



"Without fear and without favour"

Monday March 21 2011

A united front against Gaddafi

Arab leaders must stay the course behind military action

The allied air assault on Muammar Gaddafi's forces followed with impressive speed after the UN Security Council authorised the action last week. The attacks are justified. Responding instantly to the resolution, the Libyan regime announced a ceasefire and said it would comply with UN demands. It plainly had no intention of doing so. It pressed on with its attacks against rebel-held areas. The international coalition turned to force, and was right to.

Bringing this just and measured intervention to a successful end may make severe demands. One can hope that Col Gaddafi folds quickly, but he may not. He has promised a long war. For the moment, allied air strikes have stalled his assault on Benghazi, but the Libyan leader has given no sign of ending his war on fellow Libyans. How much real support he commands in the country is hard to say, given the ferocity of his repression in the areas he controls. The allies should be prepared for a prolonged involvement.

They must also stay united, which makes it disturbing that cracks in the coalition have already appeared. On Sunday, Amr Moussa, the head of the Arab League, told reporters that coalition air strikes had gone further than the league had intended

when it lent its support. The idea, he said, was to protect civilians with a no-fly zone. The force deployed was excessive.

Mr Moussa is wrong and his comments are irresponsible. The UN resolution authorised "all necessary measures" to protect civilians, acknowledging that a no-fly zone by itself would be insufficient. Keeping Libyan aircraft on the ground does not protect civilians from artillery and advancing tanks.

France, Britain and the US have made much of backing for the action in the Arab world. Arab League support for military intervention was pivotal in securing US involvement and hence in carrying the whole effort forward. Even without it, the allies' actions are justified and fully in compliance with international law – but criticism from this quarter within hours of the campaign's commencement is damaging.

Protecting Libyan civilians from the depredations of their murderous leader is a cause that has united the world. Suspicion of western motives remains, but most people in the Arab world are as keen as western governments to see Col Gaddafi checked, and with reason. Arab leaders should lend their full support, moral and material, to this effort.

Nuclear frictions

Japan must end cosy link between regulators and industry

All right-minded people must be praying that Japan's improvised and desperate measures can finally bring the crisis at the Fukushima Daiichi nuclear plant to an end.

They should certainly be grateful to the brave fire-fighters and engineers who are putting their lives at risk by dousing the overheating uranium. One can also spare a thought for Tepco's managers, who evidently did not – even in their wildest nightmares – conceive of a 10m tsunami crashing through the coastal complex.

Yet when all is said and done, Tepco – and its shareholders – must be held to account for the country's worst-ever nuclear crisis. Tepco has been too cosy with its regulators. It has abused its de facto monopoly position to cut corners. In 2003, it was forced to close all 17 of its reactors, including the six at Fukushima, after it was found to have falsified safety data. A few years later, its Kashiwazaki-Kariwa plant was rocked by a 6.5 magnitude earthquake. The company later admitted that the plant, Japan's biggest, had not been built to withstand an earthquake of anything like that strength.

Tepco's past misdeeds have not elicited a tough enough regulatory response. One reason is a big section of the Japanese public, trau-

matized by memories of radiation in Hiroshima and Nagasaki, does not trust nuclear power. The government has been determined to press on regardless. As a result, it has come perilously close to colluding with the industry it is meant to be regulating.

When this is over, the government will need to rethink its nuclear policy. The public will no longer accept bland assurances that all is well. Tepco will probably not survive in its present form. That is no great loss. It will have to write off billions of dollars in scrapped assets. Even in non-litigious Japan, it will face huge compensation claims. The discovery of radiation in milk and spinach, for example, will cause damage to both those industries. Tepco may even end up being nationalised.

But the government's own record is hardly spotless. The key will be to break the cosy bond between nuclear regulators and the regulated. It should be made harder, for example, for senior officials to move between the two.

The government must also stop treating the public like frightened children who cannot be told the truth. If it fails to seize the industry by the scruff of the neck and raise standards, the future of nuclear power in Japan looks bleak.

Letters

Resource networks should replace supply chains

From Mr Alec Quaitte.

Sir, Again Gillian Tett demonstrates her unique ability to shine a light on a core problem of global business and economics, and sadly a real-life example in the Japanese earthquake ("Japan's supply chain risk reverberates across the globe", March 16).

We innovate, we aim for competitive advantage and often we get downright devious. The result is that we develop highly complex and murky systems. Systems that even the inventors cannot see, let alone understand.

Managers should look to history and in particular the science and engineering discipline of reliability. In the 1930s and 1940s the German scientist Wernher von Braun was working to build reliable rockets.

He viewed reliability as a chain, with any link a potential failure point. The more links the more

complexity, so simplicity was rule one.

Later von Braun worked with the mathematician Eric Pieruschka and Robert Lusser, an aircraft engineer. These relationships produced the first documented models of reliability. The models were probabilistic measures and in series to reflect the chain structure. The work led to reliability models of systems with both series and parallel (redundancy) components in their design, ie distributions (networks) where you had more protection against failure.

In the 1980s and 1990s "lean" was business fashion and duplication was eliminated as organisations looked to cut costs. Smaller supplier interfaces were created with tiered levels of access and we were going more global, stretching the remaining system links.

We then entered the new

millennium where "supply" was no longer enough. Legislation was telling us we have to take away our waste, or safely eliminate our creations. This environmental component was at first a new business, but again built with a lack of alternatives.

If we now need to be serious in addressing the "vulnerabilities in these chains" can we start with a name change and the reintroduction of redundancy into systems design?

Resource could replace supply and include supply, use, termination and disposal. Chain could be replaced with network, which would inherently include redundancy. The model would need to be transparent to enable proper management and reduced risk. It will be a fatter model but one that should better withstand surprises and shocks.

Alec Quaitte, Sempach, Switzerland

Illumination on little understood effects of quake

From Prof Dan Schiller.

Sir, Thank you for Gillian Tett's illuminating story about the little understood knock-on effects of the Japan earthquake on manufacturing supply chains (Markets Insight, March 16).

As a telecommunications historian I am sensitive to a related byproduct of the devastation: the damage it did to undersea cables.

Submarine cables carry much of the business-process data needed to run supply chains... Engendering another uncertain effect.

Dan Schiller, Professor of Library and Information Science, Professor of Communication, University of Illinois at Urbana-Champaign, US

Human capital is again essential for Japan's recovery

From Prof Gregg Huff.

Sir, According to David Pilling ("The Japanese miracle is not over", March 17), "the grave faces of [Japanese] public officials cannot have looked much graver in 1945". Comparison of expressions is always difficult but could this be an overstatement?

Recall Japan's circumstances in August 1945. Allied air attacks on 66 Japanese cities had levelled almost 50 per cent of their area. No less than two-thirds of Tokyo, Osaka and Nagoya were reduced to rubble and burnt ruins. In all, Japan had lost a quarter of its available housing.

Some 1.9m Japanese were dead from the war. Japan faced desperate food shortages at home. Starvation in Japanese urban centres was certain had the war continued much past August 1945. If Hiroshima and Nagasaki had not forced Japanese surrender, a lack of food might soon have done so. Hyperinflation was just beginning.

A great lesson of Japan's spectacular postwar reconstruction is the importance of human capital in economic development. No doubt that lesson will again apply.

Gregg Huff, Senior Research Fellow, Pembroke College, Oxford, UK



Grave faces: Hiroshima in December 1945

Getty

West must not misinterpret stoicism

From Dr Alex Mackinnon.

Sir, I worked in Japan over many years and compliment your sympathetic coverage of the nation's plight and problems. But I note that the west interprets Japanese patience in adversity as stoicism, yet it is more often a "time out" period until a new pattern of stable events becomes clear. When a prearranged plan does not conform to changing events, then the events are seen as minor deviations to the plan. When the plan fails there is a delay until a new one is implemented.

Japanese solve problems, therefore, in a consecutive rather than

concurrent fashion and events are not so much misrepresented as misinterpreted. The courageous "Fukushima 50" are facing nuclear engineering problems with culturally controlled solutions.

We must not misread a lack of time in the problem-solving process as a purely nuclear event.

Alex Mackinnon, Dollar, Clackmannanshire, UK

From Ms Marcia Brocklebank.

Sir, Is this the time to invent a synonym for "stoic": "Japonic"?

Marcia Brocklebank, London W1, UK

Some chiefs have humility – we just don't hear them

From Prof Roger Steare.

Sir, Lucy Kellaway's analysis of the character defects of chief executives is entirely consistent with our research, based on psychological profiles of more than 1,000 senior business leaders including CEOs ("Chief executives are even worse than they think", March 14). They score significantly lower on humility and empathy than human norms. In other words they're arrogant and couldn't care less.

These dysfunctional qualities might also explain why they achieve short-term "success", while the rest of us pick up the long-term tab for their sociopathic behaviours.

The good news is that there are some men and women of character who are exceptions to this rule. The reason you don't often read about them is, of course, because of their humility; and because they care too much about their customers and colleagues to waste time on self-promoting "20 Questions" interviews.

Roger Steare, Corporate Philosopher in Residence, Cass Business School, London EC2, UK

Risks in public sector pensions

From Prof David Blake.

Sir, In his article "The correct pension discount rate" (FTm, March 14), John Ralfe concludes that public sector pensions "are deferred pay earned as part of a legally binding contract of employment, the equivalent of giving ILGs (index-linked gilts) to be redeemed at retirement". This is not quite correct.

Public sector pensions are equivalent to index-linked longevity bonds, and hence the appropriate discount rate should include a longevity risk premium as well as an inflation risk premium.

David Blake, Director, Pensions Institute, Cass Business School, London EC1, UK

COMMENT ON FT.COM

The Japan earthquake aftermath
The desperate efforts to avert a meltdown at nuclear plant Fukushima
www.ft.com/worldpodcast

Japan's nuclear emergency
The key events at the Fukushima Daiichi power plant since March 11
www.ft.com/reactors-timeline

Mill had a perfect description for the Libyan regime

From Mr Richard C. Hoffnung.

Sir, It is hard to tell which one Katerina Dalacoura (Letters, March 17) understands less, John Stuart Mill's essay "A Few Words on Non-Intervention" or the situation in Libya today. Mill's essay does not oppose military intervention in another country's affairs in any and all circumstances. To the contrary, it is a classic imperialist manifesto.

The essay starts off with the premise that, with regard to seeking narrow self-interest, "There is no such base feeling in the British

people. They are accustomed to see their advantage in forwarding, not in keeping back, the growth in wealth and civilisation of the world."

It continues: "The criticisms, therefore, which are so often made upon the conduct of the French in Algeria or of the English in India, proceed, it would seem, mostly on a wrong principle."

Obviously, Gandhi, his fellow Indians and the 20th century Algerians must have neglected to read up on the great 19th century philosopher.

However, when it comes to Libya, Mill's essay may have something to teach us: "A civilised government cannot help having barbarous neighbours: when it has, it cannot always content itself with a defensive position, one of mere resistance to aggression... But a despotic government only exists by its military power."

Could there be any better description of Muammar Gaddafi and his regime?

Richard C. Hoffnung, New York, NY, US

Keynes can help us make sense of contingent events

From Mr Daniel J. Aronoff.

Sir, John Kay provides an enlightening discussion of our awkwardness in thinking about contingent events that cannot be pressed into a probabilistic framework – Rumsfeldian "unknown unknowns" ("Why we struggle to make sense of our roulette wheel world", Comment, March 16).

John Maynard Keynes, the eminent early 20th-century theoretician of probability, encapsulated the concept brilliantly in an article he

wrote on another subject, economics:

"By 'uncertain' knowledge, let me explain, I do not mean merely to distinguish what is known for certain from what is only probable. The game of roulette is not subject, in this sense, to uncertainty; nor is the prospect of a Victory bond being drawn. Or, again, the expectation of life is only slightly uncertain. Even the weather is only moderately uncertain.

"The sense in which I am using the term is that in which the

prospect of a European war is uncertain, or the price of copper and the rate of interest 20 years hence, or the obsolescence of a new invention, or the position of private wealth-owners in the social system in 1970. About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know."

Daniel J. Aronoff, President and Chief Executive, The Landon Companies, Bloomfield Hills, MI, US

● To contribute please e-mail: letters.editor@ft.com or fax: +44 (0) 20 7873 5938 Include daytime telephone number and full address ● For corrections e-mail: corrections@ft.com

Capital rules, UK

Equity buffers are the best way to stymie risky mortgages

The UK has barely emerged from the global economic crisis. But some of the riskier practices prevalent in the run-up to the near-collapse of the financial system are again rearing their heads. Last week, Lord Turner, the chairman of the Financial Services Authority, warned that 28 per cent of new residential mortgages issued last year were worth more than 3.5 times the borrower's income. If interest rates rise, he added, this financial overstretch could damage borrowers and lenders alike.

Such risks should not be ignored. But nor should they be overstated. Although the percentage of mortgages with a loan-to-income ratio (LTI) of more than 3.5 has returned to 2007 levels, their number has fallen. Four years ago, 581,873 such loans were made. In 2010, the figure was 176,153. Moreover, despite making a number of spectacular errors in the run-up to the crisis, no British bank failed as a result of its mortgage book.

However, that does not mean mortgages will not be part of the next crisis. With markets anticipating an interest rate rise in the second half of 2011, and a rise in unemployment likely as the government's austerity programme kicks in, policymakers must give themselves the tools to prevent Britons assuming obligations they

could soon be unable to meet. The wrong way to do this would be to stop financial institutions offering mortgages with high loan-to-value or loan-to-income ratios. There is a limit to how far the government should go to protect consumers from their own folly. Provided that a borrower's ability to repay is assessed with sufficient rigour, and provided there are safeguards to thwart predatory lenders, there is a role (albeit a small one) for such products.

A better solution is to adjust the amount of capital banks must hold to cover their more adventurous lending. The Basel III reforms will increase the core tier one ratio banks must maintain (in order to be allowed to pay bonuses and dividends) to 7 per cent of risk-weighted assets. That is a start. But there is a good case for raising the risk-weighting of mortgages with high LTIs further, especially as an economic upswing takes hold. That should help deter banks from too much risky lending.

There is no room for complacency. Figures released last week showed that the number of Britons behind on mortgage payments rose slightly in the last quarter of 2010. The government must ensure that, having dodged one bullet during the crisis, the UK mortgage market does not get hit by the next one.

Book review

A study of the flaws inherent in America's government-sponsored mortgage lenders is turbid yet convincing, writes Christopher Caldwell

It is comforting to think of the late, calamitous bubble in US subprime real estate as having been caused by greed. If greed were the culprit, Americans could become better people as they grew more solvent. Unfortunately, there is a strong case that sentimentality and social conscience did as much to drive the US economy into a ditch as hard-headedness and lust for profit. Four New York University finance professors make a version of that case in *Guaranteed to Fail*.

The US real estate market is more heavily supported by government than any other in the west. Big tax breaks – on deductions for mortgage interest to exemptions from capital gains – subsidise homeownership over apartment-dwelling. But the jewels in the crown of US housing policy are the government-sponsored enterprises (GSEs), which by 2009 guaranteed or owned \$5,390bn worth of mortgages. The Federal National Mortgage Association (Fannie Mae), which dates

from the New Deal of the 1930s, and the more recent Federal Home Loan Mortgage Corporation (Freddie Mac) are not quite government agencies, since executive salaries there used to run into the tens of millions. But neither are they real private companies, since the US president appoints board members. Rather they are corruption-sowing hybrids, profitmaking groups that carry an implicit guarantee of government support – or did, until their bail-out in September 2008 made it perfectly explicit. The authors believe the GSEs will cost as much as \$350bn and will net out as the most costly part of the federal banking rescue.

Fannie and Freddie purchase, guarantee and securitise home loans, issuing trillions in debt to do so. They create a deep secondary market in mortgages, making possible that beautiful product – the 30-year mortgage at a low, fixed rate – on which rests the privileges of the US middle class. Politicians' attempts to broaden those privileges spelt the system's doom. The GSEs suffered from a dramatic drop in housing prices starting five years ago. But even the mildest slowdown would have done them in, the authors show.

Fannie and Freddie went bad in stages. In 1968, Lyndon Johnson, trying to fix a budget bloated by the Vietnam war and various domestic follies, "privatised" the GSEs. Most investors understood this as a fiction,

meant only to take the government's housing debts off balance sheet. They assumed, correctly, that the government would guarantee the GSEs' debt in a crisis. And their statutory advantages (including lower capital requirements) gave them "incentives to ramp up risk on the taxpayer's dime".

In 1992 came what the authors refer to as a crossing of the Rubicon. On the eve of presidential elections, George H.W. Bush greatly expanded

Guaranteed to Fail

Fannie Mae, Freddie Mac and the Debacle of Mortgage Finance
By Viral Acharya, Matthew Richardson, Stijn van Nieuwerburgh and Lawrence J. White
(Princeton £16.95, \$24.95)

the GSEs' "mission goals". Fannie and Freddie would now seek to supply "affordable housing", particularly in "underserved areas" – the government's euphemism for ethnic-minority neighbourhoods. Suddenly the government had "wiggle room" to deal in dangerous mortgages – ones with suspect borrowers and high loan-to-value ratios. President Bill Clinton crusaded against what he called "redlining" – the dearth of housing credit in poor, black, urban neighbourhoods – and President George W. Bush went further, insisting on an ever-rising low-income component to GSE lending.

Explaining credit and finance in a way that brings pleasure to the reader is a rare skill, and the authors of *Guaranteed to Fail* do not have it. (Either that or four cooks are enough to spoil the broth.) But while their book is turbid in places, it is more multi-dimensional and nuanced than most other books on the bloody crossroads where real estate and banking meet. We should therefore take seriously the authors' warnings that the Federal Reserve's holdings of \$1,400bn in GSE debt constitutes "a massive problem for the future".

The authors do not object to low-income housing programmes. But they are sceptical that stimulating mortgage lending is a good way to go about it. By 2007, risky mortgages made up 22 per cent of the GSEs' portfolio, up tenfold from a decade before. It took a long time before the consequences of the 1992 act made themselves felt. Rising home prices disguised how ill-advised many of the loans had been. But the authors show convincingly that the GSEs' subprime lending was not a noble idea that eventually went wrong or drifted into excesses – it was a fool's errand from the beginning. "The moment that the GSEs lowered their underwriting standards, there was no turning back," they write, "and as soon as housing prices started falling, their fate was sealed."

The writer is an FT columnist