

Reviews

The Storm: The World Economic Crisis and What it Means

Vince Cable

ATLANTIC BOOKS, 2009

Reviewed by Rachel Reeves

It is good to see, in this age when politicians are so spurned, that at least one is held up as a sage. Vince Cable is one of very few people to come through the credit crunch with their reputation enhanced. Cable has achieved this through some foresight (he began to ring warning bells in 2003 about an impending debt crisis), and robust analysis (he was an economist at Shell before becoming a politician), combined with reasoned and reasonable policy prescriptions that he puts forward in a polished but accessible manner.

Cable's *The Storm* starts where it started in the minds of most people in the UK, at Northern Rock and the now infamous queues outside branches up and down the country in the first bank run since 1866. Although not the root cause of the problem, it was the most visible manifestation of the credit crunch which has plunged the global economy into the worst recession since the Second World War.

Cable goes on to explain the crisis in a way which is simple, persuasive and compelling. Global economic imbalances, stemming from high savings rates in China and a spending addiction in the West, combined with low interest rates and excessive risk-taking in the financial sector with insufficient regulatory oversight, created the conditions for the storm that has led to homes being repossessed, millions languishing without jobs and businesses going bust.

Many other reviews have focussed on Cable's insights and chronology of the credit crunch and recession and I will not dwell further on his analysis. My focus instead will be twofold. Could Cable ever be Chancellor? And if so, how would his tenure differ from either a Labour or Conservative Chancellorship?

Although current opinion polls give the Tories an outright majority at the next election, the result is by no means a foregone conclusion – the public have yet to fall in love with Cameron, let alone his Party. While the Liberal Democrats are being squeezed between the two main parties, especially as the Tories have shifted (at least cosmetically) to the centre ground, they could, nevertheless, be the power brokers the day after the general election.

In such a circumstance the Liberal Democrats would surely want assurances on a referendum on electoral reform, other constitutional changes and one of the key offices of state – Foreign Secretary, Home Secretary or Chancellor. Would the Tories or Labour offer such a deal and would Nick Clegg accept it? If the deal involved Cable being offered the Treasury would he be able to serve Brown or Cameron and what direction would he take? His book offers some interesting insights.

Towards the end of *The Storm* Cable sets out his manifesto for economic policy and renewal. First, on fiscal policy. Cable is supportive of the approach of providing stimulus

now to avert a deeper systemic crisis. Pointing to the experience of the 1930s, Cable argues that global policymakers have learnt from the past – ‘whereas in the 1930s governments dithered endlessly pursuing what they thought were sound fiscal policies: balancing budgets ... deepening the systemic crisis’, this time the kitchen sink approach has avoided what could have been a much more pronounced recession. On this issue Cable’s position is much closer to Labour’s than that of the Conservatives.

On the treatment of the nationalised banks Cable advocates a more robust line than that advocated by the government. ‘At the very least, government nominees to the boards of rescued banks should be directing strategy’, he argues. While the government has taken an arms-length approach to its shareholdings, Cable wants robust lending targets to keep the banks lending, ‘recognising that there may be some bad debts as a result’. This position sits well with his fiscal stance: in the long run we need to return to fiscal balance and to a more prudent banking sector, but to carry out that adjustment immediately would plunge the economy even deeper into recession – hence the need to cut a little more slack now.

On the banking sector Cable is explicit about what the long game might look like if we were to ever see a Cable Chancellorship. While a believer in free enterprise, Cable makes it clear that with that commitment comes a commitment to regulation to sustain free markets and protect them from their worst excesses. On specific reforms, Cable wants to see counter-cyclical capital rules so banks build up reserves in the good times to make them more robust in the face of shocks; monetary policy to focus on assets as well as inflation; and remuneration and incentive rules to discourage excessive risk taking.

Most interestingly, and probably most controversially, Cable wants to see a very different structure for the banking industry in the future. The deposit-taking retail banks would be separated from investment banks and only the retail banks (which would be tightly regulated) would benefit from guarantees on deposits.

The financial crisis and recession has inflicted profound harm on those it has touched. At the time of writing 2.47 million people are unemployed, small businesses struggle to maintain bank credit and school leavers wonder what the future holds. The government has rightly focussed on protecting businesses and families as much as possible through schemes such as the loan guarantee scheme, the guarantee of work or training for sixteen- and seventeen-year-olds, support for mortgage costs and more.

But politicians and policymakers must also give some hope and vision for the future, as well as a commitment that the money being used to bail out the banks and prop up the economy is being used to good effect. Cable refers to this as the ‘link between short term fixes and long term structures’. ‘Clarity over the reform agenda is urgently needed’ Cable argues, and he is right. Even if you do not agree about a rigid separation between retail and investment banking (Adair Turner, for example, argues for something less extreme when he calls for restrictions on what banks can do with retail deposits), Cable at least is facing up to these tough questions.

There are other issues where I think it would be useful for Cable to be a bit more explicit. For example, what the future ‘real’ (as opposed to banking) economy might look like and where the jobs of the future will be created, are important issues that must be grappled but which Cable thinks the marketplace and macro-economic stability will deal with. I am less certain and believe that micro-economic policies, including on science, innovation, renewables, research and development, vocational education and regional policy are all key if we are to return to full employment. Lord Mandelson’s Business, Innovation and Skills Department are tackling some of these structural issues, which are arguably as important as banking reform if we are to build a strong, better balanced, more sustainable economy for the future. Cable’s silence in this area reflects his more liberal and free market approach compared to that of the government.

RENEWAL Vol 17 No. 3 2009

But we know many things that Cable would do at the Treasury. He would use fiscal policy in a Keynesian fashion to tackle the recession. The Bank of England's inflation target would be combined in some way with an asset-price target. The Treasury would take a more activist approach in terms of its shareholdings in the part and fully-nationalised banks. And, in the longer run those banks would have to set aside more capital, limit bonuses and ultimately be split up into less risky, more boring institutions.

Would Gordon Brown be willing to take lessons in economics from a man who compared him to Mr Bean? And, more substantively, has mocked Brown for claiming to have ended 'boom and bust', arguing since 2003 that the UK economic miracle that Brown took credit for was built on shaky foundations – most obviously debt, that would eventually land the economy in trouble. If installed, Cable would back Brown's handling of the bank recapitalisation and fiscal policies and would whole-heartedly support the overall strategy pursued to date. But his views on the future structure of the banking sector might be at odds with the New Labour philosophy which supports the wealth creation and innovation in financial services which has enabled New Labour to pursue a redistribution and public investment programme that has not had to rely on increased taxes on middle England.

What about David Cameron? Would he ditch Osborne, his long-term friend and confidant, at the altar of power, and give the job to this former Glasgow Labour councillor? On fiscal policy alone, I don't see how it could work. Cable refers in his book to clear differences between the Tories and Labour on the stimulus. 'Just as in the 1930s, the Keynesian remedy is proving controversial. British Conservatives ... have attacked such methods ... Underlying some of this hostility is a philosophical position – that recessions should purge themselves of past malinvestment'. Cable is on the other side of the philosophical tradition taking the view that 'in the current circumstances it is on balance right to attempt a fiscal stimulus ... The alternative – prolonged and deepening slump – would be worse'. And, in a recent interview with Dominic Lawson in *The Times*, Cable was explicitly asked what he would say if Cameron were to ask him to be his Chancellor in a Conservative government. The answer: 'No, that's not on. You can rule that out'. He wasn't asked about serving under Gordon Brown.

Philosophically and ideologically, Cable's views sit much closer to the social democratic tradition than the fiscally conservative, *laissez-faire* approach. Indeed, in the most reflective sections in the book, Cable strays from the macro-economic challenges we face to more profound issues. The problems faced are 'not just technical and economic, but represent a blow to the underlying value system, the social contract' Cable argues. While we (the public) were willing to tolerate economic inequality when all boats were rising, the realisation that much of the 'wealth creation' was rootless and contributed to crisis, has called into doubt our economic model. Perhaps, Cable ponders, we could learn from social democracies such as Scandinavia and Canada with stronger welfare states and higher levels of equality. These are many Labour MPs are also asking these questions.

Cable left the Labour Party in the early 1980s as the party swung to the left. Perhaps if Healey had been elected leader instead of Foot and if the militants hadn't got a foothold in the party then Cable would have stuck with Labour. His book is not a political tract but his commitment to building a fairer and stronger economy give hints of his political philosophy. Whether in government or opposition Cable is worth listening to and will continue to participate in the debate and influence economic policy. No party has a monopoly on good ideas or insights. Both Darling and Osborne would be well advised to read *The Storm* and to take on board the best of Vince Cable's ideas.

Rachel Reeves is Labour Parliamentary Candidate in Leeds West and a former Bank of England economist.