# THE BENEFITS OF SPECULATION:

## A BOND MARKET VIGILANTE REPLIES TO WILL HUTTON'S *THE STATE WE'RE IN*

PAUL STAINES

London is the world's premier financial centre, dealing more dollars than New York, more yen than Tokyo, more marks than Frankfurt. The world's bankers like the liquidity and sophistication of London's lightly regulated, free-wheeling markets.

The heart of the City's international trading culture is the floor of the London International Financial Futures Exchange[1] in Cannon Street.

Enter the marbled colosseum on a busy day and pass through the security checks, ascend the long gleaming silver escalator into the expansive atrium, swipe the entry card that admits you onto the trading floor and you come to a door. Open the door and you enter a huge throbbing mass of frenzied young pit traders. Between them these three thousand young men and women risk trillions every day. Bedecked in their firms' multi-coloured jackets, screaming prices, hand signalling buy and sell orders. It is a pulsating kaleidoscope of free market purity.

Welcome to the Capitaldome.

**IN DEFENCE OF SPECULATORS**

George Soros is the best known speculator, famous — like the man who "broke the bank of Monte Carlo" — as the man who broke the Bank of England in October 1992. Soros spectacularly walked away from the table with a billion pounds in chips.

Politicians ask: *What good is served by George Soros?* Politicians portray speculation as a zero-sum game — for every winner there is an equal and opposite loser. On the famous White Wednesday Soros' winnings came directly from the Bank and indirectly from the taxpayer; so politicians portray speculators as unsavoury spivs in pinstripes, profiting at the expense of the common good.

This analysis is exceedingly myopic. Speculators create a liquid market whose existence is essential for international trade. If a German firm — say Porsche — wants to buy some British steel, it needs to buy British pounds with marks to pay British Steel. Speculators who think that the mark is going to rise will happily sell Porsche British pounds on the foreign exchange markets. Without speculators Porsche would first have to find a British company which needed to buy marks to pay for German supplied goods. You only need to think of the nightmare of house-selling chains to realise what would happen to world trade. Porsche cannot buy from British Steel, until it buys British pounds from Hanson, who will use the marks to buy lira from Fiat, who will ... it's all very precarious, Porsche can be thwarted by Fiat dropping out of the chain. Foreign exchange markets and speculators provide ready liquidity.

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**FOR LIFE, LIBERTY AND PROPERTY**

Soros is not a villain. He is motivated by a noble goal,[2] to make profits for himself and his investors. *What good is served by George Soros?* He is the harbinger of economic reality. He did not break the Bank of England. Rather, the Bank tried to break the laws of supply and demand. In speculator-ridden free markets, the price is determined by the interaction of supply and demand, not the aged central bankers who are clearly no match for adrenalin crazed currency dealers. The problem is that central bankers, the world over, are never content to do a simple job badly, they or (more worringly) the politicians pulling their strings, get caught up with grand visions.

Fortunately the powerful currency markets are like a judge that can only be bribed for so long. When the Bank could no longer afford to bribe the markets to prop up the pound, the markets were swift to deliver justice. Soros and his like were simply members of the jury, giving their verdict on the fundamental dishonesty of the Exchange Rate Mechanism.

Speculators in the international capital markets provided a counterforce to the grandiose plans of the politicians who threaten — and in the past have succeeded — in debasing the currency. The proposed single European currency reflects the desire of the political elite to regulate the monetary conditions of the unsynchronised economies of Germany and Greece uniformly, an objective which is simply not realisable. The men and women of the investment banks at their screens and on their phones are fighting in the trenches for sound money and against what will amount to a European super-state. On White Wednesday, Soros' tactics defeated the politicians, but he is actually doing them a favour,[3] restraining them from converging the currencies of Europe with more ruinous results than they can imagine. Without speculators the collapse would have happened in slow motion; they just compressed the time frame.

Soros is not motivated by altruism, nor is he doing this just to prevent us becoming another Lander in a pan-European Reich. The fact that he is a mercenary makes no difference; he is still fighting the good fight. (To be fair, the anti-inflation hawks of the Bundesbank are not exactly keen on uniting their strong mark with the weak Greek drachma, but knowing the Germans they would not be averse to telling the Greeks how to run their economy. An anecdote gives the flavour of their attitude: Bundesbank President Helmut Schlesinger told Soros at an international conference in September 1992 that he was not against the concept of a European currency; it was just that he would rather it was called the mark.[4])

Just as investors and speculators force the politicians of Europe to focus on the economic consequences of their policies, President Clinton's friends complain that their tax and spend plans were frustrated by the "bond market vigilantes", who fear the federal government's multi-trillion dollar debt growing even more gargantuan. James Carville, the talented Clinton spin-doctor remarked: "I used to think that if there was re-incarnation, I wanted to come back as president or the Pope ... but now I want to come back as the bond market. You can intimidate everybody." The fear of Wall Street's vigilantes is clearly a powerful restraint on Clinton's latent prolifigacy. According to Bob Woodward,[5] Clinton is reported to have raged against the constraints imposed by the bond markets on US economic policy. Wall Street amusingly forced Clinton to reappoint the hardline Ayn Rand[6] fan and former Reagan appointee, Alan Greenspan, as chairman of the Federal Reserve (the US central bank). Just as stock markets reward successful companies, government bond markets reward prudent governments and punish profligate ones. If a state overspends it will cause the cost of its borrowing — and your taxes — to rise. This costs votes and is a powerful means by which capital (in the Marxist sense) restrains politicians.

The political elite's solution is not to tackle their failure to promote sound money. Their economic understanding is so poor that they think that they can outlaw speculation and control the currency and capital markets. Recently they have been railing against the dangers of financial derivatives — futures, options, swaps and other such exotica. These multi-billion dollar markets allegedly present a systemic risk to the world financial system. Never mind the thought that, on the contrary, Nick Leeson's bankrupting of Barings demonstrated the overall resiliency of the global financial system. Derivatives, used properly, allow risk to be controlled and provide incredible liquidity[7] for the fast, efficient allocation of assets. They also circumvent regulations and cross borders in a quick leap, much to the chagrin of politicians. These markets determine the relative price of money — money now, tomorrow and in decades hence. But this money builds roads, satellites, airliners, skyscrapers, the internet, manufacturing

plants, research laboratories and all the other capital hungry projects of the future. These markets really are the classical discovery mechanism through which we allocate our resources profitably. Reward comes to those who take the risks and we all benefit as a result. Risk takers built Canary Wharf and lost, but they also built the hugely profitable Sky satellite network. They lost on Eurotunnel and won on the Suez canal. Clearly without risk takers we would be materially worse off.

**THE STATE WE'RE IN**

Will Hutton's book *The State We're In*[8] topped the best-seller charts in 1995 — quite an achievement for a book on economics. His central assertion is that Britain's poor economic performance is because markets by themselves are not sufficient. He writes that the British economy is

> ... organised around a stock market based financial system ... Disengaged, uncommitted and preoccupied with liquidity, the financial system has been uniquely bad at supporting investment and innovation. The New Right reforms did not address this issue at all; indeed financial deregulation and liberalisation made it worse. Herein lies the chief economic reason for Britain's disappointing performance. (p. 21)

Hutton's other target is the supposed emphasis on the pursuit of short-term profit as companies' sole operational goal. Gentlemanly British capitalists allegedly sweat their assets to death. Lord Hanson, the asset-stripping Thatcherite entrepreneur *par excellence*, is contrasted with the corporate partnerships of Japan and Germany, where shareholders and stakeholders allegedly take a long view by "investing in people".

Hutton's critique of the class system, his analysis of the constitution and his call for a written republican constitution are not without merit. Alas, the same cannot be said for his theorising in the realm of economics. This paper will restrict itself to rebutting his case against British capitalism and the City's financial markets. His virulent attacks on the Square Mile's influence are unjustified, and I think some might say disingenuous coming from a former stockbroker. In passing, I note that he has tapped into the same vein of insecurity that Pat Buchanan taps into; the threat from the globalisation of world trade and the greed of the Square Mile/Wall Street.

Hutton rightly starts in October 1979, with Geoffrey Howe's abolition of exchange controls, followed by the abolition of credit controls, bank reserve requirements and other restrictions. This was Howe's finest hour: sterling soared on the back of oil and became an even more heavily traded currency, and the market was allowed to determine day to day interest rates.

Hutton thinks Howe vandalised the economy, citing principally the decimation of the production base. But a high pound and tougher open competition brought about a leaner, smaller, more competitive manufacturing sector, with less overmanning and an end to Luddite restrictive practises. Painful as the restructuring was in employment terms it has resulted in stronger, more competitive enterprises.

Britain's major companies are disciplined by liquid, furiously traded markets in their shares, bonds and debt. As a result they can raise capital more easily and cheaply in London than Frankfurt, New York or Tokyo. Hutton, however, thinks the City's short-termists force firms to deliver excessive and dauntingly high rates of return, in pursuit of quick profits. (These rapacious City slickers, by the way, are making profit demands for your pension.) Why, one has to ask, would rational investors take such short term views? Markets try to discount everything, and future sustainable and consistent profits are reflected in the share price. The recent £2 billion share issue on behalf of the Orange mobile phone network was a success, despite this business not being expected to make profits for several years. Investors do not demand short term profits so much as a good chance of a decent return over the period they are investing. For instance, a bond dealer buys bonds with a thirty year duration, he is thinking about the prospects for three decades, is this short-termism? If you put a million pounds into a company's bond that will not be repaid for ten years, you have, for better or worse, a long term relationship.

Hutton argues that financial institutions are disengaged from the firms they finance. The institutions buy and sell shares without ever seeing the businesses they are thus influencing. It is easy to mock Will Hutton for hypocrisy, this ex-stockbroker turned media-player — how many factories has he visited? But to do so would be to miss the point. Suppose that an insurance company has to meet a large number of claims for storm damage. The liquidity provided by stock market speculators allows them easily to turn their investments back into cash to meet those claims. Without the confidence afforded by the very liquidity so criticised by Hutton, the insurance company would not be able to invest in long-term ventures.

Hutton, like old Labour, disputes the superiority of market solutions; seeking more dirigist government policies, and would suffocate the spontaneous order derived from free markets with a blanket of yet more guidance and regulation.

Today's emasculated socialists may genuflect towards market forces. Free enterprise is almost universally accepted as the best means of production and distribution. But, high finance is still seen as the domain of the wicked top-hatted capitalist plutocrats of yore. Few politicians seem to be ready to defend the freedoms of greedy speculators. But if no one advocates the collectivisation of agriculture any longer, why should they be allowed to collectivise our monetary arrangements? Money is just as much a commodity as grain. To quote Engels, it is "the commodity of commodities".

According to Hutton the programme of the Conservatives in the eighties

> ... began to develop into a messianic laissez-faire philosophy, seeing Britain's future as a low-cost, deregulated producer in a free-market world with low social overheads and a minimalist welfare state. (pp. 57-58)

If only.

Despite this effort the failure lies "in the dominance of financial values over British corporate life and economic policy". Naturally, Hutton warns that "manufacturing exports simply have to play an enlarged role". Via some dubious statistics and even more dubious extrapolations, he insists that the state must "organise a national effort to organise a sustained increase in investment". In short: bring back a National Enterprise Board with beer and sandwiches at 10 Downing Street.

Over a hundred pages Hutton blames our economic ills on the ethos of the public schoolboys — with their cultural aversion to industry and their preference for making a small pile in the city and then retiring to the Cotswolds, while the gentlemanly capitalists of the Bank of England stand as their co-defendants. The Old Lady of Threedneedle Street is the midwife of markets; the stock market, bond market and the exceptionally wide and deep currency, money and derivative markets. As if this was not bad enough, turnover of

> equities exceeds any other financial centre. The financial sector's share of the value added in the economy is 20% — four times higher than the US and twice as high as Switzerland. (p. 143)

This staggering success, in attracting five hundred foreign banks and becoming the world centre for derivatives markets he admits

> allows London to keep its premier place in the world financial order. ... The Bank of England is no innocent bystander in the development of the financial system; it is the main actor. (p. 144)

Hutton thinks this is a disaster. He believes that the subtle, market-orientated way in which the Bank manipulates short term interest rates encourages short-termism throughout the city, raising the cost of capital to companies.

That must be why London's Square Mile raises more capital for international corporations than any where else in the world. Multinational corporations must be just hell-bent on enriching City whizz kids.

Hutton's drivel just pours out. The reason the city is so successful is the same reason this

> financial nexus is at the heart of the British economic malaise ... the financial system is even more market based, in the name of deregulation and liberalisation. ... [As if that was not bad enough, via derivatives] some of the biggest betters against sterling, when it was forced out of the European exchange rate mechanism, were British pension funds. (p. 165)

Those short-termist bastards, protecting your savings and making the currency more competitive. They probably knocked a few hundred thousand off the dole queues as well. But it gets worse; the liquid London stock market generates high dividends and drives high profitability at around 17% of GDP giving a real return of 8.7%. Japan's largest pension institution gave their aging population less than 1% return on capital in 1995, Germany's stock market returns 2.3% in

real terms.[12] How Japanese and German pensioners must pity the City's tight "financial armlock on the economy". Not.

I could go on, but the City's success is, according to Hutton, a failure. It is, he complains

> the centre of global finance. It has the biggest number of international bond dealers; it tops the table of international bank lending [just ahead of Tokyo, bad debt capital of the world]; and it is comfortably the world leader as a market for foreign shares. (p. 166)

Hutton concludes, just in case you forget how truly wicked the City's top-hatted capitalists are, that:

> The disintegration of family life and the decline in the public realm that disfigure contemporary Britain may seem far removed from London's financial markets, but they are as linked to them as remote shocks are to the epicentre of an earthquake. (p. 168)

Well, at least this is not the ranting leftist polemic of old. But Hutton's dazzling new ideology to lead us into the twenty-first century is described in his chapter "Why Keynesian Economics is Best".

## HUTTON'S ATTACK ON FREE MARKETS

What prompted me to write this paper was a seance I went to at a book signing in Islington. John Maynard Keynes,[10] speaking through Will Hutton, explained why free markets have to be corrected. The attack was theoretical and two pronged.[11] First, the rational economic man of textbook economics does not exist. Second, the market system is not optimal or self-regulating and is prone to fail. This requires addressing at some length because Hutton's critique of free market solutions provides the foundation which justifies his "back to the future" programme. The sophistry of his argument certainly impressed the Islington audience, who were elated to discover that Thatcher was wrong all along.

Undergraduate economics courses always include the concept of "rational economic agents", the standard counter-argument being that economic rationality is impossible because all the players can not have all the information or computational capacity required to make the best choice. Choices therefore do not always truly reflect the optimal option. According to Hutton this disproves

> the thesis that market outcomes are unimprovable because it concedes the possibility of mistakes and that individuals cannot be reliably expected to make a priori rational judgements. (p. 232)

So what? Hutton argues that this undermines the validity of the price signal in determining supply and demand. If this is the case, the main thrust of free market economic theory is rebutted. The Victorian economist Alfred Marshall described the market as the forum where forces of demand interact with the forces of supply; these are the two great blades of the market scissors, that produce a price at which the quantity demanded equals the quantity supplied and the market clears. Armed with price signals from the marketplace, buyers and sellers will carry on experimenting with production and purchasing until there is general competitive equilibrium.

Using all his journalistic skills and some colourful metaphors, Hutton explains — and disproves — Arrow and Debreu's General Equilibrium Model. He points out that finding a competitive equilibrium by reliance on prices alone is "a fiendishly difficult job; akin to solving simultaneous equations for changing variables in an infinite plane — which is impossible." Free market economists can only make the theory work using artificial conditions, such as ignoring the passage of time.[12] Competitive general equilibrium theory breaks down completely in the face of limits on the ability of agents to gather the totality of information necessary to compute optimal strategies.

> In other words, the major tenet of free market economics — that unregulated markets will of their own accord find unimprovable results for all participants — is now proved to be nonsense. It does not hold in theory. It is not true.

If prices are "wrong" for extensive periods, the market's self correcting capacities do not exist. Left to themselves markets do not find optimal solutions, therefore state intervention is justified. Hutton makes a strong case against the general competitive equilibrium model. If he is right then his ideas for the tempering of free market capitalism — for the socialisation of the economy with "stakeholding", corporatism and a Neo-Keynesian back-to-the-future programme — could be justified on the grounds that free markets are, to coin a phrase, not working.

## REFLEXIVITY

So, has Hutton stylishly destroyed a pillar of free market thought? Has he single handedly humiliated Kenneth Arrow, the Nobel Prize-winning father of the General Equilibrium Model? Not exactly. Arrow conceded that his old model failed some time ago, in an article in — funnily enough — *The Guardian*, Hutton's former newspaper.

Hutton's argument somewhat mirrors Ludwig Von Mises' case against the planned economy. Von Mises,[13] the father of the Austrian School, powerfully demonstrated the impossibility of socialist calculus in a command economy. Without a freely determined price signal influencing supply and demand, resources will be mis-allocated, a modern economy being too complicated to be planned. Planned economies are unresponsive to consumer demand, always degenerating into a system of rationing. If, for instance, the state tries to increase heavy industrial production and simultaneously to hold down the price of bread, it's likely to end up with thousands of tractors and no grain to harvest. Hutton's supply-side socialism is a far cry from a Soviet-style command economy; there is no plan for state-ownership of the means of production and distribution. But the state regulation/correction of markets will distort the price signal nonetheless.

That markets overshoot, crash and are sometimes unstable is a fact. Sentiment alone swings markets wildly, a fact that zealous free-marketeers are foolish to deny. That markets are imperfect is self evident. But whether or not this is a problem that can or should be corrected is not so clear. Away from the artificial models of economists our understanding of the world is inherently imperfect, because the situations we need to understand to reach our decisions are themselves affected by our decisions. There is a reflexive divergence between the expectations of people taking part in events and the actual outcome of those events. Normally the divergence is small, but at times it is so large that it becomes a factor in determining the course of events. This imperfection relates not only to our understanding, but also to the situation in which we participate. Reality is a moving target because it is affected by our understanding of it.

In his book *The Alchemy of Finance* George Soros uses the idea of reflexivity to describe the condition where a market's two-way feedback mechanism disrupts the course of events and the participants' perceptions in a way that gives rise to *disequilibrium*. Traditionally, we think of understanding as essentially a passive role, and participating as an active role. But in the real world the two roles interfere with each other, which makes it impossible for the participant to base any decisions on pure or perfect knowledge.

Classical economic theory assumes that market participants act on the basis of perfect knowledge. The market, over time, gets it right, due to the continuous interplay of endless buyers and sellers shifting prices along supply and demand curves — trial and error tends towards optimal outcomes. But that assumption is false. The market price is often — if usually briefly — very wrong.

A reflexive verb is one where the subject and the object are the same. In a market reflexivity means that the participants' perceptions influence the market in which they participate, while the market action influences the participants' perceptions. They cannot obtain perfect knowledge of the market because their thinking is always affecting the market and market conditions are simultaneously affecting their thinking.

Soros thinks that classical economic theory needs to be fundamentally reconsidered. Social sciences cannot be expected to yield results in the manner of the natural sciences. Thinking plays a role in shaping events, and not just the thinking of one rational economic agent but the thinking of all the market participants. This produces uncertainty in the sense that there is almost always a discrepancy between the participants' perceptions and the actual state of affairs, as well as the participants' intentions and the actual outcome.[14]

This divergence explains the dynamics of financial markets. Misconceptions and mistakes play the same role as mutation does in evolution. According to Soros, Hutton is right. The prevailing wisdom that markets always tend towards equilibrium is wrong. Markets are not always self correcting. Most of the time markets are in a state of near-equilibrium, giving near optimal outcomes, on the basis of the information available. However disequilibrium is inherent in the imperfect understanding of market participants. Financial markets are therefore inherently unstable.

Classical economics is like Newtonian physics. For day to day use it's fine, but it does not truly explain how the world works. Most of

the time markets function as the classical economists believe, Alfred Marshall's two great blades of the market scissors cutting along happily in a market in near equilibrium conditions. But when a condition which can be described as dynamic disequilibrium arises it brings about a state of collapse.[15] The developing science of complexity, chaos and evolutionary systems theories may prove to be more useful than the traditional econometric approach. Chaos theory, at the very least, bodes ill for any policy predicated on a centralised authority directing resources optimally. So what does the concept of reflexivity show us?

The market participant's thinking and the actual state of affairs cannot be identical, nor can they be independent of each other. Reality is reflected in one's thinking and by one's decisions, and individuals think about events that are affected by their decisions. Sub-atomic particles do not make choices. Physics deals with events that occur independently of what observers think about them. Therefore physics treats events as a succession of facts. In contrast, markets have thinking participants, leading from facts to perceptions, from perceptions to decisions and from decisions to the next set of facts. The market process is a reflexive interaction. Markets are not efficient, perfect or the result of rational expectations, they are not the product of axiomatic systems like mathematics or logic, but of us, living, thinking imperfect human beings.

Supporters of the free market should recognise that the failure of state control of markets does not imply that free markets are perfect at allocating resources. Like Churchill's comment about democracies, free markets are not perfect, but everything else is worse. Hutton is right to say that financial markets can and do sometimes lose touch with reality, but politicians and bureaucrats will almost certainly make a worse job of it. The City's mad moments do not justify hanging bond dealers from the lamp-posts.

**IN DEFENCE OF THE CAPITALDOME**

The conventional pragmatic defence of the activities of the Square Mile employs claims about invisible earnings and the number of jobs generated by financial services, wine bars and so on. Very rarely does anyone say that the activities themselves are beneficial. One is left with the impression that the City is a casino full of speculators buying and selling for the benefit of no one but themselves.

But the City's free markets allow the determination of prices on the basis of the best available knowledge gleaned by arguably some of the finest and certainly the best rewarded minds in the country. These activities encourage the efficient and profitable direction of resources. If you look around the City today, Hutton's thick public schoolboys are an endangered species; quick thinking Essex boys outwit them too easily. The toffs at Baring's have self-destructed, and the debs, drones and dodos of Cazenove should be warned. A weekend huntin' and fishin' might have impressed the clients in the past, but a Korean fund manager might not be so susceptible to such blandishments. British mercantile instincts and entrepreneurialism will, I am confident, triumph. Old Harrovian Lloyds brokers may be in terminal decline, but the futures traders from Chigwell will take their places easily and on merit.

Hutton's view of the City is decades out of date. His latest habitat, the upper echelons of the broadsheets, may still be ossified by the class stratification he laments, but in the markets the old buffers with their long lunches have been put out to pasture. The City practises what it preaches — competition rewards merit. The doddering chattering classes simply do not know what is going on in the vanguard of the economy. Feeble old-boy stockbrokers do not have a hope of surviving against equity derivative traders with their pentium-powered neural network processors, scanning option matrices seeking price anomalies to arbitrage.

If Hutton had his way, your savings would be eroded by Keynesian inflation, regulations would strangle the profitability of the companies, industries and services your pension is invested in. Stock owners would be powerless, unable to sell the shares of poorly performing companies due to "stakeholding" laws. No more short-termism if Hutton had his way, just long term stagnation and sclerosis.

The function of the City is to reward and encourage risk takers and discourage the losers. Corporate financiers, brokers and traders oil the wheels of industry. The dynamism generated is an irreplacable asset for Britain, envied across the globe. The splenetic vitriol of a failed stockbroker against the Capitaldome is as lurid as it is unjustified. Hutton's fundamental attack on free market theory shoots at a straw man, and then misses. His well packaged, soundbite sized manifesto may go down very well in Islington, but Britain's economy is headed in the right direction at the behest of the Capitaldome. Of all the institutions that need reform, the City is far down the list.

The Capitaldome is a success. It is the purest free market orientated industry we have. It is more innovative and adaptive than anything our European competitors can offer. The fact that huge continental banking combines are now buying into London demonstrates the respect that our competitors have for the City's talent. Swiss Bank buys Warburgs, ING gets Barings on the cheap, Dresdner owns Kleinwort Benson, Merril Lynch swallows Smith New Court, mighty Deutsche Bank flees Frankfurt for Morgan Grenfell's arms and the American investment banks are run by Scots and Englishmen. The rest of the world disagrees with Hutton and puts its money on the table, whilst he edits the lossmaking *Observer* newspaper and bemoans our finance dominated economy.

The coming Blair government may rattle its sabres towards the Square Mile, but it lives in fear of what the City can inflict upon it. They know what happened to Clinton. They know that they cannot afford a run on sterling, as well as soaring costs for government debt at the first sign of fiscal irresponsibility. They know that the stock market will plunge if they raise taxes. Bluntly, they are boxed in. And if Labour is contemplating becoming part of the European Monetary Union it will have to be submissive to the sado-monetarism of the Bundesbank.

New Labour may soon be in government, but not necessarily in power. In 1946 following Labour's landslide triumph, Lord Shawcross gloated in Parliament that "We are the masters at the moment, and not only at the moment, but for a very long time to come." Half a century later things have changed. We might not be gloating, but the City knows, "We are the masters now."

**NOTES**

1. The acronym for the London International Financial Futures Exchange, LIFFE, is pronounced as in "life".
2. George Soros, a former student of Karl Popper, has, through his Open Society Foundation given over a billion dollars to Eastern Europe. His financing of the Central European University alone will cost $200 million.
3. The £1 billion loss by the Bank of England might be seen as very good value. At the height of the currency turmoil interest rates hit 13%, they are now at 6%. The annual budget deficit is £30 billion. Even if one argues that White Wednesday only accelerated interest rate cuts, each percentage cut saves the state over £300 million per annum. Rates have halved.
4. Bob Woodward, *The Agenda: Inside the Clinton White House*, Simon and Schuster, New York, 1994.
5. George Soros, *Soros on Soros: Staying Ahead of the Curve*, Wiley and Sons, London, 1995, p 81.
6. Ayn Rand is the centre-page heroine of all laissez faire capitalists. Her books, with titles such as *The Virtue of Selfishness* and *Capitalism: The Unknown Ideal* give a clue as to why.
7. I must declare an interest. The largest trade I have ever done in the derivatives markets was for one billion Deutschemarks. From start to finish execution took ten seconds.
8. Will Hutton, *The State We're In*, Jonathan Cape, London, 1995. Paperback edition, Vintage, London, 1996. All page numberings taken from the Vintage edition.
9. These figures come from Barclay de Zoete Wedd's Germany Equity-Bond study 1996. Returns in real terms equal the actual return less inflation. The German figure is an average since 1960.
10. Keynes was not all bad. On his death bed he was asked if he had his life again, would he do anything differently? "Yes", he replied, "I would drink more vintage Champagne." Unfortunately at the Islington seance it was Australian plonk. What has happened to Champagne Socialism?
11. *The State We're In*, p. 226. It is actually a three pronged argument. Hutton also asserts that the law of diminishing returns is false. I have not addressed this part of his argument.
12. In fact, futures markets actually do solve the problem of the passage of time. A commodity is traded for settlement at a fixed future point in time.
13. Ludwig von Mises, *Socialism, An Economic and Sociological Analysis*, Jonathan Cape, London, 1936. Liberty Press edition, Indianapolis, 1981. First published in German, 1922.
14. There is a similar long recognised problem in sociology: the problem of the participant observer. How can a sociological researcher not influence, or be influenced by, the subjects of his research?
15. Static disequilibrium is rarely found in financial markets; it is characterised by rigid perceptions and rigid conditions/prices. When conditions/prices change and perception remains unchanged then thinking and reality become even more apart. Static disequilibrium can prevail for long periods of time. In the Soviet Union static disequilibrium was the rule. Dogma and reality were far apart. When dogma was relaxed dynamic disequilibrium came into play and the Soviet system collapsed. In a financial market static disequilibrium might occur when buyers are unwilling to bid the higher price at which sellers are prepared to offer. When the sellers begin to panic and drop their prices to meet the buyers' bids, the market crashes.