



"Without fear and without favour"

Monday April 23 2012

IMF is set to get its bigger bazooka

Assistance to the eurozone must be highly conditional

Christine Lagarde, managing director of the International Monetary Fund, is a happy woman: her institution will receive at least an extra \$430bn in resources. This will substantially increase the IMF's capacity to help if the eurozone crisis takes a turn for the worse.

Should the world welcome this success? Yes, alas, with equal emphasis on both words. It is appalling that the eurozone should need such a backup. Yet it does. It is vital, however, that the IMF ensures that any support be well used. That means tough conditions for the eurozone as a whole.

In all this is an impressive gesture of international solidarity. It is also an indication of how worried outsiders must be over the ability of the eurozone's crisis to shake the world and the inability of the eurozone alone to manage it.

Originally, the IMF had asked for another \$500bn in loans. It looks as though it will end up with something very close to that. By Friday, it had obtained €150bn (about \$200bn) from the eurozone, \$60bn from Japan and \$15bn each from South Korea, Saudi Arabia and the UK. Other donors include Sweden, Switzerland, Norway, Poland, Australia, Denmark, Singapore, the Czech Republic, China and Russia. Only the US and Canada are conspicuously absent.

Europeans are also making a very substantial contribution, separately: the new European Stability Mechanism will have a fresh lending capacity of €500bn. The combined lending ceiling of the ESM and the European Financial Stability Facility will be raised to €700bn. "The overall firewall," stated Olli Rehn, vice president of the European Commission, at the meeting of the IMF's International Monetary and Finance Committee in Washington last week, "including the amounts already committed under the Greek Loan Facility and the European Financial Stability Mechanism, amounts to approximately €800bn (\$1,060bn)." In total, then, the sums available amount to some \$1,500bn, quite apart from whatever the European Central Bank contributes. That is enough to rescue Spain. It ought to be enough to ensure liquidity for

Italy in anything but the most devastating circumstances.

Raising such a sum is a big achievement for Ms Lagarde. Yet it is also extraordinary that it should be thought necessary. The role of the IMF has always been to provide foreign currency to countries running out of currency reserves. But the euro is the second of the world's reserve currencies. That the eurozone needs this money shows how totally dysfunctional it is. Both need and dysfunction underline the case for a transformation of voting weights in the IMF.

More immediately, how should this money be used? The first part of the answer is: independently. The IMF must reach its own judgments. For this reason, non-eurozone members should decide on whether a programme for any eurozone member

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makes sense. Recipients cannot set the terms of bailouts, as Jim Flaherty, Canada's finance minister noted. In this case, it is the eurozone as a whole that is being rescued, not the member in trouble.

The second part is: with tough conditionality for the eurozone itself. In judging whether to support a programme, the IMF always seeks agreement with the relevant monetary and fiscal authorities: the monetary authority is the ECB, and the fiscal authority includes the Commission and other member states. If the policies being imposed make adjustment by crisis-hit member states impossible, the IMF must insist on change.

In fact, the programmes now being forced on countries such as Spain are highly likely to fail. By driving economies into recessions and even deflation, they will make their debt burdens worse, not better. The IMF must insist on programmes actually likely to work. If the eurozone cannot ensure that, the IMF should dare to walk away.

Taking big money out of UK politics

Cap donations or parties will continue inexorable decline

So deep is the malaise into which Britain's main political parties have fallen that it is hard to believe that just a generation ago Conservative and Labour boasted 4m members between them. There are now more members of the Caravan Club than of all of the political parties put together. The Conservative party – 2.8m strong in 1951 – has perhaps 150,000 adherents left. At this rate, organised politics in Britain (at least in the traditional sense) would die out within the next decade.

Surveying the collapse in interest, politicians are quick to reach for easy excuses. Voters, it is said, no longer feel the same tribal loyalties they once did. Material prosperity has dulled the public's enthusiasm for defending its interests through political participation. These arguments may be convenient, but they are also wrong. Voters still engage widely with politics, joining single issue movements and marching in large numbers against student tuition fees and the Iraq war. It is the mainstream parties that they shun.

Much of the problem stems from the way political parties fund themselves. As they have come to depend on large donations from a few wealthy individuals and businesses, they have naturally focused on wooing this vital source of cash. The "crime" committed recently by Peter Cruddas, Conservative treasurer, was to telegraph its consequences too clearly, promising big donors privileged access and opportunities.

The growth of big money has gone hand in hand with a steady hollowing out of the privileges enjoyed by rank-and-file members. As parties have come to depend on them less for money they have lost their ability to influence the policy debate at conference and been progressively stripped of much of their ability to choose party candidates. Not only does the centre vote and impose candidates, there is even pressure to take the final choice out of the hands of local

associations. Consider the Tory idea of selecting candidates through local open primaries. While an apparent advance in local democracy, this removes one of the main privileges of membership by allowing non-members a vote.

The only way to force parties to reconnect with their members is to limit the ability of big donors to bankroll politics. The coalition government came into office promising to do just that, and commissioned a review from Sir Christopher Kelly, which last November recommended capping donations at £10,000. Since the Cruddas affair, Labour leader Ed Miliband has demanded a lower £5,000 cap. Such a limit on donations should now be imposed – set somewhere between the two levels. Either would force parties to reconnect with a broader swath of their membership, as they would no longer be able to live off a few influential donors.

There is a question about how such a cap should apply to the trade unions, which funnel a large sum of money to Labour from the political levy they impose on their members. While this should be allowed to continue, reform is needed to make the levy more of an active contribution not, as at present, simply an addition to their dues.

The shift to a capped world will likely prove difficult for parties and there is a case for easing the transition by offering some degree of state funding. Public cash must be used sparingly, however, and matched with private donations to encourage participation. Otherwise this would risk simply substituting one big donor for another.

Britain's political parties will only deserve to have a future if they reconnect with their members. For too long the debate about party funding has been snarled up in questions of party advantage, when it is really an existential question for all parties. The sooner they see it in these stark terms the better.

Halt Eurozone's slide into a mire of depression

From Mr Antonis Angelopoulos.

Sir, Martin Wolf's article "The Union outlived de Tocqueville" (April 18), comparing the young US with the eurozone, provides a lot of memorable phrases and some good arguments, but the conclusion is unconvincing. Precisely because "the principal economic force now keeping the system together is fear of a break-up", this arrangement cannot last. As troubled countries slowly descend into the mire of depression and become ever more dependent on handouts from the European Financial Stability Facility and other international agencies, national policy makers will eventually face up to the reality that the cost their countries are paying is disproportionate to the benefit. Also, supranational policy makers will

realise that the current policies prolong the dependency of debtor countries on handouts and the money they so generously provide would be better spent to prop the – arbitrary but reasonable – exchange rates of the new currencies that would have to be resurrected.

The other reason keeping the system together, not mentioned by Mr Wolf, is the need to redenominate all sorts of contracts into the new currencies and the huge insecurity that would ensue. But there are ways round this. Policy makers need to address these issues in earnest and produce credible solutions that will mitigate the impact of the shock. Just to extol the virtues of the euro doesn't help; if anything it rings more and more hollow as time goes by.

Finally, Mr Wolf rightly argues that this insistence to stay within the eurozone puts pressure on local authorities to reform. The need to reform public administration, for example, or the provision of health services in countries such as Greece is indeed acute. This, however, will not be achieved without the engagement of public spirited and suitably trained civil servants. There are a few of those, but not nearly enough to push through the necessary changes within an inhospitable environment. The reform must be implemented in any case and maybe a disengagement from the euro would force the state to shrink and lift its stranglehold over the economy.

Antonis Angelopoulos, Birmingham, UK

Break-up of union is likely to bring widespread defaults

From Mr Daniel J. Aronoff.

Sir, I would like to add to Martin Wolf's list of forces affecting eurozone unity (April 18). The indebtedness of the periphery to Germany, in respect of German interests, is both a centripetal economic force, since a break-up of the union will almost certainly lead to widespread defaults on debts owed to Germany much larger than would

likely occur if the union stayed together, and, as Mr Wolf points out, a centrifugal political force, since the German public apparently feels moral outrage toward any deal that would allow peripheral borrowers to renege on their debt obligations. In this case, the prevailing German political sentiment runs counter to its economic interest.

It is also worth reflecting that

America endured a Civil War fought over the issue of unity and the matter was settled only after the Union prevailed, at a staggering cost in lives and property. Europe has fought many wars, but none over the principle of unity.

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

Tax decisions are for India alone

From Dr Allison Christians.

Sir, I read with interest your report "US pressure on India tax law" (April 19), about the US business lobby's efforts to create a tax policy war by asking US Treasury secretary Tim Geithner to "raise concerns" with Indian officials about the tax bill at the spring meetings of the World Bank and International Monetary Fund.

These people do not want to "raise concerns". They want to stop India's democratically elected government from enacting legislation in accordance with its sovereign status as an independent nation. It is amazing and preposterous that they expect the US government to help them do that. If US businesses really do not like what India is doing they have a viable option to do what they say they are going to do, take their assets and go home. But they do not want to do that.

They want to be able to continue doing business in India at the lowest possible cost to them. If the Indian government will not give them the tax system they want, these business leaders would prefer a government-to-government conflict instead of India opening itself to businesses willing to work within its sovereign territory according to its own rules.

Anyone is free to disagree with India's tax policy direction and anyone is free to express "concerns" about it. But India's tax policy decisions belong to India's people and it is shameful to see the US business lobby so brazenly insisting on their right to intervene. Allison Christians, Associate Professor of Tax Law, University of Wisconsin, Madison, WI, US

Easter story had a pretty good ending

From Dr Annie C. Higgins.

Sir, Robert Shrimley (Notebook, April 19) quotes an American who tells of making more fuss of Christmas than of Easter because of "distaste for any tale with the wrong ending". However, as for Easter, isn't resurrection a pretty good ending? Annie C. Higgins, Chicago, IL, US

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Happier private lives for industry

Book Review

A meticulous account helps us understand how Thatcher's sell-offs helped Britain to emerge from economic decline, writes Geoffrey Owen

Anyone glancing at the headlines in UK newspapers in recent weeks could be forgiven for thinking they were back in the 1980s. It is not just the flavour of austerity, or the rising union militancy. From the Royal Mail to roads, policing to prisons, talk of a fresh round of privatisation recalls the battles of the Thatcher era – battles of lasting relevance to British politics.

This is why the final volume of David Parker's official history of privatisation is so timely. Amid the current gloom over the state of the economy, this balanced and meticulous account helps us understand the extent to which the privatisations of the 1980s and 1990s – still viewed with suspicion by many in Britain – helped the UK emerge from a bleak period of economic decline.

Margaret Thatcher was pursuing several objectives: to raise money for the exchequer, weaken the trade unions, encourage wider share ownership and relieve politicians of control-

ling large industrial enterprises. But the most important result of privatisation was to inject competition into industries that had been insulated from the market and to force previously protected national champions to sink or swim by their own efforts.

It is sometimes forgotten how far the pro-competition policies pursued by the Thatcher and Major governments, and largely maintained by New Labour after 1997, contributed to the improvement in productivity growth during those years. Privatisation was only one ingredient in the recovery, but it removed an incubus of inefficiency and weak management that had helped to make the UK the sick man of Europe.

This is not to say that privatisation was a miracle cure for poorly performing companies, or that it was brilliantly handled. Some companies, such as British Leyland, were too far gone to be saved. Others, notably British Telecom, used their new freedom to engage in ill-judged diversification. But when BT ran into trouble in 2001, the pain was felt by shareholders, who did what shareholders are supposed to: turf out the old managers and install new ones.

As Parker shows, the mistakes the government made in the early years were partly due to Mrs Thatcher's reluctance to risk head-on confrontation with the managers of the state-owned corporations. The extreme case was British Gas, whose chairman, the formidable Sir Denis Rooke, was

determined to keep the company in one piece, insisting that the retention of a big, integrated gas producer with supposedly world-beating qualities was in the national interest. British Gas was floated, but Rooke's co-operation had been bought at a high price. It was not until the late 1990s that it was dismembered and a competitive gas market established.

Similar issues arose in electricity. Walter Marshall, chairman of the Central Electricity Generating Board,

The official history of privatisation

Volume II – Popular Capitalism 1987-97
By David Parker
Routledge, £75

believed the planned break-up of the industry was madness. Although he was forced to give way, the replacement of the CEGB by a duopoly of National Power and PowerGen did little to promote competition. Nigel Lawson, chancellor of the exchequer, would have preferred a much more radical restructuring.

Privatisation on its own was not enough; in gas and electricity the benefits of lower prices and wider customer choice came mainly from later decisions by regulators. But was competition pushed too far? Were consumers' interests given too high a prior-

Bold decisions must be taken in the race for jobs

From Prof Lars Oxelheim.

Sir, Most policy makers signal today that the financial crisis is under control. However, rescue costs as a combination of higher interest rates, inflation rates and taxes will soon be due. Global demand will take a hit. Already worrisome unemployment figures in some European Union member states will escalate. To be re-elected, EU-friendly politicians have to show they can create jobs at home.

In a fair competition world there is no quick fix. Politicians will try shortcuts and attract jobs not least from other EU member states. They will use a battery of grants, subsidies, tax exemptions, loans/equity to non-market conditions and warranties.

The race for jobs will challenge the spirit of fair competition more than previously in postwar history. First, the efforts to curb the use of transparent protectionism have made protectionism take other and less transparent forms. Second, in the race for inward foreign investment Europe has received just a minor share, with the bulk going to China. Third, the combined economic and financial crisis makes it hard to single out unfair from fair competitive measures. Attracting investments with unfair measures can be disguised; for example as a way to curb deflation, save the environment, fight terrorism, or speed up harmonisation and integration. In this context, quantitative easing is just one example of a hard to evaluate measure.

The regulatory bodies in the EU and the World Trade Organisation provide many exemptions, making them toothless in times of crises. Moreover, even if they were effective to begin with, EU politicians have eroded all respect for the rules endorsed by themselves and taken the lead in showing how to circumvent rules (the bailout clause) and disrespect them (the growth and stability pact). All in all this will foster nationalism in Europe further fuelled by politicians' efforts to press up the unemployment statistics by closing the border for those categories of immigrants that threaten to ruin the statistics.

Solidarity will be gone and migration policies will be given national interpretations creating further frictions between member states. To dampen emerging unrest scapegoats will be searched for. With the race for jobs described above they will easily be found in other member states. Proactive policies have to be implemented to avoid nationalism getting rooted.

Only two trustworthy solutions exist for the economic and monetary union – taking the last step to a full-blown union or allowing for flexible disintegration. Bold decisions must be taken in the near future. One of the two alternatives has to be chosen, otherwise the race for jobs will risk the cohesion of the entire EU and the great peace project. Lars Oxelheim, Chairman, Swedish Network for European Studies in Economics and Business, Lund University, Sweden

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