It's time to end the grotesque fiscal bail-outs and grapple with reality

This column has long-argued the Western world's policy reaction to "sub-prime" has been wrong. In my view, the grotesque fiscal bail-outs and the money printing, the ongoing assumption financial regulation could be tweaked rather than reformed wholesale, have made our collective predicament much worse.

By Liam Halligan
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The consensus view, far from grappling with the technical and political difficulties of implementing the required policy response, has failed even to admit the extent of the problem. Yet such an admission is a prerequisite, the first step in fact, of doing what needs to be done.

For almost two years now, our leaders have been in denial, burying the details and delaying the really tough decisions. In recent weeks, though, something has changed.

For the first time since the credit crunch hit the headlines in August 2007, reality is punching through. Powerful people are breaking ranks and saying what needs to be said. Pretty soon we may even begin tackling the root causes of this debacle by facing down the vested interests and making the changes necessary to rescue the Western world from years of economic stagnation.

Earlier this month, Angela Merkel, the redoubtable German Chancellor, took a stand and appealed for "a return to policies of reason" – calling time on "quantitative easing", the deeply misguided policy that has seen Western central banks double the size of their balance sheets to buy government debt.

QE was always a ruse to recapitalise insolvent banks by the back door, so their powerful executives could avoid admitting previous mistakes. Yet it has shattered the world's faith in the West's policy-making competence. It has destroyed any authority we had to tell economies elsewhere what to do.

QE will result in high inflation – in turn, destroying investment and jobs. And it will mean that, for years to come, Western taxpayers pay higher interest charges to service our government's debts.

Almost alone among the ranks of the seriously powerful speaking sense, Merkel was last week joined by Mervyn King. At the annual Mansion House dinner, the Bank of England Governor called for Gordon's Brown's disastrous "tripartite" reforms to be scrapped, returning banking supervision to Threadneedle Street.

That has to be right. UK banks have been able to act so irresponsibly because the authority to monitor them was split between the Bank and the FSA. In fact, Brown was so addicted to the political feel-good factor resulting from ever higher leverage that his system was explicitly designed to allow responsibility for reining in the banks to fall between two stools.

King also stated "it is not sensible to allow large banks to combine high street retail banking with risky investment banking or funding strategies, and then provide an implicit state guarantee".

These words echoed around the world. The Governor is calling for a re-instatement of the "Glass-Steagall" firewall – the removal of which allowed investment banks to merge with commercial banks. That meant taxpayer-backed deposits could be used by bonus-fuelled traders to make high-risk bets – in the knowledge the state would have to fund a bail-out given that ordinary voters deposits were involved.

By calling for a new "Glass-Steagall", King is taking on Wall Street and the City – among the world's most powerful vested interests.

Yet, politicians need to realise it's precisely because this safeguard was removed, and the "universal banks" became so big, that what started as a banking crisis has become a fiscal crisis – a crisis so severe that some of the world's leading nations could default and, at the very least, several generations of Western taxpayers will be saddled with the bill.

Other harsh realities are now also coming to the fore. New figures confirmed UK government debt is rising quicker than at any time in history – not least due to the bank bail-outs. As the recession hits tax revenues, May saw the biggest surge in monthly public sector borrowing since records began.

In this context, the Tories are now finally allowing themselves to face down Brown and his economically-literate allies – by admitting spending cuts are necessary. How ridiculous does Brown sound when he contrasts "Labour investment with Tory cuts"?

Then there is "deflation" – in my view, the "biggest lie" of all. In May, CPI inflation remained at 2.2pc – above the Bank of England's target. Were it not for the government's temporary VAT cut, the CPI would be 3.4pc – with the Bank have to write yet another public letter explaining why it's so high. We're a million miles from deflation.

As I've often said, the "danger of deflation" was always a myth – conjured up to give Western governments an alibi to pursue wildly expansionary fiscal and monetary policy and perpetuated by the vested interests benefiting from such largesse.

If we're to emerge from this crisis, and avoid similar future disasters, powerful figures now need to recognise and expose such inconvenient truths.

Alarm bells on public sector pensions

Some state employees work hard – and we're lucky to have them. But, in general, public-sector workers enjoy shorter hours, longer holidays, better job security and higher wages than their private-sector counterparts.

Yet 90pc of public-sector workers also have gold-plated final-salary pensions, compared to only 10pc in the private sector. They retire earlier too.

Our ageing society means most of us will reach for our slippers later and on lower pensions than previously thought. But state workers remain immune to economic reality – at everyone else's expense.

The costs of this injustice are vast. Between 2001 and 2008, our public sector pension liability officially grew 110pc to £794bn. A new Policy Exchange report by Neil Record puts the true figure at a staggering £1,104bn.

This massive debt doesn't appear on the Government's balance sheet. Yet each year taxpayers spend more on public sector pensions than defence. By 2040, the annual bill will approach what we spend on the NHS.

A former Bank of England economist, Record has a deserved reputation as an astute, non-partisan fiscal expert. His report's advisory committee includes some of the UK's top actuaries and the former chairman of the Inland Revenue.

The Tory front-bench needs to act on this study. Spin is not enough. The ratings agencies are watching – and public-sector pensions are high on their list of concerns.

BRICs at the top table

Last week, leaders of four of the world's largest economies – Brazil, Russia, India and China – met in Yekaterinburg, Russia. Known as the BRICs, these vibrant nations now account for almost 20pc of global GDP – the same as the United States.

Even this startling figure understates the importance of the BRICs, and the emerging markets (EMs) more generally. Together, they now drive 42pc of global GDP – and rising. That outstrips the US and EU combined.

Over the next few years, as the Western world stagnates, the EMs – with their low debts and highly productive workforces – will keep growing. Global investors largely agree. That's one reason the world's top 10 performing share indices so far in 2009 are all EMs.

Crucially, EMs now boast two-thirds of the world's foreign exchange reserves. The BRICs control the lion's share of that haul.

For the most part, the Western media has dismissed this first BRIC summit as "unimportant". That's partly because the G7 nations weren't invited. The reality is the BRICs' emergence on the world stage is transforming global commerce – and politics too.

These countries are crucial Western creditors. Insolvency looms, unless they keep funding our spiralling government debts. Western leaders need to grow up and realise the world has changed. If we don't accept the emerging giants at the top table, they'll create their own – resulting in a less prosperous, more dangerous world.

http://www.telegraph.co.uk/finance/comment/liamhalligan/5587809/Its-time-to-end-the-grotesque-fiscal-bail-outs-and-grapple-with-reality.html