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The Indictment

AND STILL they try to hoodwink us, the guardians who failed to prevent the global financial crisis and allowed billions to be wiped off people's savings, their futures shattered.

The failures of governance are not just about the loss of pounds in your back pocket. They are about the emotions that can drive people to suicide. In Britain, the downturn that began in 2008 was shadowed by a rise in the number of suicides, which rose by over 6% according to the Office for National Statistics. This was the first rise since 1998. Three times as many men as women killed themselves. And the highest rates were in the peripheral regions like the northeast of England. Alcohol-related deaths also rose by 3.5%.

These human responses are faster than those from the analysts who are handsomely paid to diagnose the health of the economy. It took a full year for the IMF to describe the housing sector as "inflicting heavy damage on markets and institutions at the core of the financial system". That was in April 2008, when the IMF became the first public agency to concede that the world was on the precipice of "the largest financial shock since the Great Depression".[1] And as the pressure piled up, the "Super-bears have started to say that this is perhaps 'The Big One', by which they mean the onset of a new Great Depression."[2]

Then, on May 15, 2008, one of the landmark events on the path to the depression took place. The Governor of the Bank of England sealed Britain's fate. He announced a decision that will go down in the annals of economic history as a catastrophe. Mervyn King revealed that priority would be given to curbing inflation rather

1 IMF (2008).
2 Elliott (2008b).

than protecting people's jobs and homes. All he could offer was saccharine words of comfort:

> Be patient. The 'nice' decade is behind us. The credit cycle has turned. Commodity prices are rising. We are travelling along a bumpy road as the economy rebalances. Monetary policy cannot and should not try to prevent that adjustment. Inflation will return to the target and growth will eventually recover to a sustainable rate. But we will have to be patient.

The decision had been taken by the Bank of England to sit out the struggle to save the economy. Its policies, instead of mediating the downturn, deepened the slump and left Britain vulnerable to the chaos of the post-2010 world.

According to the Bank of England's *Inflation Report* (May 2008), the UK would not return to the government's target for inflation (2%) until 2010. Its calculation was based on interest rates at 5%. Fearing the rise in food and energy prices, the Bank made the fateful decision to keep interest rates high. There would be no relief for people who were trying to fend off the repossession orders on their homes. And no relief for businesses that were being sacrificed by banks that had turned off the credit taps. Just like the disastrous errors that were made by governments in the 1930s, today's economic policy-makers are propelling their economies down a path to destruction.

In Britain, the economy was sacrificed because the Bank of England ignored the historical evidence. There was something special about the prevailing interest rate to which the Bank drew our attention. It was not a coincidence that the rate had settled on 5%. As I explain in *Boom Bust*, 5% is the rate that determines the average life of a property cycle (14 years: see box below).

In the United States, the Federal Reserve under Chairman Ben Bernanke agonised over how it could arm-wrestle the future bubbles that destabilise the economy. Under the Fed's previous chairman, Alan Greenspan, a path of least resistance was taken. The central bank assumed it could not predict, let alone tackle, asset price bubbles. So as the housing market crashed in a way not seen since the Great Depression of the 1930s, economists wondered whether regulatory tools could head-off the next property boom/bust. Or

Box 2:1

The Bankrupt Doctrine

In 1997, the Bank of England was mandated to keep inflation at 2%. In May 2008, the Bank announced that this target had been exceeded and would not return to 2% until 2010.

In *Boom Bust*, I explained why the global business cycle would hit the bottom in 2010. The strategy to head-off this outcome was based on understanding the economics of the property cycle. Drawing on 300 years of historical evidence, I reveal how the long-run rate of interest of 5% was part of the mechanism for programming the life of every business cycle (the average of which is 18 years).

But the Bank of England chose not to factor my findings into its analysis. So the Governor, Mervyn King, made light of the looming recession. He glided over the severity of the downturn by saying "we may get the odd quarter or two of negative growth".

The Bank was projecting inflation as trending down to 2% just when the economy was going to hit the bottom of the cycle. By then, it would be too late to take pre-emptive action to rescue people whose jobs were at risk. They were to be crucified by a doctrine of property rights and the state's policies on taxation which are bankrupt as tools for guiding the economy.

should they do as the Bank of England had done – raise interest rates? While they agonised, the Fed pumped up the money supply to try and rescue bankrupt institutions; in doing so, giving another upward twist to prices. That way is inflation. And the Bank of England applied a brutally crude tool that destroyed jobs. That way is stagnation.

Stagflation.

Alarmed by a global financial sector that was out of control, heads of governments went in search of monsters. Literally. Germany's President, Horst Köhler, appealed for reforms to "international financial markets [which] have developed into a monster that must be put back in its place".[3] This was comic-cuts analysis not worthy of the people of Germany.

Köhler ought to have known better. He lambasted greedy bankers for causing the financial crisis without digging deep for an explanation. If he had correctly analysed the statistics, he would have identified the vital reason why Germany was the exception to the rule in Europe, as an economy

3 Benoit and Wilson (2008).

that maximised the value it produced for customers around the world.

Germany flourished in 2008. Why? The rest of Europe – from Ireland in the west to Spain in the south and the Baltic countries in the far north – were trembling as their housing markets crashed. Those economies were heading for a downfall as unemployment rose and consumers cut back on spending. Exceptionally, Germany was not suffering from the economic disruptions associated with land speculation. *This* was the clue that would have guided Köhler to the root of the global financial crisis. Why, we must ask, didn't the President identify the German property market's quiescence as the source of their stability? As the former head of the IMF, he was schooled in the doctrines of post-classical economics. These doctrines blinker economists and governments.

Köhler scared the German population with doom-laden observations about the future: "Capitalism only has a future if it rises up to its responsibilities. Especially its responsibility towards the weak. It is about practising responsibility and solidarity without at the same time switching off market and price mechanisms." Köhler's metaphor – he said bankers were like alchemists – was not far from the truth. And he was correct to indict them as responsible for "massive destruction of assets". But he could offer no insights into how to pull off this balancing trick.

The False Diagnosis

THERE IS NOTHING inevitable about the boom/bust cycles that keep ripping apart the market economy. Strategies exist that would deliver long-run stability, freeing us to go about our business without the risk of suddenly losing our jobs or homes. But those policies are not adopted by government because, in one vital area of the economy, reason is not allowed to apply.

I know this is a grave charge, but it is confirmed by the evidence. The rules that apply elsewhere are sidelined when they threaten the vested interests of those who make fortunes by exploiting other people. Instead of the methods of science, bizarre techniques are used to guide public policy.

To illustrate my case, I will take to task

Mervyn King, the Governor of the Bank of England. I charge him with dereliction in his duty to protect our welfare. He has failed to present the facts in a way that would enable people to build barricades between themselves and the financial tsunami that has struck the economy.

- ACCUSATION 1: By misdiagnosing the origins of the crisis, power-brokers like Mervyn King distract people from remedies that can prevent the property market crash from getting worse.

Giving evidence to parliamentarians in the House of Commons on March 27, 2008, King blamed the financial crisis on greedy bankers. He used the word "hubris" to identify the culprits. This is how he put it:

> There was a lot of hubris in financial markets. The financial crisis did not come from bad loans in Latin America or Asia, but from the heart of the financial sector here and in the US.

The Bank of England blamed the credit crunch on financiers whose *pride or arrogance* got the better of them, psychological failings that would cause their ruin.

This explanation was convenient. It excused stewards of the economy such as King. Since they are not psychoanalysts, we cannot accuse the Bank of England of negligence – can we? The King diagnosis is bogus. It relies on a myopic economics whose practitioners refuse to follow the chain of causation to its roots.

Mervyn King's fatuous explanation serves to protect those laws of the land that programme the economy to dive into repeated crises, in a predictable way, irrespective of the regulatory regimes established by the law-makers.

- ACCUSATION 2: By claiming that the real economy is not involved in the crisis, Mervyn King championed a dangerous doctrine – the one that led the world to the banking crisis in the first place.

King claims that "the heart of the problem is not in the real economy. It is in the financial sector itself". In fact, what was made to *look* like a financial crisis by him *started* in the real economy where people earn their living.

The Governor of the Bank of England is blinkered by the modern school of economics – the kind that he once taught as a professor – which deliberately ignores key elements of the "real economy". We will test my claim.

King says that certain measures now need to be taken to curb future reckless lending by banks.

My reply is this: *even if his proposals were adopted, in 18 years from now the world will be torn by another financial crisis.* Do we really want to put up with another disaster that could be prevented?

With the correct analysis, it is possible to rebalance the market economy so that it serves everyone's best interests. The insights we need are to be found in classical economics. We will concentrate on a theory that was elaborated in the writings of David Ricardo. He was a wealthy stock broker who entered Parliament in 1819. Our concern is with his scientific formulation of the theory of rent. His discoveries were crucial to understanding the way the modern economy operates. In particular, his discovery was central to the understanding of how the

Box 2:II

David Ricardo: The Taxing Question

Classical economists divided the factors of production into land, labour and capital. Understanding how competition distributed the income between these three categories was the first challenge for the new science of political economy.

David Ricardo (1772-1823) identified the missing pieces in the classical theory. In essence (and for our present purposes), once labour and capital had claimed their shares, what remained was available to pay for the use of land and nature's resources. These insights enabled Ricardo to link the pricing mechanism (in the markets) with public prices (taxes).

A civilised society needs a substantial public sector. Early economic analyses from John Locke (1632-1704) through to Ricardo established that government funding had to come out of the economy's surplus income – the rent of land. *This was the one piece of the classical theory that was erased from economics in the 20th century, for ideological reasons.*

nation's income is distributed (see box on the previous page).

The contours of the future can be known, if we allow ourselves to be guided by the logic of David Ricardo's theory of rent. Why can I confidently predict a major systemic crisis in 2025-28? I can do so without divining the idiosyncrasies of whoever happens to be Chairman of the US central bank, because the trends are written into the DNA of the capitalist economy.

In my previous publications I identified the 14-year property cycle that gave the shape, and the 18-year duration, to the general business cycle. Central bankers should treat this as a testable theory if they wish to improve their performance.

- If the US Fed had examined my theory of asset prices in 2005, when *Boom Bust* was published, Greenspan could have rewritten his speech. He would have known that the 14-year boom in residential property would come to an end in 2006, so he could have alerted America's home owners that hundreds of thousands of them were vulnerable.

- If the Bank of England had tested the evidence (it had all the time from 1997 to do so), it would have known that the 14-year boom in commercial property prices would end in 2007, causing havoc among the hedge funds. The data on those property prices was available.[4]

They didn't do so. We will have to beam a searchlight on the way they *do* operate, to find out how relevant they are to people's everyday needs.

The Nature of Conspiracy

MY INQUEST is directed at understanding the future. The primary aim is to enable you to decode the covert action and language of the people who wield power.

If this is your first introduction to my insights into economics, you are entitled to ask: *Why should I believe you*? Could Harrison be another charlatan competing for your attention? This question preoccupied me as I flew to Dublin to deliver my verdict on the Celtic Tiger. Commentators whose

4 Seager (2008).

words may affect people's lives have a duty of care to the public.

My path was prepared by this assessment published by radio broadcaster and author Marc Coleman. He wrote:

> According to a leading world economist, this is the start of a two-year process ... Author of Boom Bust: House Prices, Banking and the recession of 2010, Fred Harrison will give an address at Trinity College Dublin on Tuesday evening in which he predicts that not this year, nor in 2009, but only in 2010 will we see the worst of the coming downturn. Long before myself or other commentators, Harrison has been issuing dire warnings about the over-reliance on land and property in several of the world's leading economies. Unlike many commentators, those warnings were not of the 'boy who cried wolf' variety, but well thought out and calculated.[5]

I spelt out Ireland's bleak future as I saw it. And I will not pull my punches about what is going to happen in the global economy, or about the way in which people are manipulated into remaining subservient to those who reap the riches. I must be honest and admit that I want to change your perception of how the world

5 Coleman (2008).

really works. For I do have a personal agenda.

Over the last 30 years I have been able to establish why we live in a world that is so unnecessarily disagreeable. A world that appears determined to prevent us from opting for the lifestyles that we would prefer for ourselves – if we were free to choose.

The clues to the barriers that obstructed our freedoms had to be "out there". I travelled far and wide to collate the information. My quest came full circle when it dawned that the vital facts were right under my feet. I could have been introduced to those facts by the Usual Suspects – teachers and policy-makers – but I wasn't. The vital nuggets of information that would make sense of a chaotic world were being withheld.

I dug deeper.

Finally, the evidence was at my disposal. Now, surely (I thought), the rational and fair-minded power brokers – once the facts were presented to them – would want to amend the social contract? Didn't they promote the need for social harmony? That was when I realised that I had an even bigger problem. Something – let's call it "the system", for now – was determined to inhibit the people who could guide change from even understanding what I was talking about.

My naivety took me to Russia in 1992. I thought that the anti-communist reformers would act honourably and rationally on behalf of the people who had been savagely abused by the Stalinist regime for decades. I knew that the information I was offering to them was scientifically sound – it was endorsed, in writing, by four Nobel prize economists.[6] That prize was awarded to one of them (William Vickrey) in recognition of his work on the economics of public finance which I presented to the Kremlin and the Duma, Russia's Parliament. I devoted 10 years to disseminating that information throughout Russia, and the policies were endorsed by the Union of Russian Cities. If the policies had been adopted, no-one would have been excluded from Russia's territorial riches. It didn't happen. Change – the kind which liberates – was blocked. The architects of

6 Noyes (1991).

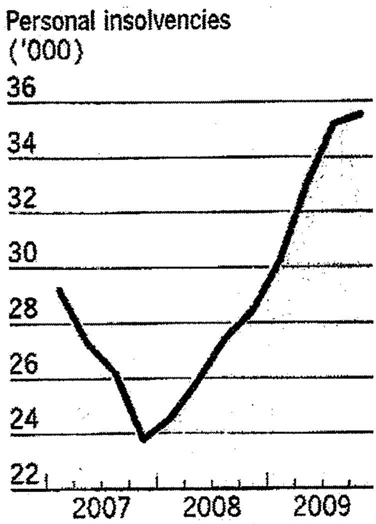
the new Russia, the young businessmen who gathered around President Boris Yeltsin, had been captivated by the doctrines of property rights and markets imported from the West.

I now know that, in certain realms of our lives, the world we have inherited is neither rational nor fair. We do not get what we read on the packaging: an economy driven by the quest for *efficiency* and individual *choice*, a politics driven by *fairness* and *equality*. That doctrine is the "authorised discourse".

It is also the Big Lie.

IT WAS HIS fixation for 10 years: Gordon Brown, The Man Who Would Be Prime Minister, brooded as he shaped the economic policies of Blair's years. But (he must have dreamt) how much better could he have modernised Britain from No. 10! After finally helping to drive Tony Blair out as undefeated Prime Minister, Brown claimed their partnership was good for Britain. He told ITV interviewer Piers Morgan: "I don't deny that, that there were fights about different issues ... but at the same time we managed, I think in the national interest, to get things sorted out".

Sorted out in whose interest? For 10 years Brown assaulted our senses with the promise that Britain would be protected from a property-led boom/bust. His Treasury back-room boys trawled the statistics to show the link between house prices and recessions. One outcome of Brown's policies: insolvencies in 2009 that outstripped those in the recession of 1992.



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