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rationale

2009
ISSUE 2

the G-20 SUMMIT

GROWTH, JOBS & STABILITY?

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Greenspan: Four Years On
The Economics of Studying

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LETTER FROM THE EDITOR

Dear Reader,

Economics has aquired a bit of a bad name of late. The global recession has left economists scratching their heads, and lesser intellects shaking their fists. However, economic theory, never an area of much consensus, has become more heatedly discussed and debated than at any time in recent memory. This issue of Ratioanle aims to capture the spirit of current debates through a selection of articles ranging from news and opinion to economic modelling; all these articles, however, have one thing in common - clear and consistent economic analysis and argumentation.

Our new-style news section is designed to get the reader up to date on the latest stories, and is intended to be as current as possible when going to press. This issue contains stories about the latest G20 finance agreements, the Google Library case and the Japanese Elections.

This issue contains some fantastic features, including an analysis of Obama's fiscal Stimulus, a look back at Greenspan's legacy, four years on, and a special 'Economics of Life' article which attempts to model the optimal level of revision!

I would especially like to draw your attention to our coverage of the G20. Nishad Majmudar attended the summit on behalf of Rationale, and has aquired some exclusive comments from Sir Nicholas Bayne, Former G20 negotiator for the UK.

Finally, Ratioanle's book review provide an essential reading list for anyone interested in economics or finance. This issue contains an amusing review of Alice Schroeder's 'Snowball', and a short piece on Akerlof and Perlman's new book, 'Animal Spirits'.

Rationale is the Magazine of the London School of Economics Students Union Economics Society. This magazine is the only student produced economics magazine at the LSE, and as far as we know, the UK. All the articles in this issue have been written by students at the LSE.

I hope you enjoy your read,

Sincerely.

Charles Hodgson

LETTERS TO THE EDITOR

Dear Editor,

I really enjoyed reading your article, 'Don't Beleive the Hype' in The Lent Term issue of Rationale - interesting insight and very neat analysis.

However, I think that you missed out a very important element from your analysis. The fact that most or all of the people applying for financial internships KNOW that there are far fewer opportunities around. I would argue that this increases the marginal benefit of getting the internship significanlty for 2 reasons:

a) I think there is a psychological benefit in securing a position when you know that it harder to do than ever before. So I would definitely factor in that benefit on top of the sheer delight of fetching coffee for 10 hot summer weeks.

b) The fact that one has managed to get an offer when times are tougher is a clear demonstration to any future employer that this person has put in additional effort during the process - and I think this would be equally beneficial in non-finance sectors as well.

So yes, marginal cost has gone up, but so has the marginal benefit, and the deadweight loss might not be as large as you made it out to be. But I guess that you wouldn't be able to fit that onto just 3 pages...

Best,

Vladislav Sukonnikov

Opinionated?

Send your letters to: c.b.hodgson@lse.ac.uk

Dear Editor,

I was passing through the campus earlier this week and my eye caught your stall and the Rationale magazine, I remarked to your stall holder that for £1 this seems a good buy. The content matter when I started to read through its pages, was interesting, topical and thought provoking.

As a 72 year old pensioner, this seemed to be a blast of fresh air having also got fed up with throwing half of the Financial Times away! Although I am not an economist I have read the Economist but its style is predictable and find the arguments in your issue 1 of more than passing interest, your articles in Rationale on the current implosion of the financial structure provide a perception and angle that is original.

Do keep up the good work I will certainly look out for the next issue, I attend many meetings at LSE open to the public. I'm sure you can get a wide audience on the net as well as visitors to the campus.

George Shaw.

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NEWS

ECONOMIC UPTURN?

After months of global recession, reports have begun to emerge that we may be on the verge of pulling out of the downturn. OECD studies suggest that many G20 countries, including Germany and Japan, show signs of either smaller than expected contractions or outright growth predictions in their economies across the second half of 2009.

In the UK, recovery is apparent in the turn in the FTSE, which (at time of writing) was trading at 10-month highs, albeit with high volatility. These recoveries have been boosted by better than expected consumer retail figures and a small gain in manufacturing across the summer. However, some commentators, including Nobel Laureate Joseph Stiglitz, have warned not to get carried away with these suggestions of full blown recovery, noting instead that some nations could slip back into a second slump in the months to come. The OECD report comes out at the same time that statistics show US unemployment to be at a 26-year high at 9.7%, with predictions of other G7 countries' unemployment rates still predicted to rise further.

STIMULUS TO STAY

With G20 finance ministers and central bankers meeting in London at the beginning of September, a political stance to keep economic stimulus packages in place has emerged dominant. Despite encouraging recovery figures, politicians are still wary of declaring a full-blown victory over the global recession, and most want to see stimulus packages remain in place until a certain and definite recovery from recession has been achieved.

However, many government leaders have been quick to show that they do have an 'exit strategy' on their minds for when the time to wind down stimuli does come; with government spending at abnormal highs and unemployment levels continuing to rise, many leaders' approval ratings and polls have been badly harmed, pushing most to attempt to demonstrate their control and strategy for managing the economy.

BONUS REFORM

Amidst the September G20 meetings of finance ministers in London, the leaders of the three biggest European economies called for a more unified and direct

approach to regulating the finance industry with particular focus on changing the bonus culture that prevails in banks and other financial companies. Gordon Brown, Angela Merkel and Nicolas Sarkozy issued a joint letter from Downing Street asking other G20 politicians to focus attention on achieving what was suggested in London in April – namely reducing bonus sizes, deferring bonus payments, and rewarding long term bank performances over individuals.

However, Sarkozy and Merkel have backed reducing bank bonus pools directly whilst Brown's opinion has been that intervening in bonuses head-on will be difficult to manage and enforce effectively. This all comes amidst furore in the US, where executives at some banks have made huge windfalls by paying themselves in stock options rather than outright bonuses which rose in value due to government bailouts.

On the 5th of September, the meeting announced a number of measures which aim to reform bonus culture to encourage long term performance over short term gains. The G20 nations agreed on requirements for the public disclosure of bonuses, and powers for bonuses to be "clawed back" if short term decisions lead to long term losses, a pattern of behaviour widely beleived to have led tot he current crisis..

LOCKERBIE BOMBER RELEASED

International outrage and debate has been rife over the decision by Scottish Justice Secretary, Kenny MacAskill, to release the only man convicted of the 1988 Lockerbie bombing, Abdel Basset al-Megrahi to his home country of Libya. Reactions in the US and the UK were both filled with indignation as al-Megrahi arrived home to a hero's welcome and high media coverage, sparking questions over MacAskill's motives and decision making. Although defending himself by claiming the release was motivated by 'grounds of compassion' considering al-Megrahi's diagnosed terminal prostate cancer, finger-pointing has spread to Westminster and specifically UK Justice Secretary Jack Straw.

It is believed that Straw may have been in negotiations with Libya over preferential trade deals regarding the UK, leading to questions of whether or not the release was motivated by international politics rather than compassion. In either case, the situation is being regarded by many as highly inappropriate, and a defeat for both the Labour government and the Scottish National Party.

AIG SALE

Government bailed out insurance provider AIG has reportedly struck a deal to sell its fund management business for $500m to the Hong Kong based Pacific Century Group. The sale marks a positive move for the US firm's incoming CEO Robert Benmosche as he looks to get fair prices for the assets up for sale in a bid to strengthen AIG's repayments of Federal bailout money of which it received last year. This sale brings the total of AIG's divestments up to $9.8bn, still a long way short of both the total $182.5bn bailout package, and the $38bn the firm owes the Fed on its current credit line.

The purchase by a Chinese based operation comes at a time of growing unrest in the Chinese business environment following the disappearances and investigations of many prominent Chinese businessmen under the guise of 'anti-corruption campaigns'. Many, however, see the anti-corruption play as more of a cover up following political power struggles in the Communist Party culminating in eliminating major supporters of opposition politicians. Reports that a $2.4bn bid for AIG's Taiwan Nan Shan Life unit by Chinatrust Financial have also surfaced.

JAPANESE POLITICAL SHAKE-UP

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The August 30th announcement of power change in the Japanese government is set to potentially initiate a major shift for the Japanese economy and political landscape. The defeat of the Liberal Democratic Party (LDP) by the Democratic Party of Japan (DPJ) marks the first time since in almost 60 years that the LDP has lost power over the country; the scale of the victory showing to be a complete landslide additionally demonstrates the welcoming of mass change championed by the Japanese public.

Amongst the policies of the DPJ are calls to reduce the Japanese obsession with export-lead growth and sweeping right wing capitalist priorities, and instead put the consumer first and turn towards domestic demand and stability. This left-leaning government looks set to move entirely away from the Western/US aligned and mirrored economic and growth policies that dominated the LDP for decades, and motivate what many analysts regard as overdue reforms to better suit Japan's position in the global economy. Instead of focussing on creating cheap business environments, liberal tax cuts to stimulate business, and subsidised industries the DPJ has promised to meet voter demands by improving healthcare, educations, and rural jobs to cull the urban 'brain drain'.

Amidst this political shift, reports have emerged that Miyuki Hatoyama, the new first lady, claims to have been abducted by UFOs and visited Venus.

GOOGLE LIBRARY

Debate surrounding the actions of internet firm Google's latest business creation has sparked fierce opposition from its competitors, universities, and authors around the world. The digitisation of libraries by Google has been in process for a number of years now, but a class-action law suit against the firm has marked the beginning of controversy surrounding the idea after a group of authors sued the Google for breach of copyright.

September this year market the deadline for publishers and authors to opt in or out of a deal constructed by Google to settle the lawsuit; this deal would allow Google to scan and digitise out of print books without seeking copyright permission from authors amongst other things – something that many are opposed to. Some of the fiercest opposition has come from European governments who argue that allowing Google to publish digital literature from the US may conflict with European national laws, initiating a hugely complicated legal matter.

On top of this big competitors of Google on this front including Microsoft, Yahoo!, and Amazon have also showed objection to the plans on the grounds of unfair competition. The case will go to a Federal Hearing later this month. This case marks growing controversy surrounding the business operations if Google in general, who also recently faced backlash against their growth of Google Earth on the grounds of breach of privacy.

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COMMENT

Bottomed Out? Maybe not...

By Wensi Lao

May 2009

What is the best thing in a bear market? A big rally. What is the worst thing in a bear market? A big sucker's rally. Excuse the bad language, but that is the actual jargon - believe it or not. When a sucker's rally turns into another round of plunge, the investors really have their tiny remaining shred of confidence torn up by the big bear.

Over the last several of weeks, the stock market has rallied and the Dow Jones Industrial Average raced past the 8000 watermark on the news of stabilising housing data and some pleasantly surprising earnings. Goldman Sachs has more than beat the expectation with their 1st quarter revenue of $9.43 billion and a net earning of $1.91 billion. JPMorgan also reported a net earning of $2.1 billion, that translates into $0.40 per share, more than double most analysts' expectation of $0.16 per share. There is even good news from Citigroup as it has turned a profit in the first two months of the year! Miracle! On top of all that, the Capital Stress Test which is about to be completed in the next week has shown that all the big financial institutions seem to be reasonably well capitalised to just about hold on to the market, at least for now. Surely that is the big cherry on the cake! We've bottomed out already!

Maybe not quite. All the senior executives and financial gurus are all still quite cautious and philosophical when they are choosing their words and investors are hesitating to push the Dow Jones much more than the 8000 mark. Sure enough, as I write this, a large fall led by banking stocks has just pushed the index back down to 7800. One peek at the JPMorgan and Goldman's first quarter earning report would provide some clues for the lack of confidence. One common feature both banks share in their impressive earning is their net revenues from fixed income trading have soared (GS has doubled from 2008 q1 figure, and JPMorgan has pulled off a 10 fold increase!). This feature reflected the particularly high volatility of the market in the 1st quarter and a big jump in the bond market volume due to general nervousness amongst investors regarding other asset classes. In all of GS and JPMorgan's other "traditional" business areas such as M&A, bond issuance, IPO, etc, the figures are still depressed, suggesting the US corporate world is still being squeezed. Investors have also recognised that GS and JP came out of the end of last year least scathed, hence part of that glory really comes from the pleasure of snatching up the business of their much weakened competitors. As for the general wellbeing of the banks, their capital has been guaranteed to a large extent and financing cost are being driven down by state protection. So at the moment, them holding up is not so much of a cause for celebration, but more of a consolation and a reached expectation. Remember, the US and UK government have already poured in hundreds of billions to fill the hole.

The truth is, the bigger picture suggested by economic data is gloomy and global trading is in a dire state. Unemployment figures and industrial woes are NOT uplifting thoughts to the minds of investors. There are talks of stabilisation and G20 summit in the beginning of the month did offer a glimmer of hope for global economic collaboration, but we simply do not know whether the economy would take another turn for the worse. After all, before the February stock market landslide which saw Dow Jones tank at 6500(down 60% from the 2007 peak) in early March, we did enjoy a few months of serenity and even a couple of rallies, "suckers' rallies" that is.

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The End of Capitalism?

By Raj Rabheru

As politicians around the world gathered in the UK for the G20 summit, Central London was pushed into a state of pandemonium as individuals throughout the country gathered to voice their rage at bankers, politicians and economists alike. These protesters were angry at what they saw as a distinct failure of capitalism to protect them from an economic crisis, which in their opinion should not have been allowed to affect them. A popular view seemed to be that although the bankers had caused this crisis, they were not taking responsibility for their actions – the reasons for this opinion are perhaps epitomised by the fate of Sir Fred Goodwin, former Chief Executive of RBS, who was ousted from after its cataclysmic failure and consequential nationalisation, but still takes home an annual pension packet in excess of £700,000. The credit crunch has seen an unprecedented series of bank failures throughout the world and policies once considered political suicide have quickly become the political norm.

> "Were centrally planned economies right all along?"

As voices for nationalism grow further still and government intervention becomes rife throughout the world, is this the end of capitalism as we know it today? Or will a rejuvenated form of capitalism be the force that eventually drives the global economy out of the worst recession since the 1930s?

It is not difficult to be swayed by the argument that Asian economies such as China, who pursued an economic framework that was in effect largely centrally planned, are in a relatively better position to tackle the crisis when compared to the Western economies. It is clear that the Asian economies have got some things right: by in large their banks have not been allowed to indulge in the complicated securities, which have created black holes in the balance sheets of Western banks; while the government, companies and individuals all saved money throughout the boom and are in a much better position to tackle the global recession as a result.

However, these perceived strengths are not all that they appear to be. While the thrift of these economies is an advantage during this recession, we must realise that they are in part an indication of the poor welfare systems throughout these developing economies. Moreover, this propensity to save acts as a powerful steamroller over domestic demand within the economy, which has led to an overdependence upon the over-indulgence of the West – without the past exuberances of the Western economies, there would have been no-one to buy the cheap manufactured goods that are believed to be the key to their success. What we are now seeing, as global demand falls further, is a decline in import demands from Western economies beginning to have an effect upon the emerging economies – you only have to look at the colossal $586 billion stimulus unveiled last November by the Chinese government to realise that their export economy is facing a dire outlook.

Furthermore, despite appearances of pursuing a centrally planned economy, the corner-stone to success of many emerging Asian economies is a move towards capitalism – by and large, it is in fact private enterprise that has catalysed growth in these countries and not the government on its own. What is clear then is that perhaps the rise of the Asian economies is more an endorsement of Capitalism rather than a damning verdict. Perhaps what has saved these economies from this particular crisis in some part, is the fact that they have not perused these policies for long enough to become fully integrated into the global economy – I doubt very much as to whether this lack of integration into the global markets will be of advantage to these economies in the long run.

As has been the case in most recessions, we have seen a distinct increase in protectionist rhetoric from politicians,

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pressure groups and individuals alike. However, this begs the question of not only whether it is economical to pursue such policies, but also the practicality of pursuing such protectionist measures – having experienced the era in which globalisation has had a profound impact upon economies far and wide, it is difficult to point out any product that is produced in its entirety in one country alone? The American Car industry may be one such example of an industry that is fighting for protection, however you must not forget that many of the components that make up these cars are produced internationally and the majority of raw materials are also obtained from abroad – surely this begs the question, how do you protect an industry that is so inherently international in its supply chain?

Overall, it seems to me that the success of the 'centrally planned' economies of the modern era have largely been based upon a pursuit of capitalist policies and a dependence upon Western consumption. This structure will surely fair worse from the crisis than that of the West. Not only will they suffer a crisis as global demand dwindles, but they are also likely to continue to face trouble while the rest of the world begins to recover; they are unlikely to see a return to the heights of the past decade, in which they have experienced unprecedented growth as a result of huge current account deficits run by Western economies. It is clear that to stand a chance in the new world that will emerge from this crisis, export-led economies will have to restructure towards a larger focus on domestic demand, best achieved by a further move towards a capitalist economy and an improvement in welfare provisions. We should not forget the huge benefits that capitalism has provided us with, as Richard Lambert, director general of the CBI employers' organisation remarked recently, "it would be good if the G20 leaders reminded people that a shift towards market economics lifted 500m people out of poverty in the last 15 years".

"The rise of the Asian economies is more an endorsement of Capitalism rather than a damning verdict. "

On top of this, the nationalistic arguments for protectionist policies are rather lacking in substance; the world has grown so interdependent that withdrawing from the global economy at a time like this will surely only serve to push a country further into the hands of depression than it already has. As a result of these factors, I very much doubt that this crisis spells the end of capitalism, but it is clear that the capitalist beast that emerges from the crisis is set to be a new monster altogether – the question still remains as to whether we will be able to tame this new beast. To this question however, I fear we may only truly know the answer when the next crisis comes knocking on our doors.

Greenspan: 4 Years On.

By Joel Lancaster

If you want a simple model for predicting the unemployment rate in the United States over the next few years, here it is: it will be what [Alan] Greenspan wants it to be, plus or minus a random error reflecting the fact that he is not quite God."

As Paul Krugman basks in the glory or receiving the Nobel Prize for his work on new trade theory, this is one quote he may like to forget about. Mr Krugman should not be embarrassed by this quote though, for like someone who is embarrassed to discover an old photo of themselves with an afro comb and flairs in the 1970's, both their embarrassments are merely a product of their times. Mr Krugman's thought merely reflected the political and economic fashion of the time, for as the rising stock market and low inflation of the 1990's pushed Mr Greenspan's star into the ascendency, Mr Krugman was not alone in thinking that Chairman Greenspan held deity like power over the direction of the US economy. Fast forward 12 years and the party is over, the asset bubble has burst, the property bubble has burst and so has the bubble in Mr Greenspan's speaking (the market peaked when Lehman brothers paid $250, 000 for the pleasure of Mr Greenspan's company). When he retired Greenspan was still widely referred to as the 'maestro', only a few years later his legacy appears to be in tatters as many blame him for having a visible hand in causing the credit crisis.

There are two main charges levelled against the Greenspan legacy, Firstly that he created a bubble in the housing market through a sustained period of low interest rates after the dot com bubble in 2000 and that he did nothing to stop it expanding. Secondly Mr Greenspan intervention in the wider political economy, contributed to policies that helped fuel the credit crunch. Let's first look at the evidence that his monetary policy helped inflate the bubbles. Mr Greenspan lowered interest rates in the wake of the dot com

"Greenspan's legacy appears to be in tatters. "

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bubble bursting and 9/11, this helped drive up house prices. The low level of interest rates meant that many people were lured into mortgage agreements with introductory 'teaser' rates, causing a large increase in demand especially in the sub-prime market. When these 'teaser' rates ran out people simply got them elsewhere, as their houses rose in value. When interest rates began to rise again, coupled with a big build up in supply, this meant that as people were unable to take out new mortgages and teaser rates ran out, many people defaulted, causing the bubble to burst. There was a large amount of capital to be invested in the housing market as low interest rates coupled with a long period of economic growth meant that investors were comfortable becoming highly leveraged and thus went searching for riskier returns beyond the traditional market, seemingly confident that prices would go up for ever. Low interest rates also drive down the price on safe bonds making other a wider variety of assets more attractive. There can be little doubt then that low interest rates helped contribute to the housing bubble, but does that mean we can blame Greenspan?

Unfortunately for scrape goat seekers, the answer is probably not for three reasons. Firstly Greenspan was taking action to stop the possibility of deflation; secondly it is hard to hold Greenspan, for the irresponsible lending on the back of lower interest rates for and thirdly he was not responsible for the large capital inflows into the USA. When Greenspan lowered interest rates by 550 basis points between January 2001 and June 2003, the aim of the policy was not to pump air into the housing market, rather it was concern about deflation. Greenspan had seen the damage deflation had done to Japan during the 'decade', and was determined that he would not repeat the mistakes of policy makers in Japan. According to a 2005 paper by Blinder and Reis this was an integral part of the Greenspan risk management stratergy - acting pre-emptively to take out insurance against extremely adverse events. So how loose was monetary policy at the time? Between the 3rd of January 2001 and the 25th of June 2003 the Fed cut the funding rate from 6.5% to 1% where it remained for a year then between June 2004 and mid 2006 the Fed gradually increased the rate back to 5.25%. According to the author of the 'Taylor rule', John Taylor, his own rule would have told Greenspan to raise the rates from 1.75% in 2001(when he was still lowering them) to 5.25% by mid 2005(a year earlier than he did). This implies a very loose monetary policy. We will never know what would have happened if Greenspan had not adopted such a loose monetary policy. It is probably now reasonable to argue that in spite of the adverse events at the start of the millennium, the appetite for risk taking and high levels of confidence since then implies that it would have been unlikely that the US economy would have entered a prolonged downturn if Greenspan had not adopted such a loose policy. With the benefit of hindsight though it is easy to criticise Greenspan but even Taylor himself said that it was understandable to have such a loose policy considering the threat of deflation.

"Greenspan can not be held responsible for what people choose to do with lower interest rates"

Greenspan can also not be held responsible for what people choose to do with lower interest rates. One of the desired effects of monetary policy is to increase lending and encourage investment. Loose monetary policy encouraged investors and bankers to take on risk and seek out new possibilities for investments, and this partly explains the demand for every riskier assets that led to the crisis in the sub-prime mortgage market. Lowering interest rates to 1% though is not a message to mortgage lender that you should be making mortgages for over 100% of the valueof the house, or to households that even though they did not have a job they could still afford a mortgage. Most of us consider this an affront to common sense. Both lenders and house hold, acted irresponsibly, making it difficult to blame Greenspan, for the build up in unwise debt. Ultimately policy makers set monetary policy with regard to the aggregate dynamics of the economy; and they can only be expected to take so much account of how each micro element will behave. The irresponsible lending that lead to the crisis represent more a regulatory failure, than one of monetary policy. Greenspan's position as Chairmen of the FOMC put him in charge of setting monetary policy not in charge of regulating and overseeing the financial sector. The USA has other institutions devoted entirely to this task and they must take a large part of blame. Lower interest rates in the USA are not the only reason the system was awash with cash though. A large current account deficit in the USA and large current account surplus' in Asian and Middle Eastern economics caused large capital inflows into the USA. In a 2008 paper Rogoff and Reinhart show how most banking crisis almost always occur on the back of large capital inflows. This is again something outside the remit of the Federal Reserve.

This does not completely exonerate Greenspan though. During his 18 years as Fed Chairmen, he did not limit his public remarks to that of purely monetary policy matters; indeed he took sides in a number of wider political economy and financial questions. Such was the magnitude of his reputation, as the quote at the start of the article shows, when he spoke out, people listened. On many of the issues he spoke out on he now appears to have been wrong and may well contrib-

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uted towards the credit crunch, some also argue it has damaged the Fed by politicising it as an institution. There is widespread agreement that one of the causes of the credit crisis was the higher levels of debt, both public and private. When President Bush proposed cutting taxes on the rich in 2001; Mr Greenspan publicly supported the move, even though it increased the government debt. He has also been criticised for his support of Bush's plan to privatise social security.

Mr Greenspan also gave his support to a number of the financial products that have been at the roots of the credit crunch. The credit crunch was not the first time a housing bubble had burst but this time the damage to the rest of the economy has been much larger than historical experiences, this is partly because sub-prime mortgage debt has been packaged up into securities and then sold as assets spreading them throughout the financial world. When people began to understand the toxic nature of these products, credit market dried up. Derivative contract also helped banks expand their levels of debt, allowing them to take on more of these assets. Some people spoke out against the use of derivatives, including leading investors such as Warren Buffet but Greenspan gave his backing to the use of both derivatives and securities. He described them as an 'extraordinarily useful vehicle to transfer risk from those who shouldn't be willing to those and willing and capable of doing so.' Another quote to forget. The banks were able to build up such high levels of debt and the explosion in the securitisation market partly a result of repeal of Glass Seagull act, which allowed the integration of commercial and investment banks. These meant new super-banks such as Citigroup were able to be involved in both brokerage and banking activities, creating with hindsight a huge conflict of interest's. The bill had Greenspan's finger prints all over it. Greenspan supported the repeal of the act, and gave key testimony to congress during debate on the bill in 1999. In sum, Greenspan's intervention into the wider political economy now appears to be the biggest strain on his legacy.

"That so many had such a strong faith in Greenspan was hardly a rational expectation."

Since leaving office Greenspan has been heavily criticised for the actions he took while Fed Chairman, and these criticisms have varying degrees of merit. We should not forget why Greenspan's chairmanship was so celebrated when he left office. Greenspan was one of the first people to recognise the increase in productivity in the 1990's and 'the great moderation' in inflation rates, allowing him to keep interest rates low and the economy to grow, without losing control of inflation. This allowed the US economy to undergo it's largest ever expansion from March 1991 to March 2001. Although the economy is now turning bad he still preceded over a remarkably long period of prosperity, economic growth and low inflation. Some have argued that he was lucky to be a chair during a period economic calm, but many other major economies suffered economic woes in that period and his chairmanship was a quiet time, partly because he made it so. During his 18 years as chair of the Fed he guided the US economy through a stock market crash within his first months of office, two wars, the east Asian crisis, corporate scandals, the dot com bubble bursting and 9/11.

What is perhaps most remarkable about the evaluation of Greenspan chairmanship is not that he did not hold the God like power the market seemed to believe he did and stop the credit crunch but rather that they held such views in the first place. That so many had such a strong faith in Greenspan was hardly a rational expectation. Greenspan was made to look human by his (and almost everyone else's) inability to predict the credit crunch, but it is unfair to hold him responsible for much at what lay at the heart of the crisis. Greenspan's chairmanship will most be blemished his forays in the questions of political economy and financial product and he has supplied his critics with ample material to criticise him. Whilst we criticise Greenspan and wider free market he has so often been a poster boy for, we should not forget that the decline in living standards that occurs during the credit crunch, is likely to be small compared to the huge gains made around the world since 1987 and we should not forget the maestro's role in it.

Bonuses Aren't to Blame

By Matthew Partridge

There is tremendous political pressure for governments to go beyond capping bonuses in firms receiving government funds and extend any restrictions to all financial firms. This is both based on the populist argument that the profession which caused the crisis should bear some of the costs and on agency theory. Put simply agency theory states that the interests of owners and managers need to be aligned, especially when management is too complex and share ownership too diffuse for the shareholders to properly hold managers to account. Proponents of this argument point out that overly-generous bonuses created a "heads I win, tails you lose" situation whereby bankers' were incentivised to take risks.

However, the argument that misalignment of interests between shareholders and senior managers was the primary cause

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of the crisis is dubious. Most banks have always forced managers to hold most of their compensation in shares. Indeed, when I worked at Lehman Brothers in the summer of 2006 it was constantly pointed out to me that the firm was majority owned by employees. However, even if it was the case that bonus structures in the financial sector encouraged undue risk taking, other counterparties (such as creditors) should have had a clear incentive to check on risky behaviour.

"The argument that misalignment of interests between shareholders and senior managers was the primary cause of the crisis is dubious."

Unfortunately, if the shareholders and counterparties themselves think that there is a possibility of a government bailout if things go wrong, then their incentive to check risky (or downright stupid) behaviour is severely diminished. In extreme cases, it could be argued that had the chief executives not factored the expected government reaction into their decision-making, they would have been in breech of their fiduciary duty to maximise shareholder returns. Of course, the extent of the "moral hazard" is always proportional to the probability of a bailout and the terms on which such a package would be carried out.

Even before TARP was tabled the Federal Reserve's past track record suggested that shareholders in banks deemed "to big (or politically important) to fail" would be allowed to retain equity with creditors and counterparties being protected. In the case of LTCM, the shareholders were able to retain $400m of equity (in contrast to the fire sale offer of $250m from Warren Buffet). Greenspan's decision to slash interest rates in an attempt to prop up the stock market in 2000-2 can also be seen as a de facto bailout. Similarly, last year Bear Stearns shareholders were able to force JP Morgan to increase their price by roughly $1 billion a fortnight after the Federal Reserve bailout.

Indeed, to misquote Ronald Reagan, the possibility of government intervention to either buy up or insure "toxic assets" was a cause of the crisis, rather than a possible solution. Certainly speculation about a TARP style package, work on which (according to Paulson's testimony) was started as early as last summer, could have been one of the reasons why banks did not make a better (and more timely) effort to properly value the mortgage securities on their balance sheets. Similarly, the current hemming-and-hawing about a government "bad bank", which could absorb the mortgage securities, might be discouraging prompt action by bankers.

So what should be done about bankers' pay? Certainly, the senior directors in those banks which have received government assistance should be asked to leave as soon as possible. A return to the Paul Volcker doctrine, where the (figurative) head of the Chief Executive is the required price of even central bank liquidity, is also in order. The British and American governments also have the right to protect their interests as shareholders. However, imposing artificial regulations on compensation are no substitute for market discipline, and risks creating the same problems as any form of price-capping.

The ultimate solution is a clear and credible commitment to severely limit bailouts and impose punitive terms on shareholders, bondholders and counterparties. There should also be a return to the traditional central banking practice of only providing emergency liquidity at penal rates against good quality assets (not dubious assets like subprime mortgages). If however, some government interference in executive compensation is unavoidable, one of the least harmful options would be to make directors of banks that take retail deposits personally liable for a certain amount of claims against the company in the case of bankruptcy. This used to be the case in those firms that were run by non limited liability partnerships – most notably Goldman Sachs until 1999.

Can Obama Stimulate America?

By Daniel E. Parisi

As the world entered 2009, there was one event that made many newspaper headlines in a variety of languages. It was President Barack Obama's inauguration as the 44th President of the United States of America. This advancement captured the attention of many people, from civil rights activists to Democratic Party enthusiasts, and even economists. The most important responsibility that Obama has recently undertaken is to manage the economic health of the USA. In his presidential campaign, Obama infamously noted his plans to improve the US economy with a $775 billion stimulus package. Now that this bill of $787 billion has been approved by congress, estimations are being made as to how much this stimulus will be distributed. This report uses the data from the Center on Budget and Policy Priorities (www.cbpp.org), which focuses on low- and moderate-income individuals, who expect to receive about $300 billion from the CBPP estimates. These two classes are important, since the upper class is expected to personally receive little from this stimulus package in the forms of direct benefits.

As the sub-prime mortgage crisis tore through the lower- and middle-income regions of the America last year, President Obama has a great opportunity in front of him to make a difference and revitalize an economy that has a great effect on the global markets. With the current American economy laden with abnormally high unemployment rates, such as December 2008's figures of 18,000 jobs created and 125,000 lost, America's current employment level is thought to be the underlying fix to allow this economy to recover. This assumption is reasonable as nations with high employment typically have high GDP and this tends to increase the country's wealth and promote growth. President Obama plans to revitalize US employment, invest money into public works, and implement constraints on Wall Street that will limit bonuses to stock options that will be held until the company pays back the government's bail out. The current global financial crisis is rooted in the American housing market, and it is on this root that the President will concentrate his efforts. Since the sector of the housing market that suffered most was that belonging to the low- and moderate-income citizens, these groups will be targeted with funds first. With these plans clearly outlined, Obama expects consumption to increase, thus increasing business revenues, and it is projected that this increase in earnings will motivate companies to increase their employment levels, combating unemployment. Obama also hopes that this stimulus plan will be a step forward in achieving his goal of creating 3 million "green" jobs, which would address America's energy needs and contribute to the employment situation. By

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assisting the low and middle classes and manufacturing sectors of the economy, the expectations are for US employment, gross domestic product (GDP), and overall trust in the market to return to a more comfortable level that promotes an appropriate and manageable growth pattern.

With increasing price levels of inflation, the average US consumer has less buying power than previously experienced. Through the stimulus package, dubbed the "American Recovery and Reinvestment Act of 2009," ARRA, Obama plans to inject billions of dollars into the US economy by expanding the budget of a variety of preexisting plans, creating new plans, and supporting the public with tax relief. This response, by Obama, is sensible so to avoid potential stagflation, occurring by an increase in prices and a decrease in output, which is inevitably controlled by employment levels. Hence, this concept to "ease the burdens on the middle-class and working families while making progress on achieving long-run budget balance" is considered by many to be a fine idea. The debate arises when asking the question, "how?"

"Obama has a great opportunity in front of him to make a difference and revitalize an economy that has a great affect on the global markets."

President Obama plans to supply this fiscal stimulus through a variety of channels so to assist and encourage spending to a greater populace. The sectors this package will most impact are Federal Medical Assistance Percentage (FMAP), State Fiscal Stabilization Fund, Hope Credit, Unemployment Insurance, Child Care and Development Block Grant (CCDBG), Workforce Investment Act (WIA), Supplemental Nutrition Assistance Program (SNAP) (previously, Food Stamp Program), Emergency Shelter Grant (ESG) Program, Child Tax Credit, Making Work Pay Credit, and a one-time Economic Recovery Payment. Through these diverse programs, Obama hopes to be able to touch those members of society who need assistance most and expects that this provided financial support will be recycled into the economy and allow the US to leave its recession.

As President Barrack Obama plans to supply assistance, it is important to understand who the assistance is going to, so one can better assess the reaction of America's economy. The temporary increase in FMAP will assist those Americans receiving Medicaid, a government aid given to qualifying candidates needing financial assistance with a medical condition or handicap, and Title IV-E foster care and adoption assistance. Since this is managed by a combination of the state and federal funds, Obama exempts states from being held responsible for any drop in their FMAP, as the previous economic conditions are the primary causes. The stimulus will also increase a base of 6.2% in each state's FMAP. Such targeting will help states manage their budgets more easily and allow for them to keep focused on serving the citizens. Another component of this plan is additional FMAP funding for states experiencing large increases in unemployment rates, enabling them to better manage their state expenses. By making sure that states properly pay physicians, hospitals, and nursing homes, fraud and moral hazards can be avoided, which could lead to more problems. Social Security and Medicare are widely viewed as great measures to stimulate the economy, as the citizens who receive these benefits are more likely to spend this cash, than the middle and upper class workers, because of their recognized income restraints.

By creating a State Fiscal Stabilization Fund, states will be provided with a $39.5 billion grant for education and an $8.8 billion grant to help fund other key state services. This fiscal relief will be given to prevent sacrificing public school and higher education budgets for the next three years. As for the flexible grant of $8.8 billion, states can choose to spend this at their own discretion on state service. For example, they may support public safety/law enforcement, services for the elderly/disabled, and/or childcare. The Obama administration is also providing $5 billion in State Incentive Grants, which will be awarded to those states that apply and demonstrate that they have made progress on initiatives like even allocation of teachers from high- and low-poverty schools or established longitudinal data systems, to help produce more accurate student data. These incentives to improve school standards are fine examples to promote an economic recovery. If the US were to cut their budget for the public education sector, it would be like burn their house to stay warm, ultimately a poor choice. Thus, this fund will be similar to an investment to experience an increase in future total factor productivity because better education is conducive for increased efficiency, or marginal product of labor (MPL).

The Hope Credit, created in 1997, as a tax subsidy for the college tuition will be enlarged and partially extended to the first time students from lower income families. This credit system has currently been renamed as the American Opportunity Tax Credit. This newly titled program will be active for the 2009 and 2010 years, and it is projected that this extended credit will be made a permanent fixture of the American tax code.

President Obama's stimulus act will provide fiscal assistance to those unemployed by increasing the unemployment benefits by $25 per week per insured. Provisions will also be made to the Unemployment Insurance Modernization Act (UIMA) with incentives for states to adopt reforms to their UIMA, coincidentally, making the program more accessible to more low-wage workers and part-time workers. This package includes $500 million for states to improve and adapt to the administration demands for the increasing claims filed as unemployment

continues to rise. There are inherent risks to this particular funding, namely an increase in the average labourer's reservation wage, a rate that marks the individuals choice to take up the particular job it is associated with, is likely to occur as a result of the increased benefits of being unemployed. Thus, if the value of wage offered to the labourer is lower than the, now increased, value of being unemployed, the laborer will choose to remain unemployed. The increase in UIMA increases the value of unemployment and will promote shirking, or laziness, because the employee's job is not as valuable when compared to the increase in potential benefits received from UI if their job is terminated. This is a poor investment of President Obama's stimulus plan.

Child care proves to be a major issue for families who are suffering from this financial meltdown. The website babycenter.com, calculates the price of a child, if born in 2009 within an average family in Midwestern America, to be about $250,000 with plans to receive an average public college education. The parents are faced with more than $10,000 in bills in just the first year of the baby's life. When accounting for these extreme prices, one can recognize how important it is to assist this category of citizen. The stimulus package will provide an additional $2 billion in funding for the Child Care and Development Block Grant (CCDBG). Subsidies will be provided to those low-income working families or low-income families in which parents are engaged in education or training. Although this plan appears to be sufficient, when compared to the European systems, the US does not support educating the family nearly as much as what is experienced in regions of Central Europe. With America giving support to one in four children, or 17 million, this $2 billion enhancement will not be appreciated as well as some might initially expect, averaging an additional of $118 per child. This dilemma of affording a youngster on an already low-income will become more difficult as the recession persists due to increasing price levels, and the effects will become twice as drastic if two people's welfare is at stake: the parent's and the child's. The Child Tax Credit Expansion is a partially refundable federal income tax credit of up to $1,000 per child (under 17), which is designed to help offset the costs of raising him/her. Vicki Turetsky questions the amount of credit expansion for child support enforcement in CLASP (Center for Law and Social Policy). Her analysis demonstrates that child support enforcement is cost effective, in that $6 is collected for every federal dollar invested into this program. As the ARRA of 2009 includes $1 billion temporary suspension in the Deficit Reduction Act of 2006, child support funding it expected to be cut by 20%. Regardless of this challenge, this credit expansion is estimated by the Joint Committee on Taxation to cost about $14.8 billion over its two-year life. When evaluating these figures, the cash flows faced by low-income families do not zero-out. Since the Federal Minimum Wage is $6.55/hour, allowing a full-time worker to make $13,624 annually, without taxes, and a well estimated average cost of living is $18,360 annually, the subsidies would have to be much larger for one to live comfortable working one job and raising a child. Obviously these costs can be reduced through sharing apartments and general bills, but there is still a significant difference that the low-income population faces. Families currently struggling with bills are still likely to suffer, although not as much.

Obama plans to provide funds for the Workforce Investment Act (WIA). This offering of $3.95 billion for training and employment services is an investment into three main areas of the labor force. Since youth activities, dislocated workers and adult activities will receive $1.2 billion, $1.25 billion, and $.5 billion, respectively, this investment is likely to have productive outcomes. President Obama intends to empower these groups with the expectation that there will be a future increase in average labor productivity (ALP), due to the training that will ideally cause a future increase in MPL and concurrently an increase in total factor productivity once these workers are implemented

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into their industries. As dislocated workers, or those previously laid off, reenter the workforce, they are better served through training than increased unemployment benefits because training keeps the society optimistic and forward looking. These three groups will be more appealing to businesses because of their newly acquired skills and this will spark competition in the industries they pursuit, thus eliminating shirking and allowing the training received to be shared throughout the workplace. This is a better investment of the ARRA than seen when enhancing the UIMA.

The SNAP will receive $20 billion, to be distributed to the 14 million households, aggregating 31 million people. This assistance is an efficient way to help and guarantees a recycling of money, as the USDA (US Department of Agriculture) confidently estimates every $1 in food stamps generates $1.84 in economic activity. Since the disposable income that this class occurs is the lowest, this food received will allow the individuals to consume other products that they were previously deprived from due to financial constraints. Another program in a similar population, which will be targeted, is the ESG Program. By receiving an additional $1.5 billion, the ESG households will be able to appreciate more relief in paying their due bills, and thus averting homelessness. These two enhancements are likely to be immediately recycled into the economy.

An important part of the ARRA of 2009 issues the Making Work Pay Credit. In this section, a tax relief of up to $400 per worker can be appreciated, and is projected to total $44.2 billion. Another relief that most Americans find attractive is the one-time Economic Recovery Payment in 2009 for recipients of Social Security, SSI (Supplemental Security Income), veterans benefits, and railroad retirees. These temporary increases of wealth will ease the financial troubles citizens are facing, as it supplies a qualifying individual with a payment of $250, making this aggregate $14 billion reaching 56 million people.

These funds will be concentrated on the states hardest hit by the house market bust. On the Friday of February 13th, Illinois outlined portions of the stimulus and is set to receive the first dispersing of stimulus in the amount of $2.9 billion. Other states, like California, Florida, Michigan, New York, Ohio, Pennsylvania and Texas are intended to be grand recipients of this stimulus package, with more than $7.8 billion each. These top funded states tend to be those with highest population and suffering the most from severe collapse of housing markets. These regions of the US seem practical when considering the outlay of the economy and the population. For example, Michigan hosts a great many automobile plants that have previously dislocated many employees due to poor sales, and California is a prime state to invest in education, as it has a fine set of public universities worth preserving. The Midwestern states, like Ohio and Illinois, suffered immensely from the housing market flop, and those citizens will need help as well. When comparing more relative figures, like the ARRA of 2009's 7 Most & Least Funded States Per Capita, one can recognize the state citizens who are most likely to appreciate a benefit from this package. With New York in the lead, this state, containing New York City, will be a crucial area for maintaining economic health, as it plays a significant role for America and other nations interacting through her. Coincidentally, the District of Columbia, commonly referred to as Washington, D.C. and the nations capital, is the second most gaining state per capita, hopefully the White House or Capital Building did not collapse with the US housing bubble! The average Virginian, a citizen of Virginia, will be profiting least from the ARRA of 2009. This can be an understandable choice, because the state contains many federally funded facilities, such as military training camps. When reviewing other low ranking per capita states, like Utah or South Dakota, their population is small and their housing markets failed to boom, implying that the states' citizen did not suffer as badly as other state's from the housing bubble and credit crunch, as New York has a greater population and more houses which produced greater unemployment when the burst occurred.

> "Conservatives argue that the stimulus package does not clearly define the specific areas that it will aid."

Most of these tactics to stimulate the economy seem reasonable, but some critics are understandably concerned with the tax breaks. Macroeconomic models prove that consumers choose to appreciate a smooth consumption level throughout their life,

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whenever possible. By implementing a temporary tax cut, an average consumer is likely to save some of this money, rather than spend all of it, as the consumer wants to experience a smooth consumption path for the present and future periods of his/her lifetime. This smooth consumption path is thought to be inefficient for policy makers when devising plans to stimulate a market, as it deteriorates the main goal, a quick reaction and fix. A consumer may also choose to save this tax cut to make up for greater taxes that will be incurred in future periods. When reviewing the ARRA, a majority of the tax cuts will be distributed to a younger tax population, families. This is not modularly considered to be efficient as giving this tax credit to the elderly, through Medicaid and Social Security. Since the older one is, the faster they are predicted to spend this credit because their ideal lifetime consumption smoothing effect is shorter, thus not as smooth. This consumption pattern for the elderly is intuitive because their future period is short than a younger person's. This concept of delaying consumption, for a smooth effect, defies the Ricardian equivalence theorem, which argues that a consumer's demand should not depend on the government's deficit because this deficit will not affect the consumer's consumption or welfare. This notion of equating the current and future taxes of a nation's life is defied by the consumption smoothing patterns currently exhibited. And, unfortunately for the policymakers, the consumption smoothing concept is a more realistic result. Nonetheless, there is a crossroad here and people stand divided because the assessment of disposable income.

"Perhaps Obama's glitzy name changes for his new programs will act as a marketing ploy with which Americans can associate."

Conservatives argue that the stimulus package does not clearly define the specific areas that it will aid. Others argue that the problem will not be solved because the initial cause, an overextension of credit and too much spending, will be repeated by the government's assistance, thus depicting an idea of fighting fire with fire. Regardless of these concerns, a more serious worry is doing too little too late. This perspective is shared by many, even NYU Professor Roubini, who states that the country will be sent into a "very severe recession," if there is no fiscal action.

What is to make of this situation? Will Obama stimulate US? When a crisis of this nature seldom occurs throughout history, it presents a blank canvas to economists, on which they will apply models and theories to create estimations and hypothesis. Truly, no one can be absolutely certain. President Obama's American Recovery and Reinvestment Act of 2009 is targeting many areas of the US economy. Some can view this as a private sector bail out, comparing it directly to the public sector bailouts experienced these past months on Wall Street, as New York Governor Patterson from the Democratic Party openly challenged the federal government when comparing the heavy and swift support given to those on "Wall Street." Perhaps Obama's glitzy name changes for his newly titled and re-titled programs will act as a marketing ploy with which Americans can associate. Time will be the best measure of President's Barrack's plan. The late Senator Everett McKinley Dirksen once proclaimed, "A billion here and a billion there, and pretty soon you're talking real money." This phrase seems to be truer today than ever before, as billions of dollars are now being dropped and most of the world waits with bated breathe to see how the Americans will react.

G20 Summit gives IMF Massive Boost but Circumvents Key Issues

By Rationale's Correspondent at the Summit, Nishad Majmudar

British Prime Minister Gordon Brown has put the executioners on notice: send the West's free-market policy orthodoxy to the gallows.

"The old Washington Consensus is over," declared Brown, minutes after concluding contentious negotiations at the Group of Twenty (G20) Summit in East London on April 2. "Today we have reached a new consensus to take global action together.

"We have resolved that from today we will together manage the process of globalisation."

Seizing on the symbolism of the first international summit since the American credit crunch spread its contagion worldwide, the British leader recognised the changing structure of world power – one in which one prominent leader can openly blame "blue-eyed, white" bankers for the global recession, for example, and another can openly challenge the U.S. dollar's credibility with little backlash, denial or impunity.

But for all the sensational rhetoric surrounding the apparent decline of American capitalism, April's meeting signaled the most sweeping expansion of the very organisation that has served as the Washington Consensus's guiding light and lightning rod alike: the International Monetary Fund.

The G20 nations stopped short of reforming international finance on the scale of Bretton Woods, but still made a bold pledge of $1.1 trillion in new funds for the global economy to boost liquidity in a time of declining trade and growth.

As anticipated, at least $500 billion will go toward restocking the IMF's financial war chest to $750 billion, making the Fund larger than the economies of four G20 member states. Japan, which already pledged $100 billion to the IMF in February, is joined by the European Union and China in providing $250 billion of this capital infusion.

The G20 have also pledged $250 billion to support trade finance. Another $250 billion in the IMF's neutral currency, Special Drawing Rights (SDR), will be allocated to countries based on their IMF quotas to provide an extra buffer as trade declines. The multilateral development banks will also benefit from an additional $100 billion for additional lending.

At least $19 billion of the new SDR will be available to low-income countries, said IMF Managing Director Dominique Strauss-Kahn, and countries with surplus SDR will be able to sell them to other countries that have balance of payments or liquidity challenges.

"It is the beginning of increasing the role of the IMF not only as a lender of last resort, not only as a forecaster, not only as an adviser in economic policy in an old traditional role," Strauss-Kahn said, "but also of providing liquidity to the world, which is the role...

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of a monetary institution like ours."

The IMF expansion aside, the G20's final communiqué also features stated commitments to continued monetary and fiscal expansion to the tune of $5 trillion worldwide by the end of 2010, adoption of new global financial regulations, and protecting international trade and development.

"April's meeting signaled the most sweeping expansion of the very organisation that has served as the Washington Consensus's guiding light and lightning rod alike: the International Monetary Fund. "

The six-point agreement from the G20 communiqué, as laid out by Brown:
Set new principles for the global banking system: bring shadow banking system, i.e. hedge funds, into regulatory framework; improve accounting standards; provide oversight of credit ratings agencies; and "name and shame" non-compliant jurisdictions that serve as tax havens. Part of this will entail the creation of "colleges" of regulatory agencies and the creation of the Financial Stability Board to report on developments in global financial markets.
Clean up banks' toxic assets through a common global approach.
Collectively implement $5 trillion in macroeconomic stimulus by end of 2010; pledge central banks to monetary expansion; infuse capital into IMF for increase global liquidity and crisis response capacity.
Continue to strive for poverty reduction through Bretton Woods institutions, necessitating increased accountability, transparency and fair representation of developing countries in these institutions' governance; heads of staff should be appointed through a competitive, merit-based selection process.
Protection of trade, 90 percent of which depends on finance; and a pledge of $250 billion in trade finance and additional funds through multilateral development banks.
Promotion low-carbon growth and a move toward creating a post-2012 worldwide climate change regime.

Sir Nicholas Bayne, a former top economic diplomat with the British Foreign and Commonwealth Office and lecturer at the London School of Economics and Political Science, said the summit was a success in that delegations were ready to work together and put their main focus on aiding countries in the most difficulty with capital boosts for the IMF.

"But the key point will be to get the promised sums delivered," Bayne said.

Just as significant as the results of the summit is what was noticeably absent from the communiqué. The G20 agreement lacked teeth on several specific issues such as climate change, specific financial regulations, and politically charged issues such as exchange rate policies and over-consumption in the United States, phenomena that may have helped produce unsustainable financial bubbles.

Ed Miliband, the British government's climate change and energy secretary, said the G20 summit was a good opportunity to begin deliberations on climate change, but admitted there is another forum for that issue.

"The G20 shows that there is an understanding among world leaders that the world economic crisis and climate crisis can be solved together," Miliband said. "It is promising but challenging to get an ambitious climate agreement. There are frameworks for climate change discussions (such as the United Nations) and we need to respect that."

'The IMF is Back'

U.S. President Barack Obama may have been the last leader to take the press limelight following the summit, but the IMF – which not long ago was fighting futility - was the real star.

"Maybe some of you were in the IMF press conference at the end of the annual meeting last October," a beaming Strauss-Kahn

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said. "Some of you may remember what I said at this time was the IMF is back. Today, you get the proof."

The massive expansion of the IMF's coffers also enhances its role as forecaster and monitor of international economic developments. The progress of the G20's initiatives will be measured against IMF projections and forecasts, building a stronger case for economic information to flow through the Fund's research department.

"I'm really happy to be the head of an institution, which more than year ago in Davos, asked for a global stimulus," Strauss-Kahn said. "Nobody, no other institution, was able to see that the crisis would be so deep that we would need a global stimulus. We asked for that and we have been followed."

With the IMF's expanded role, the complexion of the world's response to the global economic crisis will have a distinct IMF flavour. The United States, unable to extract pledges of additional fiscal stimulus from skeptical France and Germany, must now look to the IMF as its last instrument of economic power during the crisis.

A less-publicised but equally powerful prong of the IMF's post-G20 response will be the expansion of its new Flexible Credit Line, which does little to hack away at Washington Consensus orthodoxy and in some sense reinforces it.

The FCL is intended to provide "preconditional, precautionary" IMF financing to countries with "good" IMF track records, which would include countries that successfully implemented IMF adjustment policies and have a history of successful repayment of IMF loans. Mexico recently became the first country to take advantage of the FCL, gaining access to $47 billion in IMF credit.

In one attempt to balance its growth while enhancing its accountability and transparency, the Fund will also end a longstanding, informal tradition of elevating a European to manage the Fund. Now, as the communiqué points out, IMF staff will be selected through a competitive, merit-based process.

The G20 also agreed to accelerate reform of the IMF quotas that determines how much of a voting share a country may have on directing IMF programmes.

A review on the realignment of IMF quotas, which currently give the United States an effective veto with 17 percent of the vote (85 percent majority is needed to pass an IMF package), will now be due in 2011 rather than 2013.

"They are right to say quotas need to be changed but there is a timetable for that," Brown said.

The IMF stopped short of recommending a transition away from the U.S. dollar as the world's reserve currency, although Strauss-Kahn stressed the "symbolic" value of the SDR allocation. Prime Minister Brown denied there is any threat to the existing monetary order, especially considering recent renewal by China and Russia of time-old criticisms that the United States is an irresponsible custodian of the world's reserve currency.

"Issues about international currency have not led to detailed proposals from anyone," Prime Minister Brown told reporters.

The U.S. veto at the IMF will therefore remain during these crucial years of IMF expansion. The Washington establishment and its policy consensus likely still hold the keys to the car.

"The IMF is also back as a policymaker," Strauss-Kahn said. "I'm not saying the different governments of the G20 are going to do all the time what we think is the right thing to do, but at least we are the partner to discuss with and analyse what kind of policy should be implemented."

The American Chastening

On a day meant for concrete solutions to a rapidly spreading economic crisis, there was no shortage of symbolism and cynicism as new global powers came to the world stage.

On the morning of the summit, a journalist

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representing a Saudi newspaper put it this way.

"The world's problems will be saved all in a building that is owned by the Emirates," he said with a smirk, referring to ExCeL London, the East London Docklands convention centre owned by the Abu Dhabi National Exhibitions Company.

Even the London Summit logo indicates a shift in political and economic power. It depicts the earth and sun shining brilliantly along its arc. Europe is on the verge of rotating into the darkness of night, joining its friends in the United States, while a beacon of light emerges from the East. "Stability, Growth, Jobs" is the tagline.

And the U.S. president, known for his talents with the spoken word, was also battling a cough and cold that brought his normally rousing speeches down to earth, much the same way his country's financial sector has been stricken by infectious leverage and toxic assets. Ultimately, President Obama was left atoning for the alleged sins of Wall Street, which are partly to blame for a crisis that will drop world GDP growth by approximately 1.3 percent in 2009, according to the IMF.

"We exercise our leadership best when we are listening, when we lead by example and show some element of humility," Obama told reporters.

"There were occasional comments [by other delegations], usually wedged into some other topic that indicated from their perspective that this started in America or this started on Wall Street, or this started with particular banks or companies," he added. "Perhaps what helped was my willingness to acknowledge that - and it's hard to deny - that some of this contagion did start on Wall Street."

While the summit revealed a new global economic landscape, it by no means created a permanent transformational shift. The United States and United Kingdom had considerable bargaining power during the summit, and used the fact that the summit was limited to one day of discussions to create pressure for parties to come to agreement. British officials reflected to that sentiment as they assured the media that G20 delegates would nail down an agreement.

"While the summit revealed a new global economic landscape, it by no means created a permanent transformational shift. "

"I don't think we'll get that many people back around the table soon so we've got to take action today," said Lord Peter Mandelson, British business secretary, hours before G20 leaders were to emerge from the discussion room.

"There is some lively discussion but we are going to reach an agreement today," added Stephen Timms, Labour Member of Parliament for East Ham and financial secretary to the Treasury. "Everybody recognises that we need to deliver."

The Saudi reporter, who was less impressed than most by Obama's international popularity, predicted the summit would be about the United States and its allies pushing creditor countries to finance fiscal expansion in the United States and elsewhere.

"I think it is the sort of thing where Saudi Arabia, Japan and China will be told, 'look, you have to pay up,'" he said.

Bayne said there is more coordination between non-G8 participants on forming policy than is usually reported, but he added that countries may not be ready to assert themselves in the G20 environment.

"So far this has not led to major initiatives in the G20 or elsewhere," he said. "They are biding their time and testing the water. China's reserve currency idea is a first indicator. More may surface when Korea takes over the G20 chair in 2010."

What Comes Next

The lessons of the past and present may show that international cooperation is crucial to solving global economic crises. But just as important is the legitimacy of the organisation shepherding such cooperation.

President Obama has garnered praise from allies such as Turkey and Mexico for reaching out to the developing world. But as the G8 prepares to meet in Italy in July and the G20 again in New York in September, other nations are justifiably concerned that they are yet again confined to the backseat of global decision making.

As pointed out by Daniele Archibugi, a research director at the Italian National Research Council in Rome, the G20 represents 85 percent of global GDP but also includes only one country from Africa. Spain and the Netherlands have greater GDP than Saudi Arabia and Argentina, and while the former were invited to the G20, they are not officially included in the G20 while the latter two are. Countries with large populations but small aggregate economies, such as Bangladesh, do not even receive invitations to the summits that determine so much of their future.

"The inability of the G20 to come up with solutions is largely dependent on its institutional nature," Archibugi wrote in The Guardian on March 28. "In a world that demands greater accountability in world politics it is inconceivable that everyman's problems should be addressed in summits held outside the confines of democratic logic."

Bayne said the G8 is not necessarily ob-

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solete. While the G20 has been engaged primarily with financial and macroeconomic issues, the G8 has a much broader scope of issue areas to work on.

"If the G8 can effectively co-opt the leading emerging markets they can still play an effective agenda-setting and initiatory role," he said. "The Japanese chair did not do this in 2008, for fear of China. Italy this year and Canada next year may do better."

Strauss-Kahn and Obama also endorsed an increasingly multilateral approach to the economic crisis response, but it remains unclear how this will be put into practice before the next major institutional reform, the 2011 IMF quota review, comes through.

"Last time you saw the entire international architecture being remade," Obama said of the Bretton Woods meetings following World War II. "Well, if there's just Roosevelt and Churchill sitting in a room with a brandy, that's an easier negotiation. But that's not the world we live in, and it shouldn't be the world that we live in."

Strauss-Kahn said extending the G20 to be G24 or G25 with the addition of several "low-income countries" would provide an accurate representation of the world economy.

"Everybody has their own recipe – there was 12, then 13, 14, 15 and finally it has been the G20," Strauss-Kahn said. "If we really want the G20 to be a body of governance of globalisation, then we certainly need the G20 to be increased to include some country representatives of the low-income countries."

The rest of the world, still declining into recession, may not be able to wait that long.

Resources
You can view the G20 communique at HYPERLINK "http://www.londonsummit.gov.uk/en/summit-aims/summit-communique" http://www.londonsummit.gov.uk/en/summit-aims/summit-communique.

The G20's Specific Plans for Strengthening the International Financial System: HYPERLINK "http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-finsysm" http://www.londonsummit.gov.uk/resources/en/PDF/annex-strengthening-finsysm.

IMF Resources and the G20 Summit: HYPERLINK "http://www.imf.org/external/np/exr/faq/sdrfaqs.htm" http://www.imf.org/external/np/exr/faq/sdrfaqs.htm.

Why are Scholarship Bonds so Long?
By Siddharth George

Many organisations offer attractive merit-based scholarships to entice talented students to join their staff. Often, in exchange for sponsoring the scholar's studies, the organisation will require that the scholar commit to work for it for a pre-determined length of time. I term this length of time the scholarship's 'bond length'. In this article I will propose a model to explain why scholars often think scholarship bonds are too long. There are 2 actors in my model: the sponsor (organisation) and the scholar. I make the (quite valid) assumption that sponsors set bond lengths aiming to maximise their own net benefit. To that extent, perhaps, they do not consider their scholars' interests. To simplify analysis, I also assume that both scholars and sponsors exist in perfectly competitive markets, with little or no ability to influence market prices (ie. bond lengths). In actual fact, large sponsors may be able to influence the behaviour of other sponsors, especially in a small market.

First, we consider the sponsor's interests. We neglect marketing costs and costs to administer the rigorous selection process (which could well be significant), so initially, at year 0, the sponsor starts off with benefit

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= cost = 0. Say the scholar's course of study is 3 years. From year 1 to year 3, the sponsor incurs the cost of the scholar's tuition fees. The sponsor has so far not received any economic benefit from the scholar. We shall assume (quite reasonably) that the sponsor's cost curve is linear, ignoring inflation, and barring significant or abrupt fees adjustments.
This curve also constitutes the scholar's benefit curve from year 0 to year 3. After year 3, having completed her studies, the scholar is still yet to incur any economic cost in connection with her scholarship. At this point, she might well consider whether she should break her bond, weighing her potential gain against the financial and moral cost. This choice is not examined here.

After graduating, the scholar returns to work for her sponsor. From year 4 onwards, the sponsor begins to reap benefit on his investment in the scholar. The monthly return on his investment is the difference between the scholar's monthly salary and the salary she could command on the job market (the value of the scholar's labour hours). I call this the scholar's 'wage differential'. In other words, the sponsor is under-paying the scholar and thereby earning a net monthly benefit. How does this wage differential arise? On the job market, the scholar would command a higher-than-median wage, because she is a better-than-average quality worker, as her award of a selective merit-based scholarship signals. Her sponsor, however, will pay her a salary closer to the median wage. The sponsor must do this – else his investment in the scholar will never break even. The scholar's market wage rises faster than her salary at her sponsor organisation – the wage differential grows every year as experience nurtures the scholar's talent. Thus the sponsor's benefit curve rises ever more steeply.

Because the sponsor's cost curve is linear and his benefit curve rises ever more steeply, the sponsor's benefit curve will eventually cross his cost curve. At this point the sponsor 'breaks even'. The sponsor has gained benefit from the scholar equal to his investment in her. If the intersection occurs t = x years, the sponsor will ensure bonds are at least x years long. Beyond x years, the sponsor records a net gain on his investment. But what prevents the sponsor from making bonds infinitely long?

To understand this, we must first examine the scholar's cost curve. While studying, the scholar accrues benefit (equal to her tuition fees) and incurs no cost. Once she starts for the sponsor, she incurs a monthly cost equal to her wage differential. I posit that the scholar's cost curve rises ever more steeply – for 2 reasons. The first is her rising wage differential. The second is a rising opportunity cost associated with being in the 'wrong job'. While it is typically feasible for employees to leave their current job for a more suitable one, a bonded scholar cannot. Moreover, it is unlikely that a scholar, especially one being sponsored for her undergraduate studies, knows what the 'right' job for her is. It is, therefore, likely that the scholar has not committed to working with the 'right' organisation. Perhaps, while studying economics at the LSE, she developed an irrepressible urge to become an investment banker. It becomes increasingly costly for the scholar to stay in her present job as time goes on because, amongst other things, she builds more job-specific skills and less transferable skills. Thus the scholar's cost curve rises at an increasing rate.

At the intersection of the scholar's cost and benefit curves is her 'break-even' bond length (say, w years). Beyond w years, the scholar records a net loss. While the sponsor's benefit curve and the scholar's cost curves are similarly shaped, they are not the same curve, because the scholar faces the additional cost of being in the 'wrong job'. Hence, the scholar's 'break even' point occurs at a shorter bond length than the sponsor's (ie. x > w). They will coincide only if the scholar's cost of being in the 'wrong job' is negligible (ie. x = w * cost of being in the 'wrong job' = 0).
What prevents the sponsor from making bonds infinitely long? Arguably, average scholar quality is inversely related to bond length.

This simplified model provides some insight into why most scholars perceive bonds as being too long. It also supports anecdotal evidence from bonded scholars who advise against taking up a scholarship 'just for the money'. Lastly, we learn that most satisfied scholars are happy because they are in the 'right job'. As Confucius said, "Love your job and you will never work a day in your life." If only things were that simple.

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ECONOMICS OF LIFE

The Economics of Studying

A General Theory of Studying and Examination Mark Determination

By Rifdi Rafiuddin

Have you ever been worried that you are studying too little that you might fail in your exams? Or perhaps you think that you are studying a tad bit too much? How many hours should you study on average every day to be able to achieve the maximum possible mark that you can in your exams? If these are the questions that continually fill your mind whenever you are pondering over a difficult question in an Economics problem set (or keep u awake at night while you're doing any other essay question for that matter), you might consider starting to think about studying as a Homo Economicus!

In the first of the Economics of Life series, I will be analysing the economics behind studying. Studying, like many other daily activities that we carry out every day, is in fact very similar to other economic activities that happen in the market and it is amazing how many parallels can be derived from the different economic theories and models. However, like many other economic theories, there are many assumptions that have to be made to simplify the model, this being no exception.

The first and main assumption that has to be made is that the mark that you achieve during an examination is directly proportional to the amount of knowledge that you attain while you are studying. The amount of knowledge that you attain when you are studying is in turn directly proportional to the average number of hours that you spend studying in a day. This assumption allows knowledge to be quantified in some sense from its intangible form, and defines it as the average number of hours that is spent studying by a person:

Average Hours Spent Studying in a Day (X) = Total Hours Spent Studying / Total Number of Days

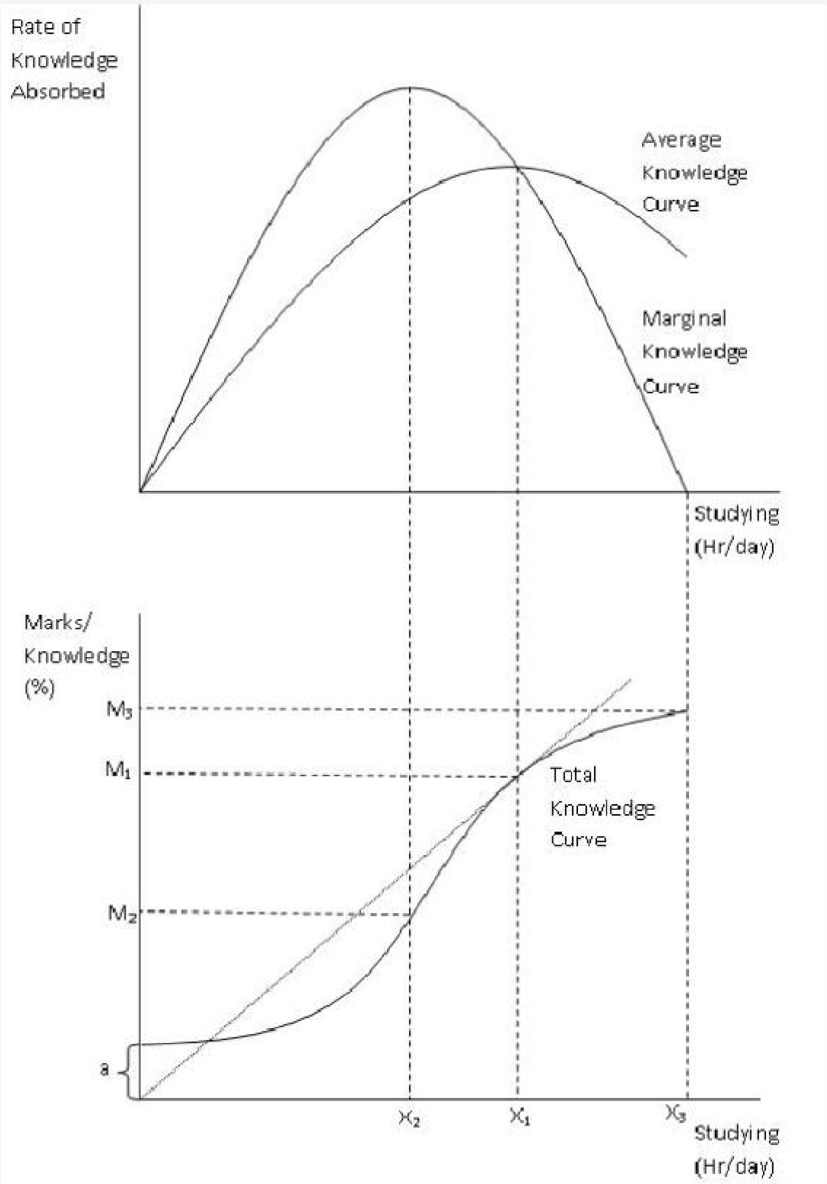

Diagram 1: Relationship between Marginal Knowledge Curve, Average Knowledge Curve and Total Knowledge Curve

Let's begin from Diagram 1, which shows the Marginal Knowledge Curve (MKC), the Average Knowledge Curve (AKC) and the Total Knowledge Curve (TKC). As you start studying, the rate of knowledge absorption will increase as shown in the MKC, thus resulting in the TKC to increase at an increasing rate up till the point X 2. This can be seen in our everyday pursuit for knowledge. After overcoming the initial fight against sleepiness, we will get into the rhythm of studying and the rate of increase of knowledge that we will attain will start increasing. Although this level of studying will probably bring about the highest marginal rate of knowledge absorption, sadly, being humans after all, this level of knowledge absorption is not sustainable and the rate at which knowledge is being attained after that point will start decreasing. Beyond this level, we will start experiencing the law of diminishing rate of marginal knowledge absorption and each hour spent studying will not bring about as much knowledge as the hour before. Nevertheless, the marginal rate of knowledge absorption will decrease till there comes a point in time

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when the level of knowledge absorption will become zero as a result of lethargy and loss of concentration and it doesn't really matter how much you try to concentrate to absorb more information because you will end up not absorbing any knowledge at all. This can be seen at point X3 in Diagram 1.

Marginal Rate of Knowledge Absorption = Δ in Total Knowledge / Δ in Number of Hours Spent Studying

As the marks that you achieve during exams are assumed to be directly proportional to the amount of knowledge that you have, the maximum mark that you can achieve is at the point when the marginal rate of knowledge absorption is zero, which is at the point when it doesn't matter how much you try to study, you have reached the limit to which you can absorb any information, which is point X3. After that point of time, there really isn't much use slaving away in your books because the cost of continuing to study is more than the cost of doing something else, such as sleeping and resting, which might end up being beneficial to you as the more that you rest, the more energised and refreshed you will feel and thus this will enable you to regain your concentration. Furthermore, a little bit of physical exercise will definitely be beneficial to your health which in turn will benefit your studies in the form of increased concentration.

As we continue, we realise that the marginal rate of knowledge absorption changes as we increase the number of hours that we spend studying. At the point where the tangent to the TKC is at its steepest, we will be able to attain the highest marginal rate of knowledge absorption, and thus at that point of time, we should be able to achieve M2% of the marks in the examination. However, as we continue to increase the number of hours that we spend studying beyond this point, the rate of increase in the percentage of marks achieved during an examination will begin to decrease. Therefore, this will continue till the point in time where we achieve the highest average amount of knowledge attained per hour of studying. This level represents the level at which we are able to gain the highest amount of knowledge per hour of studying, and is shown at the point where the ray from the origin touches the TKC in Diagram 1 and will give M1% of the marks in an examination. The highest percentage of marks that can be attained is at M3% with X3 hours of studying, which represents the level when the marginal rate of knowledge absorption is zero. This will probably be the level that people who derive utility from getting a high mark during an examination will aim for as they will consider the utility that they gain from a high mark to be more than the utility that they gain from leisure. This occurs when the achievement effect of achieving a high mark outweighs the substitution effect of having more leisure time and explains why some people are willing to devote long hours studying.

The point at which each person reaches a certain level differs from person to person. Some people, (also known as geniuses), do not have to exhaust the entire length of their marginal rate of knowledge absorption curve to be able to achieve the maximum possible mark that can be attained during the exams (scoring 100%). Similarly, a person who does not spend any time studying might not necessarily get zero marks for the exams (although there is a very high possibility that the person might fail) because of any prior knowledge or having attained a certain level of knowledge based on past studies and education. Therefore, achieving an M3% of the marks in an examination does not necessarily mean that you score 100%. Neither will not studying at all necessarily give you a zero mark in your examination due to previous education, which can be seen in Diagram 1 as the area a, which represents any prior knowledge that a person might have.

Hence, after all the discussion on how the rate of knowledge absorbed will determine the percentage of marks that a person will get during an examination,

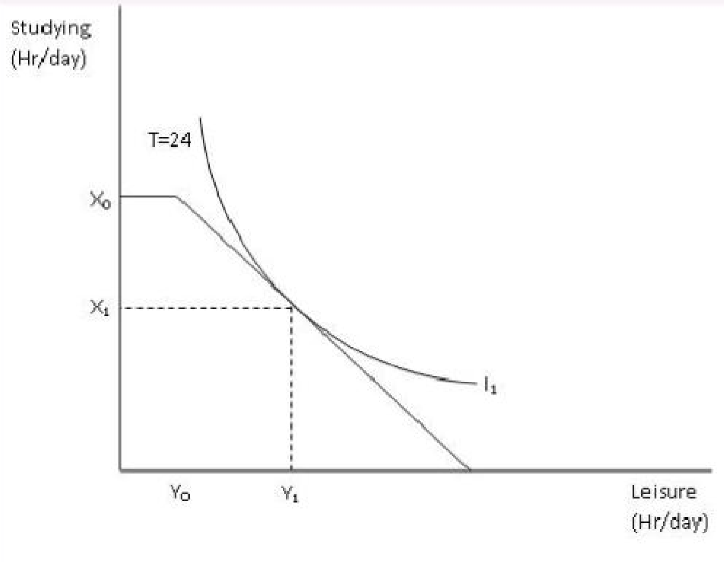

Diagram 2a: Hours Spent Studying and Leisure (I_1)

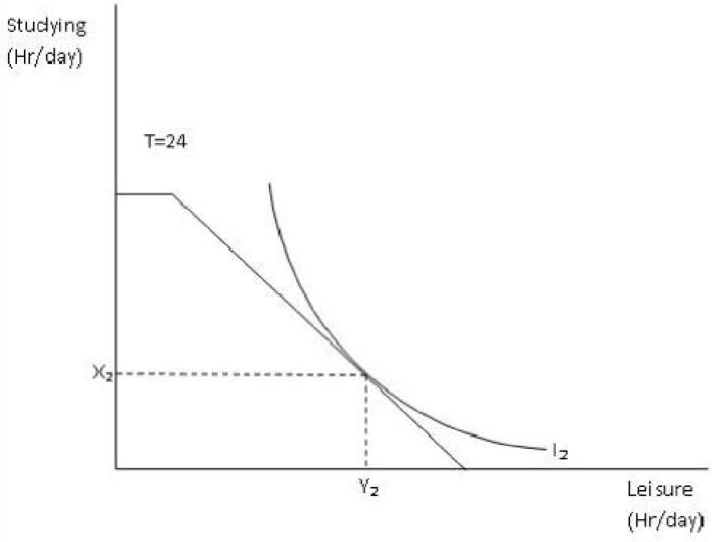

Diagram 2b: Hours Spent Studying and Leisure (I_2)

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the important question can finally be answered. How many hours should you study in a day? The answer, unsurprisingly like most other decisions concerning rational choice, depends on what you value more, marks or leisure. A rational person will continue to strive for higher marks till the point in time when the person derives more disutility than utility from an additional unit of time spent studying. Therefore, the average number of hours that a person will devote for studying in a day will be the point when the marginal utility of studying is equal to the marginal utility of leisure.

The amount of studying that a person undertakes in a day can be explained using indifference curves as shown in Diagram 2a, 2b and 2c. Let's assume that on average, the hours spent in a day are split between the time spent studying and the time spent doing something else (leisure). Notice that in Diagram 2a, 2b and 2c, the time line levels off at the top to indicate the time required for sleep and doing other necessary daily activities, therefore, even though a person might want to devote every single hour that is available on studying, the person is restricted by the need to rest. Diagrams 2a, 2b and 2c represent the different average proportion of time spent studying in a day. In Diagram 2b, the person devotes a larger proportion of time on leisure as compared to studying whereas in Diagram 2c, the person devotes a larger proportion of time on studying as compared to leisure. These diagrams show that the individual decides how much time will be spent on studying and leisure in the day based on their preference. Be aware that because the marginal rate of knowledge absorption differs from person to person, although it is entirely possible for Diagrams 1 and 2 to be related, there is an equal likelihood that a person will be required to devote a much larger proportion of time than X1 hrs of studying a day to be able to achieve an M1% of marks in an examination as compared to another person who would only require to study on average X1 hrs a day to achieve an M1% of marks in an examination.

In conclusion, the number of hours that you have to study in a day really depends on the individual. If a person has a high level of prior knowledge, this will be very beneficial as the area a in Diagram 1 will be much larger, thus enabling the person to achieve an initial high percentage of marks in an examination. Similarly, if the person has a high marginal rate of knowledge absorption, the person will be able to attain more knowledge from an hour of studying and thus will have a steeper MKC. This in turn will result in the person having a higher TKC as compared to a person with a lower marginal rate of knowledge absorption. This can be seen in Diagram 3 where a person with a higher level of prior knowledge a2 as compared to a1, and a higher marginal rate of knowledge absorption, will have a higher level of total knowledge at TKC2 as compared to TKC1. Therefore, although both individuals study the same average number of hours in a day X1, Individual 1 only achieves M1% of the marks but Individual 2 achieves M2% of the marks. This explains why some people do better in examinations despite studying only as much as another person. Therefore, what we should strive to aim for is to increase our marginal rate of knowledge absorption, our level of prior knowledge as well as the proportion of time that is spent on studying in order to get a higher mark during the examination.

However, this model is not able to take into account some factors that affect our performance during an examination. Sudden panic attacks, anxiety and our state of mind and health condition during the examination might affect the marks that a person is able to achieve. Although knowledge retention is taken into account by the marginal rate of knowledge absorption, we tend to forget information that we do not revise consistently, which basically places importance on the need to constantly revise. Nevertheless, this model is able to present a simple depiction of how economic models can also be used in the general theory of studying and examination mark determination.

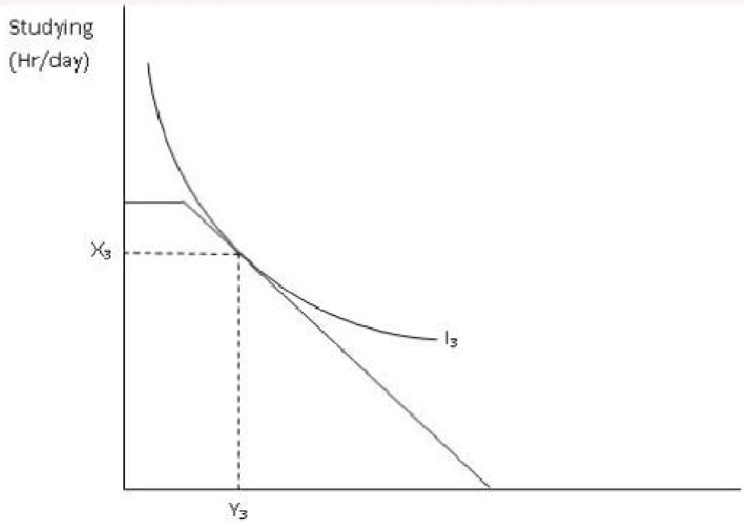

Diagram 2c: Hours Spent Studying and Leisure (I_3)

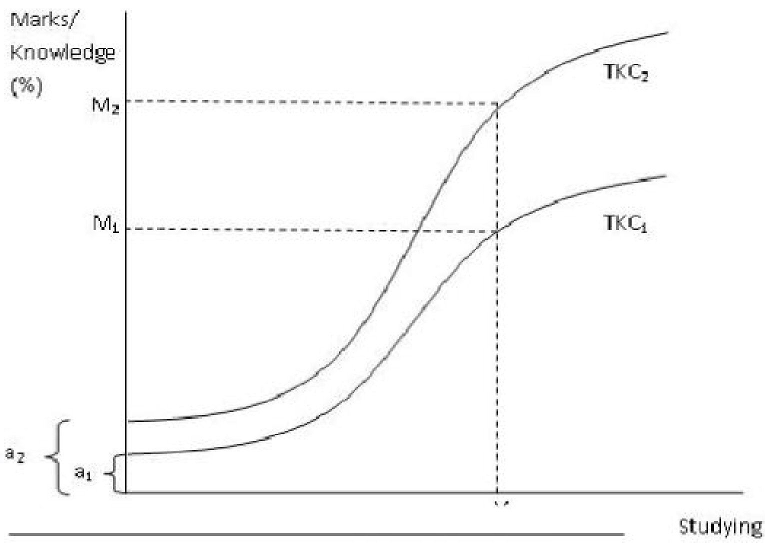

Diagram 3: Total Knowledge Curves of Individual 1 and 2

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Who Really is Fred the Shred?

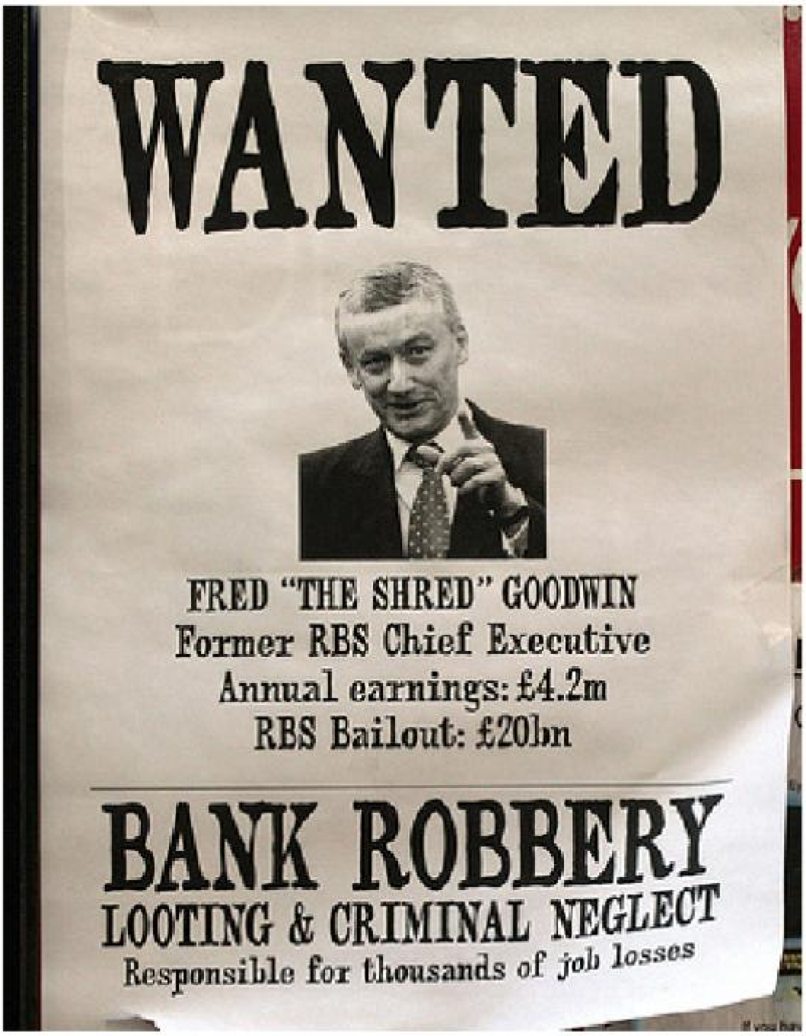
By Romy Fawehinmi

If there is a date that accurately captures the demise of Sir Fred Goodwin, then it is more than likely is October 9, 2007. This was the very day that the now –nationalised RBS group along with some financial institutions acquired Dutch Bank, ABN AMRO. Perhaps Fred the shred saw this as a "GOOD WIN" but this deal proved to be catastrophic. But before one criticises the Scottish Banker, it is important to note how Fred got to the top of the food chain.

Born in the Scottish town of paisley, Goodwin went on to study Law at Glasgow University. He then joined Touche Ross now known as Deloitte and subsequently qualified as a Chartered accountant, he prospered at Touche Ross becoming a partner at the young age of 30. His work at the financial advisory services firm gave him a taste of the banking world, after working on a due diligence report for the takeover of Clydesdale Bank by National Australia Bank. He impressed Australian Bank and was hired . At Clydesdale, he rose to CEO by 1996. During his time at the Scottish commercial bank he gained his infamous nickname of "Fred the Shred" due to his penchant for mass cost cutting.

Goodwin joined RBS in 1998 as Deputy CEO and it was the NatWest takeover of 2000 that saw him rise to prominence. But not satisfied by this accomplishment, Goodwin wanted RBS to become a financial powerhouse. During his reign at the helm of RBS, the bank went on a spending spree. These acquisitions proved beneficial on the balance sheet with RBS assets quadrupling and profits soared during his six years as chief executive.

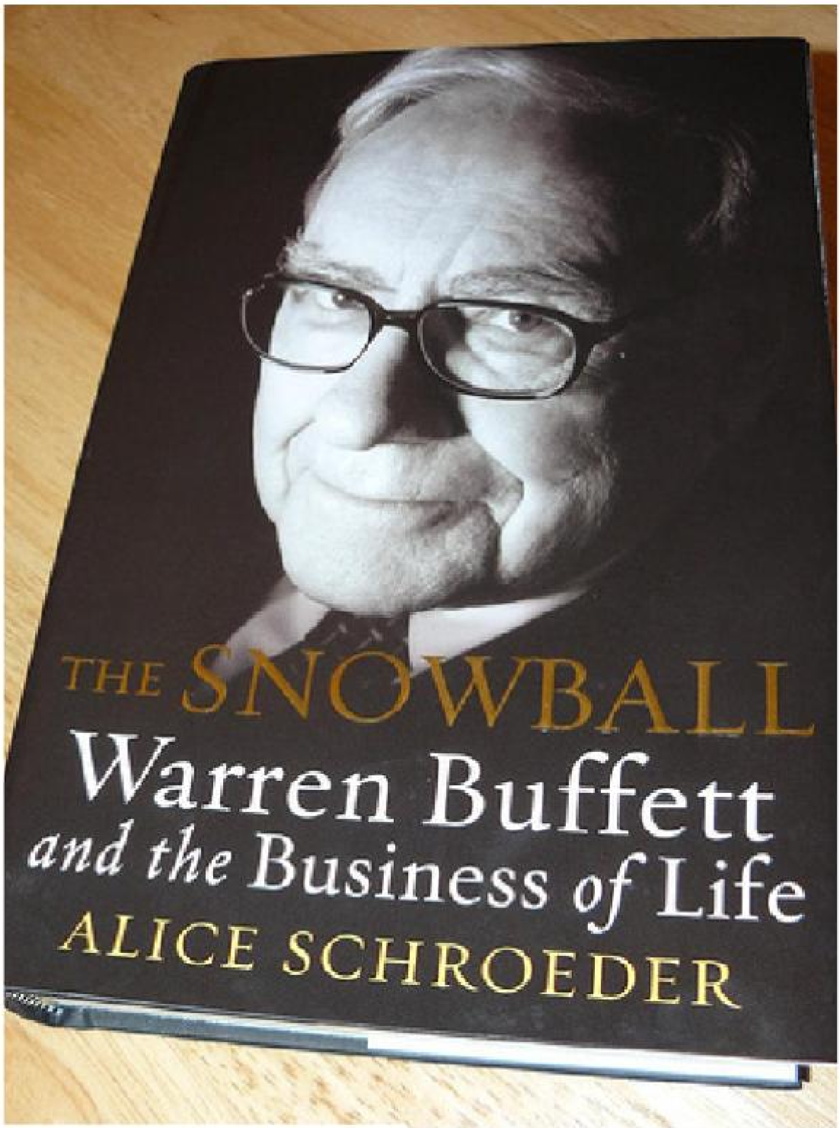
However, it was the Goodwin's strategy of growth by acquisition that led to his downfall. The ABN AMRO deal was a diabolical mistake. RBS reported a record loss of £24.1 billion for 2008 about 70% of this loss was due to the write-down as a result of this takeover. This unfortunately meant the end of Goodwin's tenure at RBS. The government stepped in to ensure that RBS would not collapse but Goodwin had to step down. In the last few months, he has seen his name, more specifically his pension all over the media. Some have called it obscene, while others feel cheated by the system. If we look at Fred Goodwin's achievements objectively it is difficult to say that he does not deserve to be remunerated handsomely. RBS post the millennium was at the top of its game, much of this due to the leadership of Goodwin. He received numerous awards in recognition for his excellence as a financier, making the Royal Bank of Scotland the 5th biggest bank in the world by market capitalization at its peak.



BOOK REVIEWS

The Snowball

By Wensi Lao



Two biggest features of this book are 1) it is thick and heavy (literally) and 2) it has not much to do with economics at all (the only economics related content I could recall is a comment on Mr Buffet's famous quip about derivatives being financial weapon of mass destruction, which is explained in layman's economics terms anyway). When I set out to read this, I was hoping to gain some insight into Mr Buffet's investment ingenuity and learn some neat stock picking tricks, well now I can honestly say to readers, if you are looking for investment advices, go look elsewhere. So why am I reviewing it for all the knowledge-hungry people in LSE if it neither teaches economics or investment? Simply for the obvious reason that this is a fascinating book and is truly delightful to read.

Before I start, I just would like to emphasise that this book is an biography, readers are advised to bear in mind that you are reading a great man's lifestory, A STORY. So drag yourself out of the usual utilitarian reading mode we have grown so accustomed to at LSE (which is rather unfortunate), sit back, really sink into it, and just let the tale unfold.

Speaking of Warren Buffet, several things spring to people's mind, Berkashire Hathaway, World's richest man (even though that status is shortlived as the stockmarket has been battered since the ranking was published in 2008), the legendary investor with surreal track record, Sage of Omaha, etc: the "shiny trophies" representing Mr Buffet's grand achievements. Fair enough I guess, people remember great men by what they have done rather then what kind of person they have become. Hence previously literature on Mr Buffet has very much focused on his investment thinkings and his understanding of the stock market and the economy. The Snowball is very different in that sense. You will be surprised by how UNTECHNICAL this book is, given that the writer Alice Schroeder had a stellar career at Morgan Stanley as an equity research analyst. As rightly claimed by the publisher, The Snowball is an deeply intimate recount of the legendary investor's personalities, character, moral values, life philosophies and journey through life. You might even go as far as finding this to be as personal as any biography could get. This great personal depth and myriad of details fill every page of the book, giving readers an unprecedented sense of connection and empathy, thus making The Snowball such an capitivating read.

It is not my job to produce a two page summary of the book. For a starter, it is not possible as there are simply too much information, moreover, it would become a spoiler for readers. However, I would like to share some thoughts I acquired from reading The Snowball and the lessons I personally feel I can draw from the book.

One thing struck me quite strongly was Mr Buffet's claim, echoed by Bill Gates(the pair are very close friends), that the essential ingredient for success is FOCUS. A lot of famous quotes on success mentions about interest, diligence, passion, etc; but I guess FOCUS really sums it all up really nicely. When you have focus, passion and interest are pre-requisite and hardworking comes as a natural thing. Rather unsurprisingly, Mr Buffet, as well as Bill (I don't feel bad calling him by first name as this is norm amongst computer nerds), is a very focused man. At the beginning phase of his career, Mr Buffet used to shuts himself away in his room for 14 hours on a roll, pouring through Moody's manual and companies' financial reports. That daily routine went on for several years!! As Mr Buffet's career developed and repuation grew, this solitary working style was no longer in play, but he still spend any available minute monitoring stocks and analysing companies. Even, when he goes on social events and even holidays, his focus has never really left his work.. There is a story about the time Mr Buffet tried to negotiate a deal over the phone while he was on a holiday boat trip, but the phone lost signal as the boat went into a canyon. As no other phones are working either, Mr Buffet had to give up and subsequently lost the deal, which he later refered to as a great pitty. Now that is focus and love for your work.

I was quite dismayed when I seemed to have realised that Mr Buffet's success is not replicable. So if I want to be World's next richest investor, I will have to think up my own way. Admittedly in the book, Alice Schroeder did explain in quite heavy details the basis of Mr Buffet's investment ideas and the ways through which he developed his methods. Readers are can follow the Sage's footpath as described in The Snowball and start ploughing through a copy of Security Analysis by Benjamin Graham(another 900 pages of very heavy reading), which Mr Buffet has literally memorised by heart and regard as the Bible for stock picking. But to me, knowledge only plays a small part of in the making of Warren Buffet; the upbringing in the great depression, education and influence of Ben Graham, the unique post-war social economic circumstances at the time, his ability to discern good managers with potentials; his strong moral principles and high regard for reputation, social network brought by his lifelong friendship with Kay Graham and last but by no means least the devotion and love of his wife Susan all play integral role in Mr Buffet's rise to greatness. I am inclined to say those things are the gifts of fate. Mr Buffet has this life philosophy of keeping his own inner scorecard. I guess the message I would try to take away is always judge myself compared to how much I am potential of achieving in a given situation, as for other things, just let fate take its path.

At least I got the consolation that the great man himself can get sentimental when picking investment targets. Amusingly, I was amazed by Mr Buffet's own admittance that buying Berkshire Hathaway stocks, a textile enterprise in the 1960s, was THE biggest investment mistake he made. Even though as it later became apparent that Berkshire Hathaway's business model was clearly obsolete and was making a loss at whatever business lines it was running, Mr Buffet kept increasing his share of the company. When Mr Buffet finally acknowledged that Berkshire Hathaway is a dog, he was so reluctantant to let it go that he started buying companies under the name of Berkshire Hathaway and turned the textile mill into a holding company. Now 40 odd years later, we have the Berkshire Hathaway stock at more than $91,000, enough to buy a BMW M5. Just shows, a little sentimentality has a place to survive in the ruthless stockmarket, as long as it's only a little.

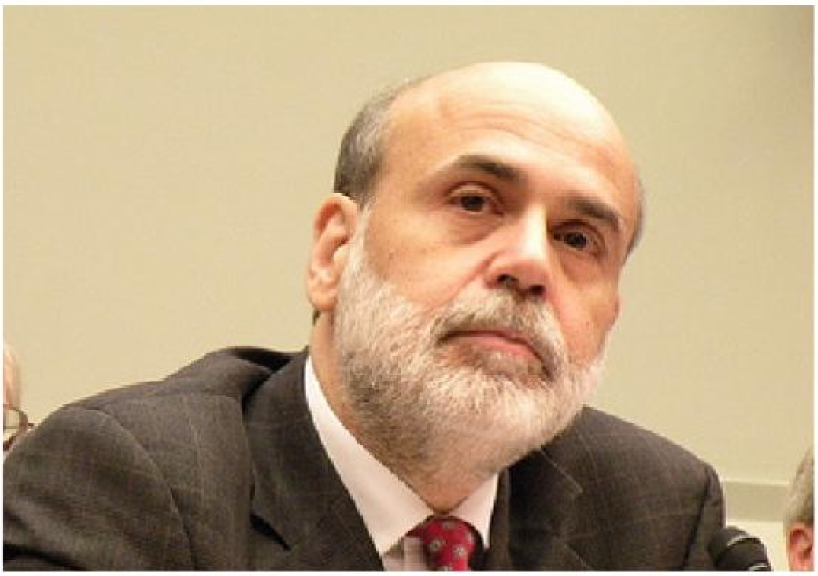
Ben Bernanke's Fed: The Federal Reserve After Greenspan

By Daniel E. Parisi

The Lent term of 2009 began with a visit by an individual whom most refer to as Bernanke. Dr. Ben S. Bernanke, the current Chairman of the Board of Governors of the United States Federal Reserve, graced the LSE with his presence on the 13th of January 2009 at the Stamp Memorial Lecture. Accompanied by Director Howard Davies, Bernanke spoke about the current condition of our global financial economy. As the inauguration of US President Obama was fast approaching, his words were most pertinent and projected an opinion that was presented with greater clarity than that of his predecessor, Alan Greenspan.

Still in the hay day of his career at the Federal Reserve, few biographies or biographical works have been written about him. Yet, in Ben Bernanke's Fed: The Federal Reserve After Greenspan, Ethan S. Harris has created a fine piece of literature that discusses the transition from Greenspan to Bernanke. As these two men have different opinions and tactics for controlling the monetary supply, Harris, a former research officer at the Federal Reserve Bank of New York, brilliantly outlines the nuances and provides an expert's opinion, which tends to be unbiased. By outlining the terminology and key events of the recent Fed, Harris is able to engage the reader in his tale of Federal Reserve decisions and reactions.

Through the background information on Bernanke's renowned study and analysis of the Great Depression, to the breaking down of the infamous 125 basis point cut of the Federal funds/discount rate, Harris presents the reader with a neat and organized canvas of the current Federal Reserve and how it plans to operate. This book is beneficial to anyone studying macroeconomics, as it outlines one of the more important figures and global economic influences of the US Federal Reserve while led by Bernanke.



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Animal Spirits
By Arjun Bali

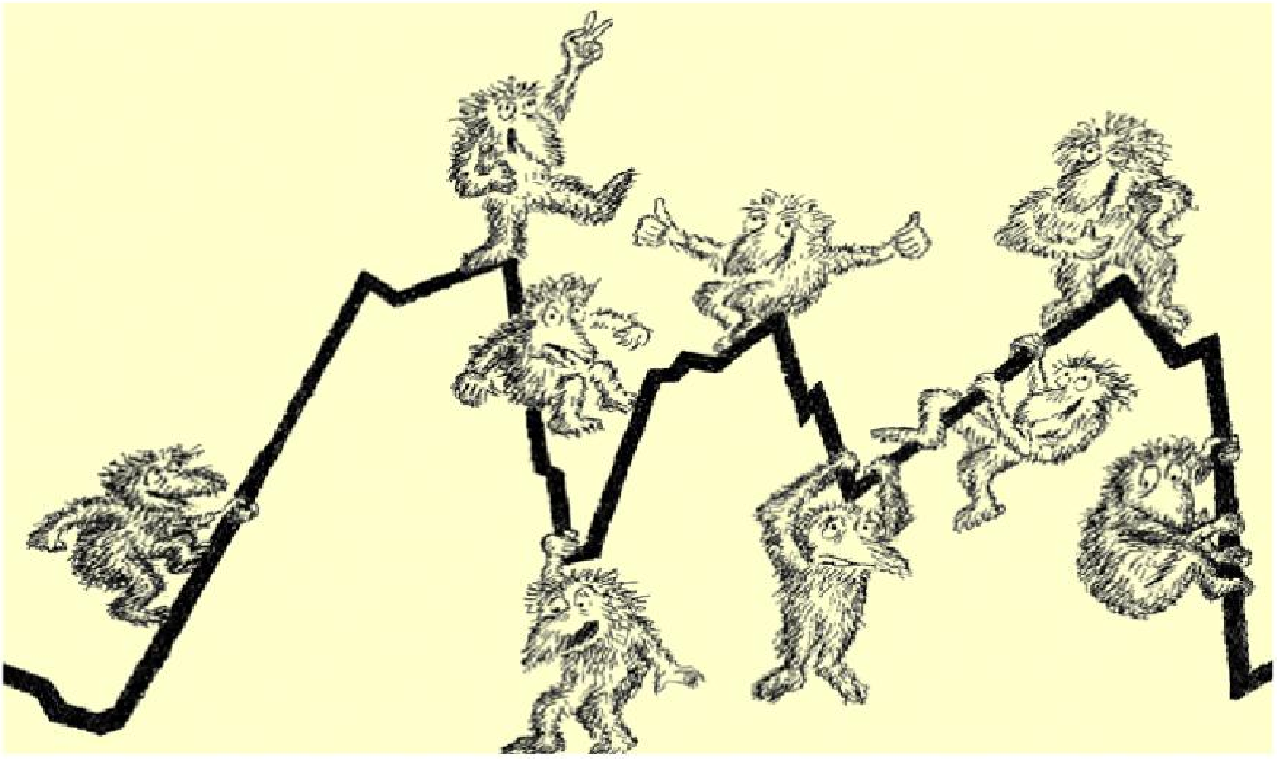
Akerlof and Shiller's theory of animal spirits provides an answer to a widely asked question: why did most of us fail to foresee the current economic crisis? It exposes the problems with the conventional wisdom that underlies current economic theory. Dynamics that trigger economic crises have been ignored by many professional economists who have become preoccupied with concepts such as "rational expectations" and "efficient markets". By intellectualising economic theory, policymakers have failed to recognise the human psychology that underlies decision making.

In their theory of animal spirits, Akerlof and Shiller point to five aspects of human nature that play a key role in our decision making process. These are confidence, corruption, money illusion, storytelling and fairness. Of these, confidence is the aspect which really fuels the business cycle. As it rockets, multiplier effects kick in which bring greater certainty and growth in the economy. As confidence plunges, the reverse occurs as a struggling economy suffers from a further reduction in spending and investment, creating a downward spiral which damages sentiment even more. Storytelling is the method by which confidence (or lack of it) can spread like wildfire throughout an economy.

Animal Spirits does more than just explain why recessions occur. Parallels between the current economic crisis and the events that led to the depression of the 1930's have been drawn using decision making psychology. Slack regulation and corruption were prominent in the late 1920s as they have been recently, thereby causing a "devil may care" attitude in the world of finance. After all, where is the incentive to care for others' interests when others are only worried about themselves? Such a psychological change is thought to be the reason for the large scale issuing of inappropriate loans from banks who knew that securities would be backed by private investors and not themselves.

The trade off between unemployment and inflation in the long run is also addressed. The authors put this down to money illusion, which is people's inability to factor inflation into their financial decisions. The UK economy may well face deflation (falling prices) this year, and the rational expectation for workers would be to take a nominal pay cut. However, many companies would chose not to do this because of the damage to loyalty and efficiency in the workplace. Companies therefore often make workers redundant rather than risk demoralising their workforce. Near full employment, inflation rockets due to increased consumer spending, thus creating the need for a balance to be created between inflation and unemployment.

Animal Spirits describes current and past events not in terms of economic agents or technical jargon, but in terms of human principles and emotions. These are ingrained so deeply into our decision making that any theory that did not acknowledge animal spirits would be an incomplete description about the way markets and the people within them work.



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