2008, and laid the blame squarely on the United States. Remedies, he said, would have to be *global*, not national.

In dissecting Brown's statements, we behold a horrifying spectacle: the depth of the duplicity of democratically elected leaders who refuse to accept that "the buck stops here" – with them. This gives us a glimpse of the difficulties we all now face, in negotiating the economic minefields created by the first housing boom of the 21st century.

Gordon Brown's systematic attempt to

rescue his political reputation – by portraying himself as both a victim of the “global crisis”, and the politician with the experience to save the world – was launched at his Labour Party’s annual conference in Manchester, two days before he turned up at the UN.

His first “tough” statement (Brown has consistently affirmed his willingness to adopt tough stances in the public’s interest) was a vow to “clean up” the City of London, where financiers had apparently behaved in an “irresponsible way”.

*Had Brown behaved responsibly?* When I forecast the boom/bust for him in 1997, he failed to adopt the corrective measures to head-off a crisis that was written into Britain’s future. *This was not responsible stewardship of the economy.*

Brown admonished directors of banks who “should [not] be able to say they did not understand the risks they were running”. *Did Brown understand the risks he was taking with the UK economy?* My analysis was delivered to the Treasury in 1997. And, again, in 2005. And again, when I briefed his closest economic adviser, Shriti Vadera (who would be

elevated by Premier Brown to the House of Lords as a baroness). We sat in the meeting room off the Chancellor's office in the Treasury, where I explained the macro-economic consequences of the tax policies being administered by the Treasury. *Brown could not claim that he was ignorant of the risks he was taking with the UK economy.*

Brown insisted that all transactions by bankers should be transparent "and not hidden". *Was Brown transparent in his financial transactions?* Over the 10 years that New Labour controlled Parliament, Brown introduced one stealth tax after another. There is a reason why those taxes are labelled "stealth". The payers are not supposed to know that they are being taxed. Transparency was the last thing the Chancellor wanted. *Gordon Brown was not honest with the public as he milked them of their money.*

Brown criticised the bankers for being greedy, in rewarding themselves with fat bonuses. *Was Brown innocent of the accusation that he had fostered greed?* As a son of the manse, he sharpened his sanctimonious language to denounce



bankers, claiming that rewards should be based on “hard work, effort and enterprise”, not on “short term speculative deals”. Then what about the fabulous – unearned – capital gains being dished out to the owners of the real estate of Great Britain? *Their “unearned increments”, as Brown called them, were fabulous. So why remain silent about the way home-owners had indulged in the speculation that drove the economy into concrete buffers (see Box, page 20)?*

Brown displaced responsibility from himself by claiming that “I wish I could have persuaded other countries to do what I wanted, and that was to create a global system of financial regulation.” *Can we excuse Brown for not taking unilateral action to protect the UK economy?* He knew that the economic basis of my analysis was correct. The structural weakness in the capitalist economy is to be found in the market for land. When land values bubble up to unaffordable levels – which happens only because they receive privileged fiscal treatment – a bust becomes inevitable. And in Britain, Brown reported, in his Budget speech to the

## Box 1:1

### **The House that Harrison Owned**

After graduating from the University of Oxford, as a mature student, I returned to London and bought my family home on the edge of London for £16,000. That was in 1972. I sold it 10 years later for £58,000. The owner of that Edwardian semi-detached, 4-bedroomed dwelling was to reap a huge bonanza. Because the house went up for sale in July 2008 for £775,000.

But the housing boom had run out of steam and, three months later, the house had dropped to a price “in excess of” £700,000.

Whatever the eventual sale price, there is no doubt that the windfall gain would be enormous. This unearned fortune had nothing to do with the occupant’s “hard work, effort and enterprise”, to quote Gordon Brown’s yardstick. It was pure profit.

Although the tele-evangelists of the property market called this a return on “bricks and mortar”, the increase in value was actually attributable to the advantages of the location. Gordon Brown and HM Treasury were fully acquainted with the economics of the land market.

House of Commons in 2004, that there was no tax “on the unearned increment in land values when undeveloped land is granted planning permission”. So as the housing boom drove up land prices, the crash was dead certain. *Why, given his decade in the Treasury, didn't Gordon Brown change the tax code to remove those “unearned increments” and cut taxes on people's wages?*

As Britain's house prices slid by 10% in 2008, his record came under scrutiny in the media. In a BBC interview televised on September 21, 2008, Brown was challenged by Andrew Marr for failing to deliver on his mantra: “No return to boom and bust.” *Was this an unfair criticism of Gordon Brown?* To camouflage his record, Brown began to craft a new meaning for what had become his magic mantra (“no more boom/busts”). He went on the offensive, accusing Marr in these terms: “The idea that you're going to rewrite the last 10 years in that way is completely wrong.” *In publicly denying the facts about his own record, Gordon Brown was lying to the people of Britain.*

## The Evidence

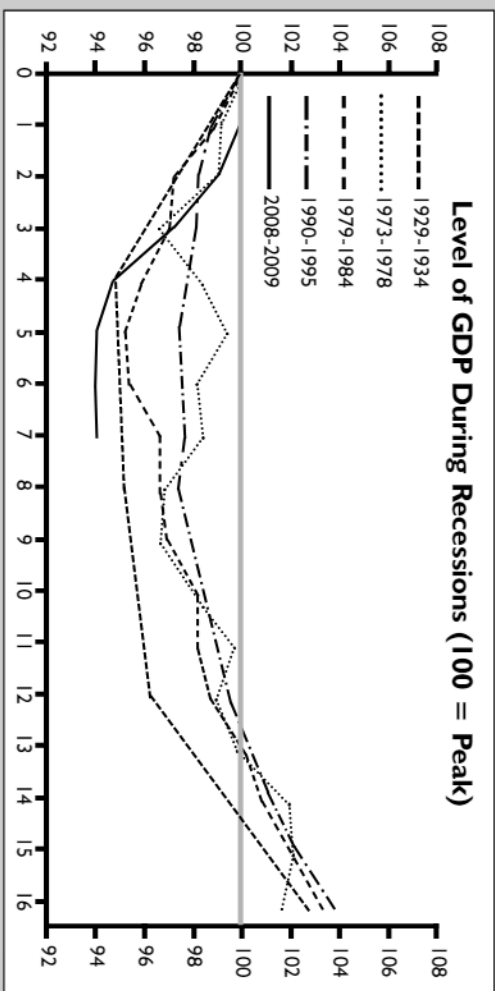
ON JANUARY 14, 2010, Britain's leading economic think-tank, the Cambridge-based National Institute for Economic and Social Research, reported: "The broader picture of the depression is that output fell sharply for the 12 months until March [2009] and has not changed very much since then."<sup>2</sup> A few days earlier (on January 11) one of Britain's best informed economic journalists assessed the US economy under the headline "America slides deeper into depression as Wall Street reveals".

Over the decade, investors had lost heavily on stocks for the first time since the 1930s. The outcome for Britain is chronicled in the graph opposite, based on data from Office for National Statistics and Capital Economics, a London consultancy. Britain was locked into the worst downturn since the 1930s.

As Chancellor of the Exchequer, Brown could not plead ignorance. Over the decade that he spent as master of Britain's finances, he repeatedly acknowledged that

2 Cohen (2010).

**Graph 1:11**



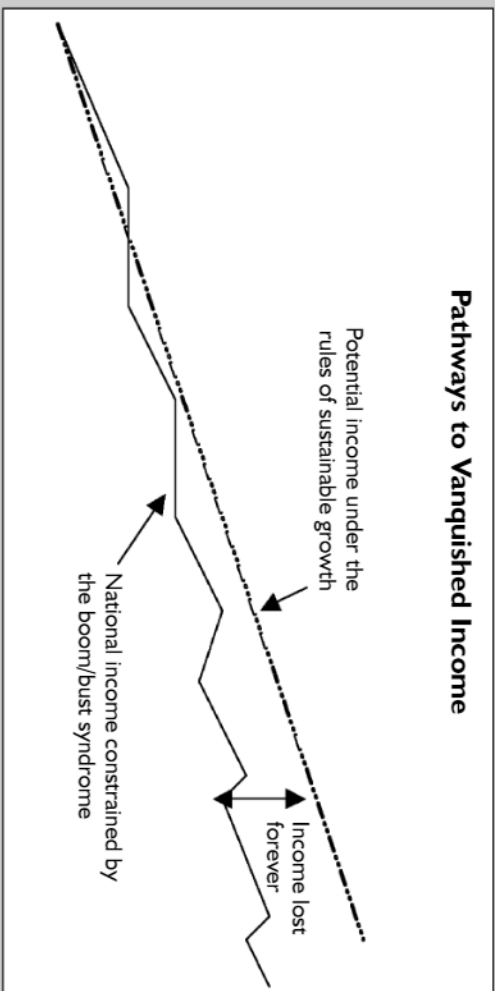
previous crises were triggered by booms and busts in the housing market. *So why did Tony Blair's government fail to act to protect Britain from the crisis that would begin in 2008?*

By 2010, the wilful waste of a vast amount of British income – which can never be recovered – was equal to at least 10% of the nation's annual output. Add the loss from the Depression of 2010 (which is not yet over) to all the downturns traced back to 1830, and you begin to appreciate that capitalism, British-style, has wasted wealth on an unimaginable scale. Try to wrap your imagination around the level of prosperity that we would all be enjoying, today, if governments had discovered how to use an automatic stabiliser in the economy!

The graphic representation opposite indicates how the waste unfolds over time. I will explain that the periodical downturns need not have laid waste to people's hopes for the good life. The economic stabiliser existed. The key policy was the stuff of economic discourse in the 18th century, and theory was fine-tuned early in the 19th century. So successive governments have refused to base the industrial economy on

**Figure 1:1**

**Pathways to Vanquished Income**



foundations strong enough to deliver growth on a smooth, sustainable basis.

The people in power need to be held to account. No country in the world, apart from China, was out of recession in 2010. The official statistics claim that growth has restarted in all the big economies. They were all on a cash-injection drip feed. We will not know until 2011 how they respond when the cash taps are turned off.

## The Mind-set

IN HIS FIRST budget speech to the House of Commons, on July 2, 1997, Brown made a promise to the nation (the emphases are mine).

For most people, the acquisition of a house is the biggest single investment that they will make. Home owners rightly expect their investment to be protected by sensible policies pursued by Government. *I am determined that as a country we never return to the instability, speculation and negative equity that characterised the housing market in the 1980s and 1990s.*

Volatility is damaging both to the housing market and to the economy as a whole, so stability will be central to our policy to help home owners. *We must be*



*prepared to take the action necessary to secure it. I will not allow house prices to get out of control and put at risk the sustainability of the recovery. I have therefore decided that it is right to take two measures aimed at stability in the housing market.*

First, I will raise stamp duty from 1 per cent. to 1½ per cent on property sales above £250,000 and to 2 per cent. for property sales above £500,000. This will take immediate effect after the Budget resolution has been approved by the House.

Secondly, continuing the reforms begun by the previous Government, who removed mortgage tax relief at the higher rate of 40 per cent in 1991, and cut it to 15 per cent by 1995, I propose to reduce mortgage tax relief by a further 5 per cent, from 15 per cent to 10 per cent, from April 1998.

*The timing of my measure should help to avoid a return to the conditions of the 1980s, when the failure to take early action guaranteed worse problems later on. I believe that these measures will help to secure what we all want: a more balanced recovery.*

This was a mixed bag of proposals that did nothing to suggest Gordon Brown knew what he was doing. Or did he? Was the Chancellor trying to hide a guilty secret?

In reviewing Brown's pledge to the nation, I decided to check the words against the version on HM Treasury's website.

Journalists are warned to take this precaution, when they are handed advance copies of a government minister's speech. All of the then Chancellor of the Exchequer's speeches were listed on the Treasury website, starting with the Budget of 1998.

The 1997 speech was missing.

But no-one can erase words from Hansard, which records every statement uttered in the House of Commons. I tracked down Brown's statement in the parliamentary proceedings.<sup>3</sup> The meaning of his words were crystal clear. Britain, according to Gordon Brown, *would not suffer another housing boom/bust under his stewardship*. In attempting to rewrite his record, Gordon Brown was trying to bend our minds.

But Brown's July 2 pledge was recorded in another publication, where his words would come back to haunt him. I had listened intently to his Budget speech, and I published his promise in *The Chaos Makers*. Those words were to ring in my ears for years to come – “*I am determined that as*

3 *Hansard*, July 2, 1997, Col. 313, available from <http://www.publications.parliament.uk/pa/cm199798/cmhansrd/vo970702/debtext/70702-21.htm>.

*a country we never return to the instability, speculation, and negative equity...”*

I knew that his proposals to thwart the next land-led boom/bust would not work. But I also recorded my confusion as to why a Labour politician should go out of his way to lecture unemployed youngsters, when land speculators were left free to enrich themselves by locking up land and denying others the chance of decently paid jobs. This is how I assessed Brown’s economic strategy:

In the era of New Labour, the signal to unemployed youngsters is that they will have to earn what money they receive from the public purse; while land speculators may continue to hoard land – literally: keep it unemployed, even while its price rises – until it suits them to make a ‘killing’ out of capital gains.<sup>4</sup>

This was the driving mechanism within the economy that created the regular booms and busts, which a reforming chancellor needed to address.

Was there more that I could have done

4 Harrison (1997: 26)

to animate Gordon Brown into introducing the fundamental changes to the tax system, so that rewards really were directed to those who *earned* them?

I could not have anticipated that Brown would hire Shriti Vadera, the economist who was to face me on the other side of Gordon Brown's table, listening to me with the ears of an investment banker. During the good times, Brown lauded the City of London as a virtuous centre of economic growth. Could he – based on Vadera's advice – hope to spoil the Mad Bankers' Money Party?<sup>5</sup>



GORDON BROWN spent 10 years boasting he had increased spending on health and education. But the Institute for Fiscal Studies discloses<sup>6</sup> that cuts of £43.8bn, necessary because of Brown's recession, would wipe out all the gains since 1997. The IFS discovered that,

5 A prominent role in the attempt to rescue Bradford & Bingley, the bank that over-funded the buy-to-let property speculators.<sup>6</sup> Brown had enlisted her from UBS, the bank that lost billions in The Great Wealth Wipe-out.

6 *Green Budget 2010*.

during his final years in the Treasury, Brown presided over a fall in the income of the poorest 20% of the population.

Brown refused to confess. As the economy went into freefall he shifted the goalposts. Abandoned was his magic mantra *No More Housing Boom/Busts*. He knew how to rescue the economy. How? By printing money galore. It was not his fault, he asserted, that the recession “was nothing to do with inflation”.

With the economy in a worse state than when it was bailed out by the IMF in 1976, the man who steered economic policy hid behind half-baked economic nostrums, appealing to people’s sentiments about poverty in the rest of the world, while concentrating attention on bankers’ bonuses. Brown uttered not a word about the multi-million pound profit made by Tony Blair from a property portfolio that benefited from the Chancellor’s house price boom.

7 Barber (2010).