
September 23, 2008

Last Updated Tuesday, 23 September 2008

Ambassador's Corner

WEEKLY MESSAGE FROM AMBASSADOR JOHN BRUTON

September 23, 2008

The Financial Situation

This week the US Congress is tackling legislation to deal with the credit crisis. The origin of the crisis is a fall in house prices, which undercut the viability of a complex series of financial instruments which had been constructed on the assumption that house prices would continue rising.

Some of these financial instruments were based on highly complex mathematics, and one wonders if the people who issued, bought and sold them fully understood the mathematics. If they did not, it would have been very hard for them to assess the risks. But they were competing hard for market share, and for big short-term profits to please their shareholders, so they may not have taken time to think deeply enough about the downside risk.

The job market also became heavily dependent on housing. Real estate-related industries accounted for 74% of all new jobs created in the United States from 2000 to 2005. A similar pattern of depending on housing to create jobs was observed in countries like Ireland and Spain. Now, things are moving in the other direction. Last month, new house starts in the US were at their lowest monthly level since 1991. But foreclosure-induced house price declines are concentrated in a relatively small number of states.

A safe mortgage has traditionally been deemed to be three times the buyer's income, but most mortgages have been up to 10 times income in the last few years. Those who bought the mortgage-backed financial instruments I mentioned earlier were betting on the ability of their homeowners to service these large debts out of a modest income. That part of the math was always simple, but people did not do the calculations!

Many of the houses recently built, and bought with borrowed money, may have been bigger than were really needed, or than the borrower could afford to heat in the winter and cool in the summer. Heating and cooling buildings uses 65% of all the electricity generated in the US, and the space to be heated and cooled in homes has been getting bigger and bigger. The average new house in the US was 1,760 square feet in 1985, but had risen to almost 2,500 square feet in 2007. Similar patterns are also seen in Europe.

Likewise, many of the new houses were built on large sites or out of town where there was no public transport, and this added to motoring costs. But, on a more positive note, the United States has a growing population and significant immigration. This will fuel demand for homes in the longer term.

Many blame the current situation on a long period of low interest rates. Because China and other exporting countries had accumulated massive trade surplus money, all of which they could not invest at home, they put it into the global money market. That meant that the price of money fell below a level that made sense in a booming economy. Inflation did not rise because new supplies of cheap goods were so plentiful that interest rates stayed low. These low interest rates then tempted people to pay more for houses than they should have.

Congress is considering legislation that would take some of the unsaleable financial instruments off the hands of the banks, allowing them to restart lending on the strength of the healthier parts of their business. This legislation is necessary to prevent paralysis.

But the price at which these unsaleable financial instruments are bought will be crucial. If the price is low enough, the taxpayer could eventually even make a profit. But if it is too low, the price paid could set a low headline for the value of similar instruments in the hands of other banks, and that could spread the problem further.

Banks now need to recapitalize themselves. They need to bring in money to reassure people that they are solid. In these circumstances one wonders if they should be spending any capital at all paying dividends to shareholders. Two economists from the University of Chicago have suggested a temporary ban on dividend payments, and a requirement on banks to issue new equity. That proposal would shift the cost of putting things right off the shoulders of the taxpayer and onto those of existing bank shareholders. But, in the modern world, these are often the same people. Most people with private pensions are, indirectly at least, shareholders in banks. And, as babyboomers begin to retire, squeezing the banks for dividends will be one way of keeping pension cheques flowing. It is not simple.

The main goal in present circumstances should be to spread the cost as widely and as thinly as possible. In that way, costs can be absorbed and panic avoided. Other countries, apart from the US, may also have to take a hand in the work.

Democratically-sanctioned international coordination will be important. Global capitalism has developed far faster than has global democracy.

The European Union, as the world's first multinational democracy, is both a model for and a building block in, the new global arrangements we will need to ensure that long-term human interests are not systemically subordinated to short-term financial interests.

Visit to Smyth County

Last week I visited Smyth County, in the southwestern corner of the State of Virginia at the invitation of the local member of Congress, Rick Boucher. Rick is a key figure in Congress with responsibility for drafting climate change legislation. He has pioneered the provision of broadband technology in rural areas to help their economic development. This was the theme of the conference he invited me to attend in Wytheville.

The aim of the conference was to study lessons from Ireland's economic success within the European Union, and see how these might be translated for use in Virginia. There was a heavy focus on education, particularly technical education. There is a worry that many people with key skills will be retiring in coming years without adequate numbers of qualified people to replace them.

Joe Ellis, President and CEO of the TEDS personnel management software company based in Atkins, Virginia, is particularly knowledgeable on these topics. Joe has made considerable investments in the local community, refurbishing the General Francis Marion Hotel and the Lincoln Theater in nearby Marion, Virginia. The Lincoln Theater is listed on the US National Register of Historic Places as one of only three existing Art Deco Mayan Revival theaters in America.

As part of my visit I also addressed students in George Wythe High School along with Rick Boucher and State Senator Philip Puckett.

Smyth County is an area that was heavily settled in the 18th century by people of Scots-Irish or Ulster-Scots descent. The history of these pioneering people is well described in the book *Born Fighting*, written by Senator Jim Webb, who represents the State of Virginia. At the conference in Wytheville, I met Councillor William Humphrey from the Belfast City County and the Ulster-Scots Agency who had come from Northern Ireland, where the Scots-Irish originated, to establish economic links between the two communities.

The Scots-Irish, Palatine Germans and English who travelled west through Virginia passed through Smyth County on their way to the Cumberland Gap and the opening towards Kentucky and the Great American West. The road they travelled is known as the Wilderness Road and I took part in ceremonies marking the opening of this road in Marion, Virginia. I also greatly enjoyed a special "Celtic Concert" held at the Lincoln Theater, which included dancers and musicians performing Appalachian music with roots in Ireland.

I also visited Pageton Farms [below], an organic dairy farm operated by Jay Richardson. The farm produces milk during the summer months. It is entirely grass-based and Jay explained to me that grass-based beef and milk mitigate risks of cancer by comparison with corn-fed beef and milk. Corn, he argued, is not a natural food for a bovine animal. He said that there should be a vigorous marketing campaign to promote grass-fed beef and milk.

Meeting with the Irish Farmers Association

I met with a large delegation from the Irish Farmers Association (IFA), led by their President Pdraig Walshe [left], which

was visiting Washington to discuss the Doha Trade Round. The delegation emphasized to me that Irish, Scottish and French beef producers would lose heavily under the compromise proposals presented by Pascal Lamy in the Doha Trade Round. They claim that these proposals would substantially increase imports of beef to the European Union from countries that did not have to incur the same costs as European beef producers did. While the proposed compromise also involves restrictions on aid to farming in the United States, it compensates for this by opening up foreign markets to American farmers. They saw no similar "compensation" was available to European beef producers and this was a major concern to the IFA.

Meeting with EU Caucus on the Doha Round

I raised this point when I met the EU Caucus in Congress, led by Congressman Ron Kind, to discuss the Doha Round. Also present were Congressman Wally Herger, Congressman Jim McDermott, Congressman Tim Petri and Congressman Darrell Issa.

I was accompanied by John Cridland, of the Confederation of British Industry (CBI) who pointed out that 150 billion dollars worth of trade opportunities were on the table on the Doha Round.

I said that trade rounds were always difficult because each participant expected to get concessions that were greater than the concessions they were prepared to offer, and with a membership of 153 countries that made for a very difficult negotiation.

But the World Trade Organization has provided a legal framework for the development of trade and it was vital that it should not be undermined, or overloaded with disputes that should have been settled politically in a trade round.

Meeting in Congress on the humanitarian situation in Haiti

Congressman Kendrick Meek of Florida convened a number of Ambassadors and members of Congress to discuss the disastrous humanitarian situation that has developed in Haiti as a result of Hurricane Ike.

We were told that the flooding had completely isolated certain communities because it had swept bridges away. Installing emergency bridges was essential to get water, food and medical help to isolated communities. The hurricane would substantially depress incomes for the next two years, in a country that is already desperately poor.

I mentioned that the EU is giving substantial assistance to Haiti. Three hundred four million euros has been committed over the next 7 years, and additional humanitarian and disaster assistance is also being provided.

This very timely meeting was also attended by the Ambassadors of Haiti, Brazil, Canada, France and the European Union. Participants from Congress included the Majority Whip, James Clyburn of South Carolina, Congressman Bobby Rush, Congresswoman Cheeks Kilpatrick, Congresswoman Jan Schakowsky, Congresswoman Maxine Waters, Congresswoman Donna Christensen, Congresswoman Barbara Lee, Congresswoman Donna Edwards, Congresswoman Corrine Brown, Congressman Bill Delahunt, Congresswoman Yvette Clarke and Congressman Eliot Engel.

Meetings with Chairman Chris Dodd and Chairman Howard Berman

I accompanied European Union High Representative for Common Foreign and Security Policy, Javier Solana [right], to meetings with Senator Chris Dodd and Congressman Howard Berman, Chairmen respectively of the Senate and House Committees on Foreign Affairs. Dr. Solana was here for talks with a range of influential figures in US foreign policy.

Senator Dodd [left] is currently chairing three committees in the Senate – the Banking Committee, the Foreign Relations Committee (in the absence of Senator Joe Biden on the campaign trail) and the Education and Labor Committee (in the temporary absence of Senator Edward Kennedy through illness).

Despite these very heavy responsibilities, Senator Dodd was in a very positive frame of mind and gave us a good explanation of the current financial, foreign policy and educational challenges facing the United States.

Please send me your comments about this or any of my weekly messages or other EU matters. I look forward to hearing from you!