RELEASE IN PART
B6

From: H <hrod17@clintonemail.com>
Sent: Sunday, June 27, 2010 6:47 PM
To: 'sbwhoeop[redacted] B6
Subject: Re: H: memo on UK politics/budget/economy Sid

Very interesting. Thanks. Speaking of Australia, I was sorry about Kevin Rudd.

----- Original Message -----
From: sbwhoeop[redacted] <sbwhoeop[redacted]
To: H
Sent: Sun Jun 27 10:35:18 2010
Subject: H: memo on UK politics/budget/economy Sid

CONFIDENTIAL

June 27, 2010

For: HRC
From: Sid
Re: UK politics/economy

1. UK polls show support for the Lib-Dems after the launch of the draconian Cameron government budget cratering. LD support is down to 16 percent, half what it was at its peak during the election and half of LD members now express a desire to defect from their party. They feel deceived by LD ministers' participation in a Tory budget opposed to their own beliefs. In Parliament, a secret caucus of LDs is meeting with Labour about opposing the budget. Meanwhile, short term support for Cameron is static and for the government slightly up, but only translated to the Tories. Both the Tories and Labour are up, profiting from the LD quandary. The scenario is potentially portentous for the LD Party: There was once an influential Australian Liberal Democratic Party, holding 11 percent of the vote and the balance of power in the Australian Senate. Upon reaching its zenith in 1996 the ALDP supported a Liberal (that is to say, a conservative) government's budget and suffered collapse. Today the ALDP holds 1 percent of the seats in the lower House. The political effect of the conservative budget will almost certainly lead to an implosion of the Tory-LD coalition. In the short run it's possible the Tories will emerge having the greatest plurality of support. But if their budget does not produce prosperity they will pay the price, too. See Stiglitz's analysis below on the Tory budget with cold analysis of the US predicament.
2. The implications for US-UK cooperation are apparent. While there are spheres that remain, they are contingent, including the Afghanistan War, opposed by 75 percent of UK public and about which Cameron felt compelled this week to declare UK engagement would end in five years (that is, before the next UK election). On economic policy, the UK is no partner and no bridge to Europe, where the Merkel government has entered a fugue state of vertigo (another

subject). At no other time since World War II have the US and UK governments been at such odds over international economics. With JFK and Macmillan, Macmillan accepted the postwar Keynesian consensus. Reagan and Thatcher, of course, were of one mind ideologically, and the international economy was buoyed by Reagan's hyper-Keynesianism masked as Thatcherism. Unfortunately, Obama did not reach out to Brown, who sought to reestablish the special relationship around international economic recovery. Speaking of laissez faire, Cameron must be let alone to receive the consequences (within 18 months) of his ideologically driven economics. Can he be engaged on international development? Or does his budget rule that out too? There's not much there.

3. The Labour Party leadership contest is heating up. David Miliband has an article out today on how the Cameron budget will foster "a lost generation." More on that soon...

http://www.independent.co.uk/news/uk/politics/osbornes-first-budget-its-wrong-wrong-wrong-2011501.html
Osborne's first Budget? It's wrong, wrong, wrong!
Joseph Stiglitz, the Nobel prizewinner who predicted the global crisis, delivers his verdict on the Chancellor's first Budget and tells Paul Vallely it will take the UK deeper into recession and hit millions – the poorest – badly Sunday, 27 June 2010
George Osborne will probably not be very bothered that there is a man who thinks he got last week's emergency Budget almost entirely wrong. But he should be. Because that man is a former chief economist at the World Bank who won the Nobel Prize for Economics for his work on why markets do not produce the outcomes which, in theory, they ought to. Professor Joseph Stiglitz, who has been described as the biggest brain in economics, is distinctly unimpressed by George Osborne's strategy. This, he predicts, will make Britain's recovery from recession longer, slower and harder than it needs to be. The rise in VAT could even tip us into a double-dip recession.
Stiglitz, who was once Bill Clinton's senior economic adviser, is now professor of economics and finance at Columbia Business School. He was in the UK this week at the University of Manchester, where he chairs the Brooks World Poverty Institute, but he lifted his head from the detail of international development to scrutinise the economic strategy of the Conservative Chancellor whose Liberal Democrat partners recently reversed their judgement that massive public spending cuts now would endanger the economy and joined in the Tory slash-and-burn strategy. They were deeply wrong to do so, he believes.
It would be a mistake to ignore Stiglitz on this. He has a track record of getting his predictions right. He was one of the few economists who predicted the global financial meltdown long before it occurred.
"What happened was very much in accord with what I expected," he tells me when we meet for a coffee outside the Blackwell bookshop in the centre of the university. "The data was pretty clear about that." And the scale of the crash? "That wasn't a surprise," he adds, in a matter-of-fact manner. "The bigger the bubble, the bigger the burst.
"The thing most economists did not fully grasp was the extent to which the banks engaged in murky risk-taking activities. They were taking a risk with our money, their shareholders' money, the bond-holders' money," he says. Banks were demanding up to 40 per cent of the corporate profits, saying their innovative financing was adding value. But "all this talk about innovation was a sham" because it did not relate to any real increase in the economy's productivity, he says. "There was a prima facie case of something screwy going on [with all the] perverse incentives that would lead them to take excessive risk. But there was no way anyone could know or believe that the banks were [conducting themselves] at that level of stupidity. I predicted that there was going to be a collapse because of the information asymmetry problems that were being created." His Nobel prize was given for exactly that – showing how markets fail because different people in them hold different levels of information.
Yet there is no hint of I-told-you-so about Stiglitz's tone as he asks the waiter for coffee. He orders decaffeinated, but suggests the British economy needs the opposite: a stiff stimulant rather than the "fiscal consolidation" which is George Osborne's economic euphemism for cuts.
Fiscal stimulus is out of fashion now. World leaders embarked on that strategy – injecting money to re-energise the economy – after the banking crash three years ago. It was widely perceived not to have worked because the money governments pumped into the banks was not passed on to ailing businesses or individuals in trouble with their mortgages.
"The problem was that, in the US, the stimulus wasn't big enough," he says. "Too much of it was in tax cuts. And when they gave money to the banks they gave it to the wrong banks and, as a result, credit has not been restored – we can expect a couple of million or more homes to be repossessed this year than last year – and the economy has not been

restarted." Instead of producing a consensus that the government should have done more, it has created disillusion that the government can do anything, Stiglitz says.

The result is that, following the attacks by the financial markets on Greece and then Spain, everybody is now in a mood of retrenchment. "It's not just pre-Keynesian, it's Hooverite," he says. By which he means governments are not just refusing to stimulate, they are making cuts, as Herbert Hoover did in the US in 1929 – when he turned the Wall Street Crash into the Great Depression. "Hoover had this idea that, whenever you go into recession, deficits grow, so he decided to go for cuts – which is what the foolish financial markets that got us into this trouble in the first place now want."

It has become the new received wisdom throughout Europe. But it is the classic error made by those who confuse a household's economics with those of a national economy.

"If you have a household that can't pay its debts, you tell it to cut back on spending to free up the cash to pay the debts. But in a national economy, if you cut back on your spending, then economic activity goes down, nobody invests, the amount of tax you take goes down, the amount you pay out in unemployment benefits goes up – and you don't have enough money to pay your debts.

"The old story is still true: you cut expenditures and the economy goes down. We have lots of experiments which show this, thanks to Herbert Hoover and the IMF," he adds. The IMF imposed that mistaken policy in Korea, Thailand, Indonesia, Argentina and hosts of other developing countries in the 1980s and 1990s. "So we know what will happen: economies will get weaker, investment will get stymied and it's a downward vicious spiral. How far down we don't know – it could be a Japanese malaise. Japan did an experiment just like this in 1997; just as it was recovering, it raised VAT and went into another recession."

Then why have we not learned from all that? Because politicians like George Osborne are driven by ideology; the national deficit is an excuse to shrink the state because that is what he wanted anyway. Because the financial market only cares about one thing – getting repaid. And because other European governments are panicking because of the market's wild attack on Greece and Spain, and they don't want to be next.

"But cutbacks in Germany, Britain and France will mean all of Europe will suffer. The cuts will all feed back negatively. And if everyone follows this policy, their budget deficits will get worse, so they will have to make more cuts and raise taxes more. It's a vicious downward spiral. We're now looking at a long, hard, slow recovery with the possibility of a double dip if everybody cuts back at the same time. The best scenario is long and hard ... and the worst is much worse. If any one of these countries is forced into default, the banking system is so highly leveraged that it could cause real problems. This is really risky, really scary."

So what should we be doing? "The lesson is not that you cut back spending, but that you redirect it. You cut out the war in Afghanistan. You cut a couple of hundred billion dollars of wasteful military expenditure. You cut out oil subsidies. There's a long list of things we can cut. But you increase spending in other areas, such as research and development, infrastructure, education" – areas where government can get a good return on the investment of public money. "I haven't done the calculation for Britain, but, for the US, all you need is a return on government investment of 5 to 6 per cent and the long-term deficit debt is lowered."

Taxes also need to be restructured. Osborne has increased capital gains tax for high earners from 18 to 28 per cent. "There's absolutely no reason why you couldn't tax speculative gains [from rising house or land prices] by 40 per cent. There's no social return on it and land is going to be there whether people have speculated or not. But you lower the tax on investment in things like R&D."

Stiglitz has one more practical solution to offer. Governments should set up their own banks to restart lending to businesses and save struggling homeowners from repossession. "If the banks aren't lending, let's create a new lending facility to do that job," he says. "In the US, we gave $700bn to the banks; if we had used a fraction of that to create a new bank, we could have financed all the lending that was needed."

Indeed, it could be done for far less. "Take $100bn, lever that at 10 to 1 [by attracting funds from the private sector] and that's a trillion-dollar new lending capacity – more than the real economy needs."

Such a move would help ordinary people more than all Osborne's rhetoric about being tough but fair. Stiglitz is sceptical, too, about the moral underpinning of a Budget which claims that "we are all in this together", but then hits the poorest hardest.

Analysis by the Institute for Fiscal Studies has suggested that the Chancellor's Budget will cost the poor 2.5 per cent of their income, while the rich will lose just 1 per cent. "I've not made an independent study on that point, but cuts in public services will have a disproportionate effect on the poor," Stiglitz says. Osborne's Budget "may be wellintentioned, but it takes an enormous amount of work to make sure that a package of public spending cuts of that magnitude doesn't hit the poor disproportionately".

His big fear is that overseas aid, which has been protected in this first round of cuts, will not escape a second.

"Developing countries have redirected themselves towards Asia, and China in particular, in recent years, so growth in Africa will be more robust than one might have expected, given the severity of the downturn," he says.

Even so, aid remains vital to poor countries. "If aid is cut back, growth will be badly affected," he says. "China is providing aid, but its aid is all in infrastructure, whereas aid from the US and Europe is mainly in education and health – areas in which ordinary people will suffer most if there are cuts."

Joseph Stiglitz has come full circle. What the world needs now – developing and developed – is not retrenchment but greater economic stimulus. It is not a message many are in the mood to hear. But they didn't listen to him last time, either. And he turned out to be right, and they were wrong – and at what a cost to us all.