THE TIMES

It's never too late to change course, Chancellor

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Over 22 years at The Times I've learnt that today's predicted disasters can turn into tomorrow's blessings

The weather is beautiful, but sadly it is not reflected in the economic and political prospects. The nation is in recession and unemployment is inexorably climbing with no end in sight. Britain still seems an island of stability in a world of political chaos, but the Cabinet is racked by ideological struggles that threaten the key relationship between the Prime Minister and Chancellor and will soon destabilise the entire Government, although nobody can imagine this yet. Meanwhile in Europe, tectonic shifts are occurring that will transform the conventional wisdom of the past decade.

The year is 1990 — and on the first Monday of October, a day that I still recall as unseasonably warm and gloriously sunny, I took up my new post as Economics Editor of *The Times*. As this is my last column for the paper, I feel entitled to some reminiscence. My excuse for this self-indulgence is that experiences long ago can sometimes be quite relevant for understanding the present, and such experience is all too readily forgotten as the generations pass.

At 4pm on Friday afternoon of my first week at *The Times*, the Treasury released a terse statement that was to transform and dominate British public life for the next decade. This Treasury statement announced the Government's decision to join the European exchange-rate mechanism, the precursor to the European single currency programme launched a year later with the Maastricht treaty of 1991.

The ERM decision precipitated Margaret Thatcher's resignation as Prime Minister nearly two months later, caused more damage to Britain's property-owning middle classes than any previous recession, destroyed the Tories' reputation for economic competence and ultimately paved the way for Tony Blair and Gordon Brown. Yet on that memorable Friday the ERM decision was greeted as an economic panacea and a political masterstroke by Conservative backbenchers, by the CBI and all respectable business and City opinion. It was endorsed even by the TUC, Labour and the Liberal Democrats. And it was welcomed enthusiastically by every serious newspaper in Britain.

Apart from *The Times*. The only condition I had laid down before taking up the offer to join the paper was freedom to argue against the monolithic consensus that had built up in favour of the ERM. Dealing with Simon Jenkins, as the iconoclastic Editor, and David Brewerton as Business Editor, I found I was pushing at an open door. *The Times* thus immediately denounced the ERM decision as a dangerous gimmick, predicting that the short-term political acclaim for the Chancellor, John Major (who ousted his boss, Mrs Thatcher before Christmas), would soon be overwhelmed by immense economic costs for the nation.

The Times's lonely opposition to the ERM policy caused indignation in the Government, apparently including suggestions to the Editor that some of my columns were tantamount to high treason. But we persisted in defying the conventional wisdom and were soon proved right.

In the two years from October 1990 until Britain's departure from the ERM on September 16, 1992, millions of people lost their jobs, tens of thousands of families their houses, the Bank of England lost Britain's entire foreign exchange reserves and John Major was reduced to an impotent observer of the Government he nominally led, described memorably by Norman Lamont as "in office but not in power".

The ERM debacle is relevant today for one obvious reason and one that is less so. Obviously, the fiasco was a dress rehearsal for the single-currency disaster now spreading across Europe. But the other lesson is equally important: defying conventional wisdom and reversing a universally supported policy deemed to be irreversible can sometimes produce spectacularly successful results. This has implications today for Britain as well as the eurozone.

A break-up of the euro, if Europe fails to create a full-scale political federation, will probably be much less disruptive than expected and could even prove a blessing to the EU. The same will be true if George Osborne abandons his present austerity targets before the general election, perhaps catalysed by a split in the coalition. If and when this happens, the rating agencies may downgrade Britain and the pound may fall briefly, but the economy will quickly rebound.

That was exactly what happened 20 years ago when John Major was forced into the momentous devaluation that he had denounced in blood-curdling language just five days before. Within hours of the ERM collapse, I wrote a column headlined "Happy Days are Here Again". And indeed the 16 years from 1992 saw the longest period of uninterrupted growth, full employment and improving living standards in British history. Which brings us to 2008 — and my worst mistake.

Looking back over my columns since 1990, I made many bad calls — on oil prices, Bank of England independence and Iraq — as well as some good ones: on John Smith’s suicidal 1992 tax plans, the internet bubble, sterling and UK interest rates, and house prices (both on the way up and down).

But my worst mistake by far was failing to understand the full interdependence between government and banking, especially in Britain, with its extreme reliance on international finance. I still believe there was nothing intrinsically wrong with the model that seemed to work remarkably well for Britain in the years after 1992. Expansion of finance made sense for Britain because of our clear comparative advantage in this sector, as did an increase in household debt as interest rates dramatically and permanently declined after 1992.

What did not make sense, however, was the belief that free market forces alone would always efficiently allocate resources in finance or that private banking could operate without a safety net of taxpayer guarantees and support. The events of 2008 disproved the Thatcher-Reagan myth that markets are ultimately self-regulating.

I was always sceptical of such market fundamentalist ideas — but insufficiently so. Hence my failure to anticipate the scale of the disaster in 2008. I have tried to make amends by writing a book on the need to abandon this market fundamentalism and build a new model of capitalism based on checks and balances between government and markets.

This reinvention of capitalism will, I believe, be the key issue driving politics all over the world in the coming decade.