N 22

FINANCIAL TIMES

Monday November 29 2010 | £2.00

Clouds over Cancún

Expectations are low, but not low enough. Pages 10, 14 and 15

The City's future relies on an independent Bank

Alistair Darling. Page 15

World Business Newspaper

News Briefing

BP sells stake in Pan American for $7bn
BP's asset disposals have topped the $20bn (£12.8bn) mark after the UK oil group agreed to sell its interest in Argentina's Pan American Energy for $7.06bn to its joint venture partner Bridas Corporation. **Page 21; BP pensions, Page 15; Lex, Page 20; TNK-BP trading arm launch, Page 22; www.ft.com/bp**

Amazon's global push
Amazon says it plans to build its international e-commerce platform to make it easier to reach customers in new markets. **Page 21; Google-backed satellite service, Page 25; www.ft.com/technology**

Lack of tenders cited
Private providers of NHS services have lodged a formal complaint with the health department over plans that will see almost £10bn of care handed over to other parts of the health service or to social enterprise without being put out to tender. **Page 2**

Korea crisis talks urged
China has called for "emergency consultations" by members of the six-party talks with North Korea to cool tensions over Pyongyang's shelling of a South Korean island on Tuesday, which killed four people. **Page 10**

Foreign tax review
George Osborne will today launch a consultation on a far-reaching overhaul of rules blamed for the departure of multinationals in recent years. **Page 2**

Airline presses Boeing
The repeated delays affecting Boeing's 787 Dreamliner are "a great disappointment", said its first customer, Japan's All Nippon Airways. **Page 21; www.ft.com/airlines**

Tencent to revamp site
Tencent, which runs QQ, the world's largest instant messaging service, will offer users links to third-party websites and access to externally developed applications for the first time, mirroring some features of Facebook. **Page 21**

Travellers back checks
Most travellers support the introduction of strict security measures at airports including full-body scanners and profiling techniques that could identify passengers who pose a terrorist threat, according to a Financial Times/Harris opinion poll published today. **Page 11**

Egypt poll complaints
Opposition candidates and election monitoring groups complained of widespread irregularities as Egyptians went to the polls to elect a new parliament. **Page 10; www.ft.com/newspodcast**

Dubai eyes sell-offs
Dubai is considering the privatisation of corporate champions as a means to start paying down its estimated $110bn in debts, senior officials said. **www.ft.com/dubai**

Rio stronghold raided
Brazilian security forces have taken control of Rio de Janeiro's biggest crime stronghold. **www.ft.com/americas**

Separate sections

Managing Climate Change
Accord in danger of disintegration

FTfm
Fund management update

Watchdog to raise figures on growth

City economists urge cautious response

Fears eased over double-dip recession

By Chris Giles and George Parker

Growth for 2010 is expected to be revised upwards and potential public sector job losses adjusted downwards today when the new independent budget watchdog presents its first autumn forecast.

But leading economists warn in a Financial Times snapshot survey that in spite of some cheerier news, it is too early to stop worrying about the effects of the coalition's deficit reduction plans on future growth.

That view is shared by Alan Johnson, shadow chancellor, who tells the FT in an interview today: "The signal says 'proceed with caution' but they're just full throttle, full steam ahead. It's a huge, reckless gamble."

Sixteen City economists believe the Office for Budget Responsibility would be ill-advised to take the faster-than-expected growth this year as evidence the economy can easily withstand the imminent tax rises and public spending cuts.

Robert Chote, chairman of the OBR, will outline the latest official economic forecasts today and is expected to raise the estimate for 2010 growth – made at the time of the June Budget – from 1.2 to almost 1.8 per cent.

Public sector job losses projected at 490,000 by 2014-15 in the last OBR report could be scaled back, after George Osborne, chancellor, decided to take an axe to benefits, sparing some public spending.

In the second and third quarters of 2010, the economy grew by 0.8 per cent more than the OBR expected at the time of June's Budget. This rapid growth came on the back of income tax and VAT rises and as cuts were implemented.

But Jonathan Loynes of Capital Economics said the fact economic growth was already slowing in the third quarter is "a worry" and "evidence from other countries which have started their fiscal consolidations – not least Ireland – is hardly encouraging".

Colin Ellis of the British Venture Capital Association said: "I would expect support from the household sector to ease even without the cuts – and with investment and trade still yet to seriously take up the baton of growth, there is still a risk we see soggy growth for a while as the cuts really start to bite."

None of the 16 economists expected a double-dip recession, but most expected the rate of growth roughly to halve from that of the most recent two quarters.

Peter Spencer of the Ernst & Young Item Club said it was now the responsibility of corporate executives to lead a private sector recovery.

It is likely the OBR will hug the City consensus, reducing its forecast for 2011 growth a little, thereby avoiding appearing excessively optimistic in its first forecast since being established on a permanent footing.

Expert's verdict, Page 3

EU agrees €85bn Irish bail-out and accelerates debt-crisis scheme

George Osborne, chancellor, with his French opposite number Christine Lagarde in Brussels on Sunday AP

By Nikki Tait and Joshua Chaffin in Brussels, Quentin Peel in Berlin and John Murray Brown in Dublin

European Union finance ministers last night signed off an €85bn (£72.5bn) bail-out package for Ireland and approved the outlines of a permanent mechanism for dealing with future debt crises in the eurozone, in a move to head off further contagion affecting borrowing for Portugal and Spain.

In a surprise move, plans for the permanent mechanism were accelerated from a December deadline, after a flurry of telephone calls between Berlin and Paris and top officials in Brussels and the European Central Bank. The plan would replace the present €440bn eurozone rescue fund, set to expire in 2013, with a permanent "European stabilisation mechanism".

At the same time, private creditors would be involved in any future debt rescheduling or restructuring through collective action clauses attached to eurozone government bonds after 2013 – in line with current International Monetary Fund practices.

> 'We are applying a doctrine based on the experience of the IMF at a global level'
>
> **Jean-Claude Trichet, ECB president**

"We are applying a doctrine based on the experience of the IMF at a global level," said Jean-Claude Trichet, president of the European Central Bank.

EU leaders hope the moves will calm bond markets in the 16-country eurozone. Olli Rehn, EU monetary affairs commissioner, said that the aim was to "clarify once and for all" private sector involvement in future government debt crises.

Under the Irish package, EU countries and the IMF will provide up to €85bn, which may be drawn down over up to seven and a half years.

About €50bn is aimed at bolstering Ireland's public finances while it implements a €15bn austerity package in the next four years. Of the remaining €35bn, €10bn will recapitalise Ireland's stricken banks, while €25bn will be a contingency fund to help support the banking system if necessary.

Dublin will contribute €17.5bn towards the bank contingency fund, while the IMF will put in €22.5bn. This will also include three bilateral loans from the UK, Sweden and Denmark, with the British contribution being about €3.8bn.

Interest rates will vary on different parts of the package but the Irish government said that the average rate would be 5.8 per cent. But opposition parties in Ireland have already raised concerns that by closing off short-term bank borrowing from the ECB to Irish banks and replacing this with longer-term bank assistance, EU institutions were in effect shifting risk between themselves and leaving Ireland with a higher interest bill.

Brian Cowen, Ireland's prime minister, said that the bail-out was the "very best that is achievable for our country".

Reports and analysis, Pages 6-8
Editorial Comment, Page 14
Wolfgang Münchau, Page 15
Lex, Page 20
In depth at www.ft.com/ireland

Free thinking

Glasgow University, the alma mater of James Watt and John Logie Baird, is making a bold attempt to commercialise academic research by offering its intellectual property for free to British entrepreneurs. The move, a first for a UK university, is aimed at raising the profile of Glasgow's research and helping companies maximise competitiveness. Diagnostic pill technology and techniques to improve cancer therapy are among the ideas on offer.

Report, Page 2

US damage-control as WikiLeaks lays bare undiplomatic dealings

Cables cover Cameron, North Korea and Iran

By Daniel Dombey in Washington and George Parker in London

North Korea has provided Iran with new, more capable missiles, US diplomats at the UN are seeking intelligence on allies and Washington is deeply concerned about loose nuclear material in Pakistan, according to documents released yesterday in the world's biggest leak.

WikiLeaks' release of the first batch of about 250,000 US diplomatic cables lays bare US dealings with the rest of the world and Washington's assessments of foreign leaders.

It left Barack Obama's administration scrambling to limit the damage.

The Guardian, which along with the New York Times, Der Spiegel, Le Monde and El País had advance sight of the documents, claims that they contain "devastating criticism" of British military operations in Afghanistan as well as criticism of David Cameron, prime minister, before the general election.

It also reports what it says are "highly critical private remarks" by Mervyn King, governor of the Bank of England, about Mr Cameron and chancellor George Osborne's "lack of depth".

The cables indicate that Iran has obtained 19 BM-25 missiles from North Korea with a range of 2,000 miles – which would be sufficient to hit western Europe – and highlight Arab calls for a military attack on Tehran.

King Abdullah of Saudi Arabia is quoted as calling for an attack to "cut off the head of the snake".

The reports also recount instructions for US diplomats to obtain sensitive information for intelligence agencies, including credit card numbers, on their counterparts in the UN and elsewhere. They add that the US has tried since 2007 to remove weapons-grade uranium from a Pakistani research reactor, out of fear that it could be used for a bomb.

"These cables could compromise private discussions with foreign governments and opposition leaders," said the White House.

"When the substance of private conversations is printed on the front pages of newspapers across the world, it can deeply impact not only US foreign policy interests, but those of our allies and friends around the world."

It described the "field reporting" in the cables as candid, often incomplete and not an expression of policy.

Reports and analysis, Page 12
In depth: www.ft.com/wikileaks

9 770307 176319 48

Selling price in Irish Republic €2.50

World Markets

STOCK MARKETS

	Nov 26	Nov 19	Wk's chg%
S&P 500	1189.4	1199.73	-0.86
Nasdaq Comp	2534.56	2518.12	0.65
Dow Jones Ind	11092.0	11203.55	-1.00
FTSEurofirst 300	1086.65	1102.18	-1.41
DJ Euro Stoxx 50	2736.96	2845.75	-3.82
FTSE 100	5668.7	5732.83	-1.12
FTSE All-Share UK	2930.78	2959.82	-0.98
CAC 40	3728.65	3860.16	-3.41
Xetra Dax	6848.98	6843.55	0.08
Nikkei	10039.56	10022.39	0.17
Hang Seng	22877.25	23605.71	-3.09
FTSE All World $	205.7	210.4	-2.23

CURRENCIES

	Nov 26	Nov 19		Nov 26	Nov 19
$ per €	1.322	1.366	€ per $	0.757	0.732
$ per £	1.561	1.595	£ per $	0.641	0.627
£ per €	0.846	0.856	€ per £	1.181	1.168
¥ per $	84.04	83.46	¥ per €	111.1	114.0
¥ per £	131.2	133.1	£ index	80.90	81.30
$ index	82.00	80.90	€ index	94.30	95.87
SFr per €	1.326	1.365	SFr per £	1.567	1.594

COMMODITIES

	Nov 26	Nov 19	Wk's chg
Oil WTI $ Jan	83.76	81.51	2.25
Oil Brent $ Jan	85.58	84.34	1.24
Gold $	1,374.62	1,351.25	23.37

INTEREST RATES

	price	yield	Wk's chg
US Gov 10 yr	97.89	2.87	0.00
UK Gov 10 yr	111.12	3.35	-0.04
Ger Gov 10 yr	97.90	2.74	0.04
Jpn Gov 10 yr	96.54	1.19	0.11
US Gov 30 yr	100.63	4.21	-0.03
Ger Gov 2 yr	100.14	0.93	-0.19

	Nov 26	Nov 19	Wk's chg
Fed Funds Eff	0.20	0.20	-
US 3m Bills	0.15	0.14	0.01
Euro Libor 3m	0.97	0.98	-0.01
UK 3m	0.66	0.66	-

Inside today

Germany

A stronger Berlin balks at global role

Separate section

Printed in London, Liverpool, Dublin, Frankfurt, Brussels, Stockholm, Milan, Madrid, New York, Chicago, Dallas, Los Angeles, San Francisco, Atlanta, Orlando, Washington DC, Tokyo, Hong Kong, Singapore, Seoul, Abu Dhabi, Sydney, Johannesburg

National news

Lack of NHS tenders angers private sector

Only 4% of care open to competition

Hopes of 'fantastic opportunities' fade

By Nicholas Timmins, Public Policy Editor

Private providers of NHS services have lodged a formal complaint with the health department over plans that will see almost £10bn of care handed over to other parts of the health service or to social enterprise without being put out to tender.

Under the previous Labour government, private providers were told there were "real opportunities" for them to bid to take over the community hospitals, district nursing and home and GP therapy services that are run by primary care trusts.

By April, these so-called "provider arms" of PCTs will be separated from the PCTs' commissioning arms.

However, under the Conservative-led coalition – and despite its public commitment to competition and choice in health – the health department has disclosed that just 4 per cent of the provider arms are to be put out to tender to the private and voluntary sectors.

Some 86 per cent are being passed over to other parts of the NHS to run, or are being turned into a form of NHS foundation trust.

The remaining 10 per cent, providing £900m worth of services, are being handed over to staff to run as social enterprises, without any formal competition, in what critics see as "sweetheart" deals.

David Worskett, director of the NHS Partners Network that represents private providers of NHS care, said: "We have been told for some years now that there would be significant opportunities for the private and voluntary sectors to bid for this work.

"Just before the election we were reassured by health department officials that perhaps 20 per cent of this business would be put out to tender. Now it appears that only 4 per cent will be going to market," he said.

"How can the health department possibly be sure that the arrangements being put in place will offer best value to the NHS at a time when it is completely vital for the service that this happens?"

There were "fantastic opportunities" for the private and voluntary sectors to provide more NHS care, a senior health department official publicly said as recently as September.

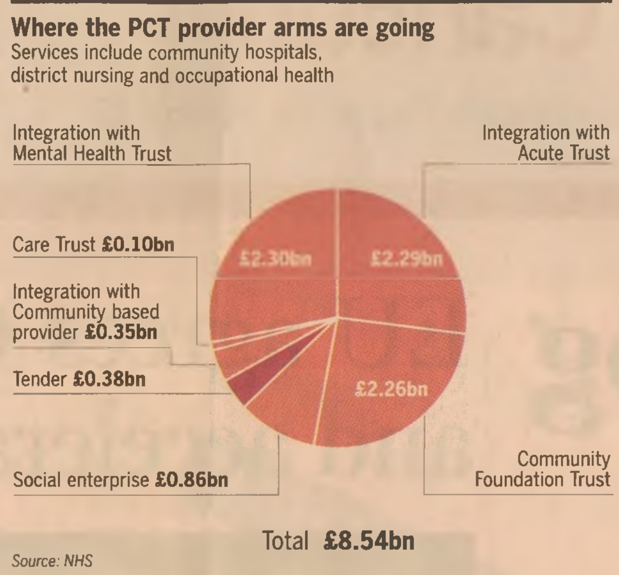
The partners' network, Mr Worskett said, had lodged a formal objection with the health department, asking it to refer the issue to the Co-operation and Competition Panel, which has the power to investigate market abuse in the NHS when asked by the health department. The department said it had "no plans" to refer on a complaint that in effect challenges its own behaviour.

Susan Anderson, head of public services at the CBI employers' organisation, said the coalition should be more radical. "Simply rebadging services is not the answer." The best provider should be found to run them, she said.

Simon Burns, the health minister, said the arrangements would put "frontline staff in the driving seat to improve quality and integrate services to ensure the most effective outcomes for patients".

Unison, the health union, said it was "delighted" that "despite a massive push from the government" [illegible] 10 per cent of provider arms at most would become social enterprises, where staff quit the NHS to sell their services back.

The health department confirmed contracts for social enterprises were likely to be for three to five years. Mr Worskett said such providers would become entrenched, meaning "the scope to test the value of these services will be denied for the better part of a decade".



University leads way with free research offer

By Jonathan Moules, Enterprise Correspondent

Glasgow university, the alma mater of inventors James Watt and John Logie Baird, is making a bold attempt to get academic research commercialised by offering its intellectual property free of charge to British entrepreneurs.

The move, a first for a UK university, is aimed at raising the profile of Glasgow's research achievements and helping companies maximise their competitiveness.

Diagnostic pill technology, a model for Parkinson's disease and techniques to improve cancer therapy are among the breakthroughs on offer.

If a company can demonstrate that it can use the university's discoveries for a commercial application, it will be offered free rein to do so with no fees attached. If no commercial application is forthcoming within a specified time limit, the university retains the right to offer the research to others.

More than 90 per cent of the IP archive will be made available, according to the university. Only research funded by companies will be excluded from the plans.

Anton Muscatelli, university principal, said: "One of the core missions of the university is the creation, advancement and sharing of knowledge and we aim to transfer as much IP into commercial use as we can."

One of the first companies to benefit is Hertfordshire-based Elliot Scientific, which is using the university's breakthroughs in laser beam technology to add new features to its precision instruments.

Miles Padgett, professor at the university's school of physics and astronomy, which is working with the company, said: "My belief is that as academics we have an obligation to promote transfer of our technology into the real world."

Doug Richard, a former *Dragons' Den* panellist and a technology entrepreneur, said the move was likely to upset academics in other universities, who fiercely guard their innovations.

"It is something that everybody has dreamed about in the tech community for ages," he said. "Some will love it. Some will hate it."

The internet has made it easier for companies to find out about other IP they can commercialise. Marketplace websites, such as yet2.com, allow organisations to trade IP online.

Matt Dixon, a partner at law firm Harrison Goddard Foote, said the move could upset some who might imagine publicly funded university research was the property of taxpayers. "You hear a lot of this from academics – that they don't want to patent their research, they just want to get it out there," he said. "Of course if it turns into something big, they then want a slice of the profits."

Manic Monday Online retailers braced for rush

Amazon workers at an international distribution centre in Swansea prepare for Cyber Monday, the day following Thanksgiving that ushers in the busiest period for retailers in the UK and US, as shoppers get ready for Christmas PA

Osborne to review tax on multinationals

By Vanessa Houlder

George Osborne will today set out his stall for restoring Britain's tax competitiveness with a consultation on a far-reaching overhaul of rules blamed for the departure of several multinationals in recent years.

The Treasury will propose making the tax system more "territorial" by restricting its right to impose tax on profits earned in low tax jurisdictions, as part of a drive to make the UK "the most competitive corporate tax system in the G20".

The reforms to the "controlled foreign companies" rules, the anti-avoidance regime affecting foreign profits, are designed to stop companies moving their tax base out of Britain to countries with no CFC rules, such as Ireland.

The Treasury is under pressure both to make the reform of the rules radical enough to satisfy footloose companies while reassuring businesses that fear their taxes may rise to pay for the CFC changes.

Today's consultation is set to shape the government's relationship with big business over tax, according to advisers who said the Treasury was under pressure to deliver on its business-friendly message.

The change of government prompted some footloose businesses to put migration plans on hold to await the Treasury's plans. A September decision by Wolseley, the builders' merchant, to move to Switzerland for tax reasons was a rare exception.

The Treasury faces a delicate balancing act in designing a cost-neutral package in which it will juggle a range of allowances and reliefs, in a bid to minimise the winners and losers from the proposed reforms. But some companies are nervous about the possibility of higher bills, according to Anneli Collins, head of tax policy at KPMG, professional services group.

The most extreme proposal under consideration would get rid of CFC rules in their current form but in return limit deduction of interest costs in respect of foreign profits. This trade-off would protect the tax base from erosion but would risk alienating inward investors.

In a survey of 200 companies conducted by KPMG, only one in four supported the idea of a restriction on interest deductions in return for an abolition of the CFC regime. Many more favoured the idea of a focused CFC regime aimed only at artificial structures offshore.

Under Labour, the Treasury wrestled with reform of the CFC rules and considered moving more to a territorial system but judged that the curb on interest deductions for non-UK profits would damage UK competitiveness.

> Some footloose businesses put migration plans on hold to await the Treasury's plans

The Treasury is expected to put forward options for consideration, ranging from almost no change to a radical simplification.

The Treasury has signalled that it also intends to give more detail on how it might make reductions in the corporate tax rate, going beyond the fall from 28 per cent to 24 per cent over four years. David Gauke, exchequer secretary, said last week. "We need a more competitive tax system, a simpler tax system, one with fewer exemptions and fewer reliefs."

Ms Collins said most businesses would accept some restrictions to reliefs but would want a drop in [illegible] corporate tax rate – perhaps to as low as 18 per cent before supporting changes.

Alistair Darling, Page 15

Fox drops vow to exit EU defence agency

By George Parker, Political Editor

Liam Fox, defence secretary, has dropped his pre-election promise to pull Britain out of the European Defence Agency, the Brussels-based body that aims to co-ordinate military procurement across the EU.

But Mr Fox has written to Lady Ashton, head of the agency, warning that Britain will block proposals for a 3.9 per cent rise in its budget next year, claiming it was "impossible to justify" at a time of austerity.

Although the EDA has a relatively small budget, Mr Fox has always viewed it as an unacceptable reflection of the expanding ambitions of Brussels. However, Mr Fox's aides confirmed on Sunday that he was no longer committed to an immediate British withdrawal from the agency, although the UK's longer-term membership was under review.

Mr Fox has secured the agreement of David Cameron that Britain will use its veto if necessary to block the proposed rise, even though it would cost the taxpayer less than £200,000.

The fight has a broader political significance since Mr Cameron is fighting on a number of fronts to control EU spending at a time when Conservative backbenchers are becoming increasingly restive on European issues.

Mr Fox says in a letter to Lady Ashton: "We would want, at best, zero growth for the agency's total budget for 2011. It will be impossible to justify a 3.9 per cent increase in the EDA budget . . . when we are having to cut capabilities and reduce service personnel at home."

Mr Cameron has also taken a tough line in restricting the proposed increase in the overall European Union budget, insisting he would be happy to block a 2011 settlement and to see an effective freeze as a result.

Mr Fox's fight to control EDA spending also reflects his preference for bilateral defence deals – such as the recent treaty with France – rather than co-ordinating military procurement through Brussels.

The agency was set up to try to improve Europe's military capabilities – including in crisis management – following the failure of member states to halt the bloodshed in the Balkans in the 1990s.

One of its key objectives is to co-ordinate procurement between different countries, to try to address the problem that Europe secures a markedly smaller "bang for its buck" than the US.

The coalition deal struck by the Conservatives with the pro-European Liberal Democrats has forced Mr Fox and other Eurosceptic ministers to rein in some of their initial plans.

News digest

Services outlook grows gloomier

Consumer services companies have become more pessimistic in the fourth quarter, according to a survey by the CBI.

The employers' organisation found that respondents expecting sales to shrink in the next three months outnumbered those expecting an expansion. This contrasted with the previous quarter's more optimistic responses.

Among business and professional services providers, the outlook is less gloomy. Those expecting business to grow roughly balance those who expect sales to shrink.

Martin Sandbu

Breastfeeding at work urged

The government is urging employers to set aside private areas where mothers can breastfeed their babies after they return to work.

A public health white paper this week will set out proposals to encourage companies to adopt "breastfeeding-friendly employment policies".

Ministers say increasing breastfeeding rates can cut infant mortality levels.

Press Association

Tube workers start strike

Thousands of London Underground workers started a 24-hour strike on Sunday night, threatening disruption for commuters and other passengers.

Members of the Rail, Maritime and Transport Union and the Transport Salaried Staffs' Association walked out at 6.30pm in protest at 800 ticket office job cuts.

It is the fourth recent stoppage in the bitter row that has been deadlocked for months.

Transport for London said it would run as many Tube services as possible, although it warned there would be disruption throughout the whole of today, with services returning to normal on Tuesday.

Press Association

House prices fall for fifth month

House prices fell for the fifth month in a row in November as demand from potential buyers dropped at its fastest pace for nearly two years, research shows today.

The average cost of a home in England and Wales fell by 0.8 per cent in the month to £155,000, following a 0.9 per cent slide in October, according to Hometrack, the property intelligence group.

The latest fall was accompanied by estate agents' reports of a 4.3 per cent fall in those looking for a home, the steepest decline since January 2009.

Press Association

FINANCIAL TIMES
Number One Southwark Bridge, London SE1 9HL Tel: +44 20 7873 3000

SUBSCRIPTIONS
Tel: 0800 298 4708
www.ft.com/subscribenow
ADVERTISING
Tel: 020 7873 3181 ukads@ft.com
www.ft.com/advertising
CUSTOMER SERVICE
Tel: 020 7873 4211
reader.enquiries@ft.com
subscriptions@ft.com

LETTERS TO THE EDITOR
Fax: +44 20 7873 5938
letters.editor@ft.com

BACK COPIES
Tel: 0207 873 4871
Fax: 0207 873 3070
E-mail: synd.admin@ft.com

Published by: The Financial Times Limited, Number One Southwark Bridge, London SE1 9 HL United Kingdom. Tel: +44 (0) 20 7873 3000: Fax: +44 (0) 20 7407 5700: Editor: Lionel Barber

Printed by: Newsfax (Bow) Ltd, London, Newsprinters (Knowsley) Limited, Merseyside and Midland Tribune Printing Limited, Birr, Ireland

Ireland bail-out

Dublin pays €17.5bn for own rescue

Pension fund and cash reserve raided

Senior bondholders at banks avoid loss

By Joshua Chaffin in Brussels

Ireland will contribute €17.5bn to its own rescue, easing the strain on European Union finances in case Portugal or other crisis-hit member states require assistance.

The Irish contribution to the €85bn bail-out will come from its cash reserves and its National Pension Reserve Fund, a sovereign wealth fund which, at the end of September, had €24.5bn under management.

After much debate, it was also determined that the senior bondholders who lent money to Irish banks will not have to suffer losses. "There will be no haircut on senior debt," said Olli Rehn, the EU's commissioner for economic and monetary affairs.

Mr Rehn said the interest rates Ireland would pay would average approximately 6 per cent. That figure is based on prevailing market rates, plus an additional 300 basis points.

Ireland extracted one concession from the commission and the IMF: an agreement to extend by one year its deadline to reduce its fiscal deficit to 3 per cent of GDP. According to the terms of the package, it will now have to do so by 2015.

The interest rates were among the last pieces of the package to be agreed, and have been the subject of intense bickering between EU officials and the Irish government as they scrambled to finalise the package over the weekend.

Finance ministers discussed Portugal and Spain during Sunday's meeting, with both countries reviewing their responses to the crisis. Yet officials refrained from mentioning either country. For the last week, they have launched a public campaign to draw distinctions between them and Ireland.

"It's clear that the Portuguese don't believe they need [help] yet," said one person briefed on the meeting.

"No one can ask us for more austerity measures because it would make matters worse and endanger our recovery from the crisis," Elena Salgado, Spanish finance minister, told reporters in Brussels.

The bail-out represents the first time the EU has drawn on a €750bn emergency funding system drawn up with the International Monetary Fund following the Greek bail-out in May. The sheer size of the system was supposed to reassure investors that it would never be put to use.

6%

Average rate of interest on bail-out repayment

€22.5bn

IMF contribution to the €85bn bail-out package

Of the €85bn package, the IMF will contribute €22.5bn and Europe will contribute €45bn. Half the European share will come from the European Financial Stability Mechanism, a fund overseen by the commission and backed by the EU budget. The balance will come from the European Financial Stability Facility, backed by the 16 members of the eurozone, as well as bilateral loans from the UK, Sweden and Denmark.

The UK will put up €3.84bn in such loans. It will also account for €3.1bn of the EFSM money – or roughly 3 per cent. The Swedish loans will amount to €598m, while the Danish contribution will be €393m.

The question of imposing losses on bondholders was debated intensely leading up to Sunday's agreement. While it would be politically popular in Ireland, European policymakers were concerned that it could again unnerve markets just as they are trying to reassure them and bring the crisis to a halt.

Fears that it could spread further were one reason that policymakers were keen to limit the strain on the EU's financial arsenal.

Diplomats generally agree that there is enough money in the system to cover a bail-out for Portugal, but probably not Spain.

Both countries saw their borrowing costs continue to rise last week even after the outlines of the Irish austerity package. That suggests investors are still nervous about European debt.

European leaders will receive a first indication if their latest effort has been more successful when markets open today. Seeking to sway the debate, Mr Rehn said that the Irish bail-out "should decisively address the current nervousness in the financial markets".

Additional reporting by John Murray Brown in Dublin

Cowen tries to assuage interest rate fears

John Murray Brown in Dublin

Brian Cowen, Irish prime minister, has claimed the bail-out was the "very best that is achievable for our country".

Mr Cowen said fixing the banks was "hugely important for everyone who is thankfully at work in this country, and those who want job prospects in the future".

Announcing a sum of €35bn for the banking system, including €10bn in immediate recapitalisation, Mr Cowen said the downsizing of the banking sector would result in banks "more proportionate to the size of the economy".

Amid concern over the interest bill Ireland will incur, he said the funding, at a blended rate of 5.8 per cent, "will now be available to Ireland at a cheaper interest rate than if we borrowed on those markets".

He said the government had explored what he called the "option" of requiring the subordinated bondholders to share some of the cost of the bail out, but that no decision had been taken.

To limit the additional interest bill, the bail-out involves tapping Ireland's sovereign wealth fund – the National Pension Reserve Fund – for around €12.5bn.

The government is also using €5bn of cash reserves.

Ajai Chopra, head of the International Monetary Fund mission to Ireland, said the bail-out programme had been "largely designed by the Irish authorities".

Pat Rabbitte, Labour MP, said the bail-out was "going to pauperise us and we're now going to have to bend the knee to our European masters".

Olivia Mitchell, MP with Fine Gael, the main opposition party, said the use of the NPRF would further curtail the ability of an incoming government to provide economic stimulus.

"For any future government, a stimulus package is almost impossible, because that was the last fund we had, the last hope we had of getting people back to work," she said.

Earlier it emerged Enda Kenny, the Fine Gael leader, had written to Dominique Strauss-Kahn, head of the IMF, and José Manuel Barroso, the European Commission president, to seek assurances that any incoming Irish government would be able to introduce its own fiscal plans.

Mr Cowen said Ireland's European Union partners had agreed that the timeframe to return to a deficit of below 3 per cent of national output by 2014 might be extended to 2015, if the four-year timeframe to make the €15bn adjustment "proves to be insufficient". But with an early election inevitable, opinion polls suggest it will be Fine Gael, in coalition with Labour, that will have to administer this programme.

Banking landscape to see dramatic changes

Financial sector

By Sharlene Goff and Jennifer Hughes in London

The landscape of the Irish banking market is set to change beyond recognition after the government on Sunday night signed off a €35bn rescue package to restore capital and liquidity to the country's financial institutions.

The bail-out will include an upfront capital injection of €10bn as a quick fix for the banks' tattered balance sheets and a further €25bn of liquidity measures to ease the recent paralysis in their funding markets.

The recapitalisation will fire the starting shot on a painful restructuring process that is expected to trigger a wave of building society mergers and push every large lender into government hands.

Allied Irish Banks will in effect be nationalised after the government is expected to provide €5.3bn of fresh funds needed to lift its core tier one capital ratio above the newly required level of 12 per cent. Bank of Ireland must raise €2.2bn of fresh funds and could see the government's stake rise from 36 per cent to as high as 80 per cent.

The banks have already been forced to make considerable concessions for the state aid they have received during the financial crisis and people close to the latest bail-out talks believe this time the terms will be even tougher.

Both Bank of Ireland and Allied Irish are to be shrunk to a fraction of their former size, while smaller lenders, such as mutually owned EBS, Irish Nationwide Building Society and Irish Life and Permanent, could disappear altogether as they are merged or folded into larger organisations.

Analysts say the key to restoring confidence in the banks is to strip them of the billions of euros of risky loans that are still clogging up their balance sheets.

However, people close to bail-out talks say a big challenge is finding a way to clean up the banks without crystallising large losses, which would renew pressures on their capital levels.

The government is expected to set targets for the banks to slim down their balance sheets and work with them to identify packages of loans for sale.

An additional €16bn of distressed loans is set to be siphoned off into Nama, the vehicle set up to buy toxic commercial assets, as a part of the deleveraging process.

The government recognizes that investors are unlikely to show interest in assets at anything but rock-bottom prices and so has set aside €2bn of the initial €10bn capital injection to boost the quality of saleable loan portfolios.

It is understood to still be discussing the creation of a giant state-owned bad bank that could sweep up all the institutions' toxic loans. However, this would mean the government would still shoulder the risk of the loans turning bad.

Speculation had focused on whether the banks could force their senior, or most protected, bondholders to take losses as part of any recapitalisation. Cutting their debt would help shrink the banks' balance sheets. However, the heavy reliance of the sector on government-guaranteed bonds and secured borrowing means that of the €46.2bn of bonds to be repaid in the next three years by the three largest banks – Bank of Ireland, Allied Irish and Anglo Irish Bank – only 35 per cent is not already tied up in this way.

Bankers have warned too that a so-called "haircut" on senior bondholders – which only usually happens in bankruptcy – would risk upsetting other European banks' access to the senior debt markets, where they have collectively raised more than €560bn this year.

Another big concern is the dramatic reduction of competition likely to come as a result of the bail-out.

Bank of Ireland and Allied Irish, the two largest lenders, will be focused on deleveraging, while the wind-down of already nationalised Anglo Irish is expected to be accelerated.

Plans to merge the three smaller lenders – Permanent TSB, the banking arm of Irish Life and Permanent, EBS and Irish Nationwide – are also being discussed.

Two foreign providers – Danske Bank of Denmark and Ulster Bank, which is owned by Royal Bank of Scotland – say that they are still committed to Ireland but both have drastically scaled back their lending operations.

Irish anger: demonstrators take to Dublin's streets on Saturday to protest against the bail-out Epa

Public pension fund to be tapped for €12.5bn

By John Murray Brown

A fund set up to finance public service pensions for those retiring a decade from now is to be used to supplement the bail-out provided by the International Monetary Fund and the European Union.

The National Pension Reserve Fund, which will provide €12.5bn of the €85bn bail-out, is Ireland's own sovereign wealth fund.

It was established at a time when Ireland enjoyed healthy budget surpluses, as a rainy day fund to address Ireland's future pensions timebomb.

At the end of September, it had assets under management of €24.5bn. Under the original legislation, the government assigns the equivalent of 1 per cent of GDP to the fund every year. Until the onset of the financial crisis, it was not envisaged that money would be drawn down until after 2025.

But Brian Lenihan, the finance minister, has already tapped the fund to recapitalize Bank of Ireland and Allied Irish Bank, with the fund investing €3.5bn in March 2009 in exchange for preference shares in each bank.

The move required legislation which allowed the minister to use the fund "to remedy a serious disturbance in the economy" and to prevent potential serious damage to the financial system." The NPRF now holds just under 19 per cent of Bank of Ireland, after the bank was stopped by its bondholders from paying a coupon to the government and took shares instead.

Even before Sunday's bail-out terms emerged, the NPRF was set to increase its stake in AIB to as high as 99 per cent as a result of underwriting its €6.6bn fundraising, with the bank ordered by the regulator to bolster its capital position.

The fund is invested in quoted equities, eurozone government bonds, and financial assets such as property, commodities, and private equity. It also has approximately €4.1bn cash, which in the first instance is likely to be deployed to support the banks.

The fund reported a 6 per cent return on its investments in the first nine months of 2010. Since the launch of the fund in 2001, the annualized performance was 3 per cent per annum.

Running the NPRF is the responsibility of the National Treasury Management Agency, the government's debt agency which also oversees the operations of the National Asset Management Agency, the government's bad bank.

INSIDE AND ONLINE
Coinage debased, Page 13
Editorial Comment, Page 14
Wolfgang Münchau, Page 15
Lex, Page 20

Italy elections
Crisis could strengthen Berlusconi's hand
www.ft.com/europes

Ireland rescue
In-depth reports and analysis
www.ft.com/ireland

Bondholder fight set to delay Anglo restructure

Investor reactions

By Jennifer Hughes, Senior Markets Correspondent

A second bondholder group has claimed to hold a stake sufficient to block part of Anglo Irish Bank's efforts to bolster its capital – raising the prospect of the bank's restructuring being delayed.

The bank's battle with its bondholders is being closely watched for what it might imply for Ireland's ability to inflict losses on junior creditors in its ailing banking sector. Anglo Irish has offered its junior, or subordinated, noteholders just 20 per cent of the face value of their holdings.

Frank Scheunert, who runs Exchange Investors, a distressed debt specialist fund, told the Financial Times that he now represented a group worth more than a quarter of the bank's bonds known as the 2014s – one of three bonds targeted in the deal.

Any successful block will hold up the government's plans to restructure Anglo Irish, which it nationalised in January 2009.

Investors in the group's 2017 bonds have already accepted the deal but the holders of the other two bonds will vote next month. Three-quarters of each group must accept for the offer to be applied to their bonds.

Mr Scheunert's claim comes on top of another investor group, represented by Brown Rudnick, the law firm, also claiming blocking stakes in the 2014s and another bond, the 2016s.

Mr Scheunert said his group is a mix of distressed debt specialists – who buy deeply discounted debt and profit from any premium offered in an exchange like this – and so-called "par" holders, mostly private individuals, who bought the bonds at near face value.

Anglo Irish's offer is controversial for the particularly harsh terms it offers. Mr Scheunert described the deal as "blackmail".

"If you're going to try to find new investors in the future, this is not the way," he said.

He also attacked the uneven nature of the bank's so-called "burden-sharing". Anglo Irish is something of a test case for European policymakers' clear desire for bank bondholders to share losses alongside any taxpayer bailout.

"You can do burden-sharing, but offering 20 per cent to sub debt holders while saying the seniors are safe? That's not sharing, that's just trying to make one group suffer," he said.

Senior debt holders rank virtually equal with depositors. Offering them a deal below face value would raise serious questions of whether the bank was in fact defaulting, not restructuring as it now claims.

British, Swedish and Danish reach out to 'friend in need'

Bilateral loans

By George Parker in London, Joshua Chaffin in Brussels and Andrew Ward in Stockholm

Britain has approved £3.2bn in bilateral loans to Ireland, as part of a wider UK contribution to the bail-out of its "friend in need" across the Irish Sea.

George Osborne, chancellor, also agreed British loans worth £2.6bn to Ireland through its participation in the EU's €60bn ($80bn) stability mechanism, as well as support worth £800m through the International Monetary Fund. Total costs to the UK will be up to £6.6bn.

Mr Osborne said the rate of interest applicable to the bilateral loan would be "very similar" to that applied to the rest of the Irish bail-out package. "That is money we fully expect to get back," he said.

Britain's participation in the rescue of a eurozone country has been controversial with many of Mr Osborne's Conservative colleagues, who say the issue is primarily one for members of the single currency.

But the chancellor has tried to allay their concerns by arguing that Ireland is a "specific case" because of its strong economic links with Britain.

Anders Borg: assistance was in Sweden's interests

Mr Osborne is also concerned about the exposure of British banks to Ireland.

Sweden and Denmark – two other non-eurozone countries – also weighed in, with contributions of €598m and €303m respectively.

Sweden's participation underscored its status as one of Europe's most willing economic firefighters since the global financial crisis erupted, having played a central role in international bail-outs for Iceland and Latvia in 2008.

Anders Borg, Swedish finance minister, told the Financial Times last week it was in Sweden's interests to help: "The financial stability of Europe is at risk so it is important to make a broader effort to try to stabilise the situation. For a country like Sweden, that is so open and dependent on Europe, it is impossible to sit on the sidelines when this kind of risk occurs."

Eurozone woes

Berlin and Paris agree debt crisis mechanism

Bail-out response

Role of private creditors outlined

Changes to come into effect in 2013

By Ben Hall in Paris, Quentin Peel in Berlin and Joshua Chaffin in Brussels

European finance ministers have given their blessing to the outline of a new permanent mechanism to deal with future eurozone financial crises, after a deal was brokered in Brussels with France and Germany.

The proposal was presented to the finance ministers by the European Commission on Sunday, with the blessing of Jean-Claude Juncker, chairman of the 16 eurozone member states in the Eurogroup, and Herman Van Rompuy, president of the European Council, as well as the French and German governments.

The plan spells out how private creditors will be involved in future eurozone debt crises, and how a new European stabilisation mechanism will take over as a financing mechanism for debt-laden states from 2013, when the present €440bn scheme runs out.

Officials said they hoped a deal would convince the markets of the resilience of the eurozone.

The main feature of the new system, the ESM, will be for future borrowing by eurozone members to include collective action clauses that would involve bondholders in any eventual debt restructuring.

The clauses make it easier for creditors and debtors to agree to change the terms of a bond.

"The message to the markets is that it will only come into effect in 2013, and there is nothing in there that the markets do not already know about," a senior German official said. "Collective action clauses are already used in the US and UK."

Governments that borrow from the facility would be bound by the sort of strict conditions regarding their fiscal and economic policies that were attached to Greece's bail-out in May.

One potential obstacle to EU-wide approval for the mechanism came from Italy, which, according to French and German officials, argued against collective action clauses fearing they would reduce bond market liquidity.

A central element of the plan is that future debt crises in eurozone member states would be dealt with on a case-by-case basis, rather than according to any automatic mechanism.

"We are not putting in place a default mechanism of any sort," said a senior official at the Elysée palace, who pointed out that the arrangement was based on procedures used by the International Monetary Fund, a key demand of Paris and the ECB.

A eurozone country with liquidity problems would be able to apply for emergency funding from the ESM subject to a tough fiscal adjustment programme – as with Ireland or Greece – without having to restructure its debts or agree a standstill.

However, if the country's debt position was judged by the IMF, the ECB and the Commission to be unsustainable, it would have to enter negotiations with its creditors to restructure its debt as a condition of further bail-out funding.

With this new second stage of the mechanism, Germany appears to have gained some of the "automaticity" it was seeking.

During a liquidity crisis, private sector creditors would be encouraged to maintain their exposure to the real economy of a troubled country or to its sovereign debt. But during the second stage, there could be a graduated response, including debt standstills, maturity extensions, interest rate cuts and outright writedowns or haircuts.

French officials insisted that restructuring was a last-resort scenario and that collective action clauses did not make it more likely.

Under the proposal, the new system will be phased in after 2013, meaning it would take six to eight years before the new government bonds, including collective action clauses, amount to a majority of public debt.

The Commission was originally supposed to present the outlines of the mechanism at a meeting of European leaders in December. But the parties decided to accelerate their work in order to give greater clarity to jittery investors. Speculation that they would face harsh treatment in future crises is one factor that unsettled the markets, ultimately forcing Ireland to request a bail-out.

The compromise was produced following urgent negotiations over the weekend between Berlin, Paris and Brussels.

Steffen Seibert, German government spokesman, said the two-page paper was finalised by France and Germany, working "very closely" with Jean-Claude Juncker, the Luxembourg prime minister who chairs the 16 eurozone members in the Eurogroup, as well as Herman Van Rompuy, permanent chairman of the European Council, and with José Manuel Barroso, president of the European Commission.

Berlin and Paris are anxious not to be seen to be laying down the law for the other EU member states but to be working in close collaboration with all the EU institutions.

Greece's rescue prompted anger over austerity measures. The mechanism is designed to smooth future debt crises AFP

ECB to rethink phasing out of liquidity support

Governing council

By Ralph Atkins in Frankfurt

The eurozone's escalating crisis has put the European Central Bank on guard ahead of its interest rate-setting meeting this week, leaving open the possibility it will shelve further steps to unwind emergency liquidity support for the region's banks.

Jean-Claude Trichet, president, has flagged Thursday's meeting as the moment when it will decide on liquidity arrangements for early 2011. Public comments prior to the ECB's pre-meeting purdah period had hinted at another move towards normalisation.

But mounting financial market tensions over Ireland, and the threat the crisis will engulf Portugal and Spain, have altered the debate within the ECB's 22-strong governing council and strengthened the case for staying its hand.

Mr Trichet could instead focus more on maximising the pressure on governments to act swiftly to stabilise problem banks and restore investor confidence. "Mr Trichet's touch is going to have to be as deft as ever in managing the debate and communication," said Julian Callow, European economist at Barclays Capital.

Earlier this month, Jürgen Stark, one of the more hawkish council members, argued "conditions in both money and financial markets had improved significantly" notwithstanding the problems in "some" segments. "The phasing out of our liquidity support measures will continue after the end of the current quarter," he added.

After the collapse of Lehman Brothers in September 2008, the ECB started providing unlimited liquidity for periods of up to a year. It has since stopped supplying unlimited 12-month and six-month loans, without creating much disruption. A next move could be to reintroduce an auction system for three-month liquidity.

Such a step, however, would depend on the market reaction to the weekend's Irish developments – as well as on the ECB judging that the eurozone's weakest banks could manage on unlimited offers of only monthly and weekly liquidity, and that such an announcement would not add to market nervousness.

When setting its main interest rate, ECB decisions are based on conditions in the eurozone as a whole. But policymakers at the euro's monetary guardian know it is not possible to take the same approach with "non-standard measures", such as the unlimited liquidity provision.

Use of the facilities is concentrated in the eurozone "peripheral" economies, where banks are cut off from other sources of financing. At the end of October, Irish banks had €130bn ($172bn) in loans outstanding from the ECB, almost a quarter of the total. They have also borrowed directly from the Irish central bank – suggesting some might have run out of the collateral needed to borrow from the ECB.

'Trichet's touch is going to have to be deft in managing the debate and communication'

But banks in Portugal, Spain, Greece and even stronger economies such as Germany, are still borrowing heavily from the ECB.

To ease their dilemma, ECB council members could consider action to deal directly with the problem of those banks "addicted" to its liquidity, possibly by altering its operational framework. But it seems unlikely that such measures will be announced as early as this week.

Meanwhile, economists expect the ECB to revise its economic forecasts to show the 16-country eurozone economy expanding by about 1.6 per cent next year. In September it had expected 2011 growth in a range with a mid-point of 1.4 per cent. A similar pace of growth is likely to be forecast for 2012.

Forecasts for annual inflation are expected to show it remaining more or less within the ECB's goal of a rate "below but close" to 2 per cent – strengthening expectations that the ECB's main interest rate will remain firmly at the record low of 1 per cent at least until well into next year.

Sócrates goes on offensive to boost market confidence

Portugal

By Peter Wise in Lisbon

Portugal, struggling to prevent contagion from the Irish crisis from forcing it to seek a similar bail-out, has announced an initiative to lift export-led growth and improve the competitiveness of its debt-laden economy.

José Sócrates, the prime minister, is to meet the country's 10 biggest export companies this week, as well as trade unions and employers' organisations, to discuss plans to increase economic growth, "improve labour market conditions" and reduce business costs.

The move follows the approval on Friday of a tough 2011 austerity budget, including tax rises and spending cuts that many economists fear could plunge Portugal back into recession after a year of moderate growth.

"Portugal has all the conditions it needs to continue financing itself in the markets," Mr Sócrates said, rejecting the possibility that he could be forced to request an international financial rescue if government borrowing costs continued at current levels. After the budget vote on Friday, they remained close to euro-era highs.

"I'm hopeful that the difficult budget measures we have taken will strengthen market confidence in the development of our economy," he said.

His initiative is seen as a move beyond fiscal tightening to address what international bodies including the European Commission see as Portugal's main underlying problem: a "lost decade" of low growth caused by a steady rise in unit labour costs above productivity gains.

9.2%

Rate of Portugal's export growth in first half of year

As well as its fiscal problems, said Gilles Moec, senior European economist with Deutsche Bank, the Lisbon government still had to deal with "a nagging competitiveness issue".

This is partly reflected in a current account deficit that has averaged about 10 per cent of gross domestic product during the past five years.

The minority Socialist government has been cheered by first-half export growth of 9.2 per cent, contributing to GDP growth expected to reach 1.3 per cent this year, after a 2.5 per cent contraction in 2009.

Mr Sócrates hopes to build on this momentum to offset fears that his ambitious deficit-reduction programme, which includes a 5 per cent cut in public sector pay, will choke off growth.

His talks with export groups, which include the oil company Petrogal and papermaker Soporcel, are expected to focus on diversifying markets away from Europe to fast-growing Portuguese-speaking countries such as Brazil and Angola.

The suggestion by Mr Socrates that he may be willing to consider further labour market reforms after changes made in 2008 comes as an unexpected reversal of government policy.

The idea has already been rejected by unions, who last week staged their biggest general strike in recent history in protest against the austerity measures.

Zapatero joined by business elites in promise of reform

Spain

By Victor Mallet in Madrid

José Luis Rodríguez Zapatero, Spain's prime minister, has hosted 37 business chiefs to demonstrate a joint commitment to economic reform and promote international confidence in the country.

The weekend gathering at the prime minister's office in Madrid – bringing together senior ministers and bosses of companies employing 1m people and with turnover equivalent to 40 per cent of Spain's economic output – was the latest move to convince investors that Spain has no need of a bail-out from the European Union and the International Monetary Fund.

"This is a day that has strengthened confidence," declared Mr Zapatero after the meeting of nearly four hours. "We have reinforced our commitment to the economic stability of Spain and to recovery."

40%

Portion of GDP produced by the companies represented

Among those attending were César Alierta of Telefónica, Emilio Botín of Santander, the biggest bank in the eurozone by market capitalisation, and Ignacio Sánchez Galán of Iberdrola, Spain's biggest power utility.

In private, many Spanish business leaders have sharply criticised Mr Zapatero's economic management since the start of the crisis and have called for deeper reforms to the labour market to improve competitiveness. They also resent the high financial and bureaucratic costs of Spain's decentralised political system and its 17 autonomous regions.

But most are convinced that the government's austerity plans, if implemented properly, are sufficient to restore order to Spanish public finances and that further cuts could stop any recovery in its tracks.

Mr Zapatero said his Socialist government was basing its crisis strategy on three pillars: austerity and reduction of the budget deficit; reform of the banking system through mergers among the cajas, or savings banks – due to be completed by December 24; and structural economic reforms to be put rapidly into practice.

The government has said it wants to reform the pension system, extending the retirement age to 67 from 65 early next year, and plans to launch a National Competitiveness Commission.

Both the finance ministry and the Bank of Spain have decided that the best way to calm the increasingly frenzied international debt markets is through greater transparency about Spain's financial position. On Friday, the finance ministry said the central government would report monthly on Spain's public debt, while regional governments would have to give budget updates every quarter.

A coinage debased

Government bonds As the eurozone undergoes the second bail-out of a member state, investors are signalling they can no longer assume that the west's debt is risk-free, write **David Oakley** and **Richard Milne**

National coins, common currency: the 16-country eurozone is under pressure as never before. The debt of Hungary, not a member, is seen in the markets as more likely to be repaid than that of Greece, which joined in 2001

It was a small decision but the symbolism was huge. A few months before Ireland's multibillion-euro bail-out, announced last week, Morgan Stanley quietly switched dealing in the country's bonds, along with those of Greece, Portugal and Spain – together, the four "peripheral" countries often seen as the eurozone's weaker members – from its sovereign debt desk to traders specialising in distressed financial assets, some of the riskiest investments out there.

"Peripheral debt is now an asset class in itself," says a person close to the bank.

Just three years ago, the peripherals enjoyed the same interest rates on their 10-year bonds as Germany, seen as the safest member of the eurozone. Portugal and Ireland even had rates briefly lower than German bunds. But today, in the wake of a debt crisis that has already claimed Greece and Ireland as victims, and is threatening Portugal and Spain, the debt of peripheral countries is viewed as among the world's riskiest. Ireland must pay higher interest rates – also known as yields – to borrow than Hungary, which turned to the International Monetary Fund for $20bn in financial assistance two years ago.

The dramatic change in the fortunes of peripheral countries is part of a bigger story. Since the financial crisis erupted in August 2007, the investment world has undergone a complete transformation – a shift with ramifications reaching far beyond the dealing rooms of the City of London and Wall Street to affect everyone with a pension or a bank account. With widespread instability in the financial markets and a growing fear of the first default by a developed country since the 1940s, those savings are no longer as safe as they once were.

Under both the Basel III rules governing international banking and global insurance rules, top-rated government bonds, such as those of the US and the UK, have long been among the few asset classes against which financial groups need hold no capital because they are deemed certain not to default. Today, however, this rule is beginning to be questioned by investors and even some regulators and policymakers.

"If you think government defaults are likely, then you can conclude [the faith] investors . . . have built up in the risk-free nature of bonds will be challenged and then overturned. This is a mechanism by which contagion will eventually spread to the stronger countries," says Matt King, head of credit strategy at Citigroup.

Such an outcome would lead to increasing pressure on some of the world's biggest and most indebted countries, such as the US and Japan, which depend on the trust of investors to finance their huge borrowing needs.

Mr King sees the present situation as a watershed for bonds similar to those faced by equities in 2000 and property in 2008. "When it is one country, Greece, you can dismiss it. Two, OK. But once it gets to Portugal and Spain, then you can't think about it in the same way again."

Alan Wilde, head of fixed income and currencies at Baring Asset Management, adds: "For many clients, particularly those in America and Asia, Europe has become the big issue. They feel there is a big default risk among some of the peripheral economies." The concern is that a deepening European crisis could jeopardise the financial sector's fragile recovery.

The more immediate worry is just how far the eurozone crisis will spread. Markets are all but certain that Portugal will be snared in the coming months. A big redemption of its debt is due in April, meaning that new money will need to be raised – an event seen as akin to that which triggered the €110bn Greek bail-out in May.

Already, investors have turned their attention to Spain, seen by many as too big to fail if the eurozone wishes to survive. As his country's borrowing costs in recent days hit record highs, José Luis Rodríguez Zapatero, prime minister, told a Spanish broadcaster: "I should warn those investors who are short-selling Spain that they are going to be wrong and will go against their own interests." He "absolutely" ruled out any need for a rescue.

Default barometer

The eurozone debt crisis has pushed one of the more complex and obscure corners of the bond markets into the limelight – credit default swaps. These instruments, used to protect bondholders against default, are being monitored closely as they show an increasing chance of default among "peripheral" countries in the 16-country single currency area.

Greece has risen to a 77 per cent probability of default over the next 10 years, Ireland 53 per cent and Portugal 48 per cent. But CDS volumes are just a fraction of trading levels in the government bond markets themselves, leading some to question their usefulness.

Role of the markets

A wild herd or wary shielders of wealth

"Bond vigilantes" have long been the nemesis of debt-laden countries. Markets were "behaving irrationally", Brian Cowen, Ireland's prime minister, recently complained. Politicians facing a crisis like to blame a lack of rational thought among bond traders.

But to understand Europe's debt crisis fully, it is important to be reminded of the basics of bond investing. Unlike shareholders, who have the potential of a big upside, the best a bondholder can hope for is to get their money back, plus a set amount of interest along the way.

Getting back par, as face value is known, is crucial for bond investors and helps to explain their behaviour. "The bond market is like a herd of wildebeest. When they are running scared, they can individually act perfectly rationally but collectively that can be extremely dangerous. What they want to get back is par. At the slightest suggestion that they won't receive that, they run for cover," says Matt King, Citigroup's head of credit strategy.

"For bond investors it is very binary: 'my upside is par, my downside is default'."

The phrase bond vigilante, coined nearly three decades ago by Ed Yardeni, an American economist and investment strategist, describes the way that markets often regulate the economy when governments and central banks refuse to. That can cause consternation among politicians.

"I do worry that this crisis is being exacerbated because many European politicians fail to grasp how bond markets work," says a senior European policymaker. "These guys aren't aggressive – they are conservative. They just want their money back."

Many bankers argue that the problems of the eurozone have been created not by the markets but by the failure of governments to control public debt. It is for this reason that money has been switched out of bond markets in the "peripheral" countries of the eurozone – those seen as economically weaker – and into other securities.

Research by Citi shows that foreign investors have sharply reduced their exposure to peripheral eurozone government bond markets. The debt held by foreigners in Portugal and Ireland fell from 85 per cent of what the countries issued in 2009 to 65 per cent by the end of the second quarter of this year – a trend bankers say has continued since.

But investors do admit that markets can overshoot. "Look at Europe. A few years ago we were saying that Ireland is as safe as Germany. That was clearly wrong. But now, have we overshot again? The danger is definitely there," says one.

'Clients in America and Asia feel there is a big default risk among some peripheral economies'

Despite such assurances, investors remain concerned that the crisis could spread to Spain. "The question we ask ourselves is . . . will the Europeans have a circuit breaker or will they lose control of the situation?" says Andrew Balls, head of European portfolio management at Pimco, one of the world's largest bond investors.

Politicians in other countries do not conceal their concern. Anders Borg, finance minister of Sweden, which is not a eurozone member, said in May at the height of the Greek sovereign debt crisis, with peripheral yields shooting up: "We now see . . . wolf-pack behaviour, and if we will not stop these packs, even if it is self-inflicted weakness, they will tear the weaker countries apart."

Such events have upended traditional notions about which assets should be classed as risky. "The world no longer falls neatly into developed and emerging market status," says Nigel Rendell of RBC Capital Markets, the Canadian investment bank. "Hungary, which two years ago most fund managers would not touch with a bargepole, now finds itself a safer country to invest in than both Greece and Ireland." Default risks for big emerging market economies, such as Brazil and China, and even for smaller ones such as Chile and Poland, are seen as low.

The changes in perception of risk following the financial crisis in the west have prompted investors to switch out of assets in the eurozone, which is plagued by high public debt levels and fears about economic growth, into robust developing markets. Inflows into emerging market bond funds this year have risen above $50bn, according to EPFR Global, a data provider.

Investment flows out of the eurozone have increased in recent weeks as many peripheral countries' bond yields have risen to levels unprecedented since the launch of the euro in 1999.

After a brief stabilisation in the summer, the turning point for the markets came with a Franco-German proposal announced in October that from 2013 bondholders should share the burden of any state bail-outs. Investors suddenly focused more intently on the risk of losing money.

For months, European policymakers had assured them no eurozone country would be allowed to default. The European Union summit on October 29 forced investors to reassess their faith in such assurances. The Germans, in particular, insisted on a future mechanism for debt restructuring in which investors footed some of the bill.

Jacques Cailloux, chief European economist at RBS, the British bank, says: "After October 29, investors saw the bail-out option as a short-term solution. Longer term, they would have to face up to losses. Many felt this would apply to existing bonds. With a rescheduling of Greek debt very likely, and increasing chances that Ireland and Portugal would go the same way, the few investors that still held these bonds decided it was time to sell."

As the eurozone crisis advances, investors are starting to look at the bigger lessons of the affair. Debt from peripheral countries looked attractive when it offered a higher return than German or US bonds but seemingly without any more risk. Instead of pricing in "credit risk", or the chance of a default, many investors viewed all developed-country debt as posing only "rates risk". This is where there is no possibility of default but the danger is of lower returns if official interest rates are raised.

Mr Balls says: "You had a lot of investors that looked at [peripheral debt] as interest-rate risk with free spread [the premium paid above German bond yields] attached who have had a very painful wake-up call." Today, he says, those investors have been forced to realise that: "Germany has practically zero credit risk. At the other extreme, you have Greece with a very large credit risk."

Other investors have followed suit in reassessing the risk in peripheral debt. Soon after reshuffling its trading desks, Morgan Stanley suggested that peripheral eurozone countries' bonds should no longer be classed as government debt for investment purposes. It argued they now lack the characteristics of the highest-rated sovereign debt, which can easily be sold in times of stress. Anyone trying to sell Irish bonds recently, for instance, will have found it difficult.

"Peripheral bonds are credits – you shouldn't look at them as government bonds," says Gary Jenkins, head of fixed income at Evolution Securities.

These fundamental changes in the markets, in turn, raise questions about the standards imposed by global financial supervision. According to Mr King: "What is brutally exposed is the fallacy of the banking and insurance regulations that government bonds have zero default risk and zero liquidity risk." A senior European policymaker involved in the global regulatory talks covering banking and insurance says: "The idea that any government bond could be perceived as having no risk at all has long struck me as wrong."

Today, the number of governments whose debt still qualifies as risk-free has dwindled to a handful, including the US, the UK and Germany, after countries such as Ireland and Spain lost their top credit ratings.

But even these economies are not as resilient as they once were. Enormous public debt levels in the US and UK cloud the outlook. For Germany, the problems of the eurozone are seen as a threat. The finance director of one of the country's leading financial groups says: "I don't think markets are quite appreciating the risks facing Germany. If it has to pay up for a big European rescue, yields on bunds should rise."

Although the US and the UK retain their top-notch triple-A credit ratings, they are not seen as stable as they once were. Standard & Poor's, the rating agency, last year warned the UK that it could lose its triple-A status if its public debt was not reined in, although it has since softened its stance. Moody's, a rival agency, said in a report that the US and UK ratings had weakened; though they remained in the triple-A category, the increasing amount they had to pay to service their debt made their economies more prone to financial shocks.

"It is not going to be an easy ride for even the biggest and wealthiest economies," says Mr Jenkins. "The peripheral crisis may just be the tip of the iceberg. There has rarely been this much uncertainty in the markets."

VIDEO

Lex writers discuss why bond investors are selling **www.ft.com/lexvideo**

A crossover in confidence
Government 10-year bond yields

Source: Thomson Reuters Datastream

FINANCIAL TIMES

"Without fear and without favour"

Monday November 29 2010

Germany sets out roadmap to default

Berlin's moves on bank and sovereign debt are welcome

Throughout the eurozone crisis, policymakers have been reluctant to countenance the idea that either sovereign borrowers or big banks might ever default. Now Germany has come up with two policies that would make both far more credible. This is to be welcomed.

The first is an idea to append so-called collective action clauses to all future issues of eurozone sovereign debt. The second is a law that Berlin is pushing through to establish a special resolution regime that would allow the regulator to deal with failing banks.

Germany has been rightly arguing for an orderly mechanism to allow countries to default if they cannot repay their debts. The collective action clause could be a way to achieve this. Eurozone countries would add the clause to the contracts of new sovereign debt issues, allowing restructurings to be accepted by a majority vote of the creditors. By overriding holdouts, this would make orderly restructurings possible.

True, this would not change things today. Collective action clauses help only when enough of a country's outstanding debt contains such clauses to make a difference. That lies some years in the future – even were such a measure to be agreed upon across the eurozone and enacted immediately. But where it might help in the current crisis is in persuading Germany to extend or enlarge the European financial stability facility.

In the meantime, with sovereign solvency far from assured, there is a risk of contagion to the financial sector – especially for those sovereigns with bloated banks. Crises can blow up with surprising speed. So it is to be welcomed that Germany is finally enacting a special resolution regime that could permit the regulator to impose restructurings on banks. True, this will work only if the regulator has the gumption to use it. So far, Berlin has shown little willingness to let creditors suffer. But at least it demonstrates that Germany is trying to get ahead of events at last, rather than trail behind them.

Doing these things in the midst of a crisis is not ideal. Objectors will point out that they will push up borrowing costs both for banks and for states at the very moment when this is hardest to bear.

But there are no easy choices. Some countries already face sky-high borrowing costs. And it is clear that there can be no return to pre-crisis conditions, where all could borrow at or near German rates. That flawed model is now broken. Berlin's ideas may not be the final destination, but at least they point in the right direction.

The hot debate

Leaders at Cancún must act to curb climate change

Even the United Nations admits the Cancún meeting is unlikely to produce an international pact on how to deal with global warming. We should not allow international discord to persuade us that tackling climate change is impossible, however. Taking steps to curb carbon emissions is a reasonable premium for catastrophe insurance: we cannot gamble with the planet.

The risk of climate change is among the most complex collective challenges humanity confronts. It is not surprising there is no easy resolution. But progress has been made since the 1992 Rio Earth Summit. Then, climate change was a minority concern; now, most scientists agree that man-made global warming is a real, urgent crisis.

That international summits have not produced a binding commitment to cutting emissions does not mean such gatherings achieve nothing. All talk and no action is bad. But abandoning the conferences would push climate change even further down – or off – the agenda. Summits also apply moral suasion on countries to stand by their existing commitments.

Meetings have not accomplished enough. Though nearly 200 nations have advocates in Cancún, the main disagreements about possible action are staked out within the Group of 20 nations, between China and the US in particular. At Seoul, the G20 failed to take the lead on preparing a deal.

Finance ministers should now be at the heart of climate change policy. We must put a number on the cost of degrading the earth to give the environment a value in political calculations. Sensible decisions can be made on the basis even of estimates. The 2006 Stern Review on climate change found that early action to cut emissions outweighed the costs. Spending one per cent of gross domestic product per annum would avoid the worst effects – an acceptable insurance premium.

Costing the earth is difficult, but we can price carbon – and make countries pay for what they emit. A global scheme of tradeable emissions quotas is the best way to do this. Leaders at Cancún should flesh out the vague commitments they made at Copenhagen. This includes a more detailed timetable for cutting emissions and an agreement in principle on the idea of national quotas – including for the emerging world: China is now the world's largest carbon emitter.

The best that can be hoped for Cancún is that, even when discussion heats up, the meeting continues. Warming tempers in Mexico can be contained. Warming temperatures on the planet cannot. That is the point.

Insiders off side

Investigators are right to treat insider trading aggressively

Insider trading is being treated with a new seriousness on both sides of the Atlantic. In the US, the Federal Bureau of Investigation last week raided several hedge funds as part of a broad inquiry. In the UK, charges were brought against five people in a crackdown on investing abuses by the Financial Services Authority.

The US sweep is led by Preet Bharara, a federal attorney, who has defended wiretapping as a necessary step to gather evidence on a crime that is notoriously hard to prove. The FSA is attempting to compensate for past failure to enforce criminal sanctions against the offence in the UK.

Some academics, such as Milton Friedman, have argued for insider trading to be legal on the grounds that it is not only difficult to stop, but helps to prevent a false market in shares. They say that insiders are best placed to know how a company is doing and share that knowledge rapidly by buying and selling shares. It has even been argued that insider trading creates an incentive for innovation, since executives can make entrepreneur-like profits by coming up with new products and buying shares ahead of others. On this view, insider trading is a victimless crime that benefits shareholders.

These arguments completely fail to justify what amounts to corporate corruption. If executives – and the bankers, consultants and lawyers who advise them – are permitted to profit from inside information in this way, it makes a mockery of fairness and undermines the legitimacy of financial markets.

The US probe focuses not only on investment funds but also on "expert networks" – consulting groups linking investors who want to learn about industries or technologies with experts in the fields, including current and former executives of public companies.

These activities are risky, and the largest expert networks have controls in place to stop executives from leaking price-sensitive information. But standards are not uniform across the industry, and calls between experts and investors are rarely tape-recorded or monitored.

Through aggressive techniques such as wire-tapping, investigators may have uncovered abuses that must be addressed through stricter self-policing or regulation. Expert networks have a proper function in informing investors, but they must operate within the law.

We have not yet seen the scope of the US investigation but the evidence so far is that regulators have woken up to the seriousness of insider trading abuse. Every fair investor should welcome that.

Letters

Wide implications from logic of banking reform

From Mr Richard Barwell.

Sir, David Miles ("Banks fail to convince crying foul over Basel reforms", Comment, November 24) argues that the costs of the Basel process have been grossly exaggerated, pointing to the "powerful logic" of the Modigliani-Miller irrelevance propositions.

In theory the impact of reducing leverage on banks' funding costs should be offset by a decline in the required return on equity. If MM holds, the costs of implementing Basel III will be minimal.

The MM propositions rest on a number of assumptions. Forget the fact that interest payments and dividends are treated differently in the tax code – one distortion should not justify another.

The key question is whether MM fails because the market is inefficient – because contracts are not perfect, valuable information is not common knowledge and the market is not populated with the rational, optimising, arbitraging automatons that classical finance assumes.

If – and for some it is a big if – the efficient market assumptions are a reasonable approximation to reality then the benefits of tighter regulatory requirements should far outweigh the costs. But those assumptions also imply that there is a modest role for macroprudential policy – the proposals for counter-cyclical capital and liquidity surcharges over and above the regulatory floor.

The justification for macro-prudential interventions is to counteract market failures which lead to a build up of risk within the system that increases the probability and severity of crises.

But those market failures don't exist in the efficient market: there is no risk illusion, no herding around poor strategies driven by a lack of information or payoffs that increase in the size of the herd, no excess risk-taking on the back of bad contracts.

A key goal of macroprudential policy is to stabilise lending. But MM suggests that any attempt to use capital requirements to achieve that goal will end in failure. Capital structure is irrelevant and policymakers will have little traction on lending.

The Modigliani-Miller irrelevance propositions may be the right framework for calibrating the new regulatory standards.

But their powerful logic has clear implications for the policy prescription du jour.

Richard Barwell,
UK Economist,
RBS Global Banking & Markets,
London EC2, UK

Reality is Basel will damage the weakest lenders the most

From Mr Simon Samuels.

Sir, In "Banks fail to convince crying foul over Basel reforms" (Comment, November 24), David Miles supports the Modigliani-Miller logic that banks with higher capital ratios should enjoy lower funding costs, which in turn questions banks who protest that higher Basel III ratios will be a drag on profitability.

At the risk of rattling the cage of these three economists, I would disagree.

The distortion of implicit government guarantees means that in wholesale funding markets some of the weakest capitalised banks fund cheaper than some of the strongest – think German versus Spanish banks.

In the most important funding market – customer deposits – explicit government guarantees through (ever more generous) deposit guarantee schemes renders capital ratios almost meaningless in setting deposit funding costs.

As the famous baseball manager Yogi Berra observed: "In theory, there is no difference between theory and practice. In practice there is."

Simon Samuels,
Radlett, Herts, UK

From Mr Simon Gleeson.

Sir, It is surprising to see the line that bank capital increases are costless because of the Modigliani-Miller theory being advanced by a member of the Bank of England's monetary policy committee ("Banks fail to convince crying foul over Basel reforms", Comment, November 24).

The Bank considered precisely this issue in its June 2009 Financial Stability Report, and produced a very good graph illustrating its conclusion that no matter how true this may be as a piece of theory, "there is not a strong relationship in practice between banks' capital positions and the cost of debt".

Simon Gleeson,
Clifford Chance,
London E14, UK

Dublin airport's T2 just isn't necessary

From Mr Michael O'Leary.

Sir, Dublin airport's spin doctor (Letters, November 24) cannot make a silk purse out of a sow's ear, or in the case of Dublin airport, a big white elephant's ear!

Lest your readers be misled about Dublin airport's new €1.2bn Taj Mahal terminal (a fitting welcome lounge for the International Monetary Fund!) may I correct Paul O'Kane's claims as follows:

1) Terminal 2 is 12 months late and five times over budget. Dublin airport originally promised that this terminal would be operational in "late 2009" and would cost "€170m-€200m". In fact it opened in late 2010 and it cost €1.2bn, a five-fold overrun.

2) This new white elephant isn't necessary. The existing terminal at Dublin can handle up to 30m passengers a year, but traffic has collapsed from 24.5m in 2008, to 18m passengers in 2010. This is directly due to Dublin airport's ludicrous cost increases including a 40 per cent hike in fees in 2010, when inflation in Ireland is 0 per cent.

3) Ryanair's description of T2 as a bankrupt property development is entirely appropriate given that its owner, the Dublin Airport Authority, last year recorded a loss of €14m, yet has borrowed some €1.2bn to develop T2, which Dublin airport doesn't need, and its airlines won't use. Dublin airport is incapable of generating sufficient income to repay these extraordinary debts.

4) Finally, both the DAA and Terminal 2 are "state funded". This year the minister for transport ordered the Irish aviation regulator to approve a 40 per cent increase in DAA fees, solely to fund T2 and to prioritise the "financial viability" of the DAA over all other considerations such as tourism or passenger welfare.

Michael O'Leary,
Chief Executive, Ryanair,
Dublin Airport, Co Dublin, Ireland

A sell sign?

An ominous four black swan event

From Mr B.J. Rickard.

Sir, I do not wish to cause any despondency, but earlier this year, at Reading, my wife took this photo of a pair of black swans and their two cygnets. We have never seen or heard of such an event on the Thames before. Should we sell everything and put it into gold?

B.J. Rickard,
Kingston upon Thames, Surrey, UK

Brazil needs to upgrade runways

From Mr Edward Berry.

Sir, Brazil's airport shortfall can not solely be remedied by increasing spending on the capacity of the terminals ("Brazil faces airport shortfall at World Cup", November 19). I would remind you of the runway length and pavement buckling issues at Congonhas in São Paulo that led to the horrible crash there in 2007. In July 2010 on one occasion the airport at Salvador, Bahia, had to close for a day due to pavement issues caused by heavy rain similar to Congonhas. Brazil needs to upgrade its runways to take larger and heavier planes where possible, before they lose frequent visitors like myself.

Edward Berry,
Prineville, OR, US

Bank was always in a position to act

From Mr Peter Lloyd.

Sir, When Martin Wolf says it is not "surprising that private suppliers of credit failed to discipline the boom: they caused it", he raises an interesting governance issue, and can at best only be partly right ("Ireland upends the German perspective on the eurozone", Comment, November 24).

Individual bank lenders should pay for the consequences of their reckless actions and of course in Ireland they are not, having been bailed out. However, looking at their lending behaviour collectively, which is the key issue, the Irish central bank was always in a position to act even without any control over interest rates.

According to its own figures, adjusted private sector credit was growing at 30 per cent annually in June 2006 and more than 20 per cent for most of 2007, a two-year growth of almost 60 per cent. You don't have to be a pure monetarist to know that those levels of growth in a low-inflation environment are likely to be carrying very high levels of risk for your country.

I am unaware of any eurozone economic rule that prevents governments taking action in such circumstances. Private sector lenders may have been rash, and should suffer, but it was in fact the government's failure, for whatever reason, to deal with that credit boom which was the great governance failure and the cause of the crisis.

Peter Lloyd,
London SW15, UK

The government has scrapped the wrong aircraft

From Mr John A. Rimington.

Sir, The Financial Times reported ("Top general urges forces to back cuts", November 23) that the new chief of defence staff had emphasised the need for Britain to retain a flexible security posture.

This need has been denied from the outset by scrapping the Harrier, the only aircraft in the current UK arsenal that can operate from present and future aircraft carriers.

On frequent occasions during the Bosnia and Kosovo operations, land-based aircraft including those from the Royal Air Force operating from allied airfields were grounded by fog, and so cover was provided by carrier-based aircraft, sometimes the US navy, sometimes the Royal Navy or French navy.

The Sierra Leone operation was a great success, when air defence of the forces involved was luckily not necessary, but that will not always be the case. The Falklands case is well-known.

The government has scrapped the wrong aircraft.

By retaining Tornado, on which savings of £7.1bn could have been made, and scrapping Harrier, arguably the better aircraft for counter insurgency operations, thereby saving £1.1bn, it has denied the Royal Navy that vital ability to provide the UK with a worldwide fixed-wing strike capability for at least the next 10 years, and the savings accrued could have paid for both the new aircraft carriers.

Further the expertise acquired in RN carrier fixed-wing operations over many decades does not grow on trees and few of the experts currently serving afloat will still be there when the Joint Strike Fighter eventually enters service.

Do not suggest that the RAF could supply this "expertise". It tried prior to the second world war and it did not work. If it had wanted to serve at sea, it would have joined the navy.

The government needs to think again.

John A. Rimington,
London SW18, UK

In active service for 96 years

From Mr Tom Hayhoe.

Sir, The 97-year-old lady volunteer at Canterbury Cathedral and the 96 year old at BBQ are both an inspiring example (Letters, November 25), but still don't quite match Admiral of the Fleet Sir Provo Wallis who, as a beneficiary of a special retirement rule for those who had held command during the Napoleonic War, remained on the Royal Navy's active list until his death at 100, a full 96 years after taking the King's Shilling.

Tom Hayhoe,
London W6, UK

Correction

● The rock salt industry in the UK as a whole has doubled production in 2010, not Salt Union, as reported in an article on November 26.

COMMENT ON FT.COM

FT Arts podcast
With the opening of Alexander Raskatov's A Dog's Heart, is operatic tradition dead?
www.ft.com/podcasts

Letters online
For correspondence on climate strategy and European populists go to
www.ft.com/letters

● To contribute please e-mail: letters.editor@ft.com or fax: +44 (0) 20 7873 5938 Include daytime telephone number and full address ● For corrections e-mail: corrections@ft.com

A humbled Ireland looks to its roots

Book Review

Politics and public life must be transformed if the one-time Celtic Tiger is to recover its poise, according to a trenchant critique that impresses **David Gardner**

Irish Republicanism is overlain with the history of struggle against English rule, the war of independence, the civil war that followed and divided nationalists into opposing tribes that still dominate the main parties, and, of course, the bloody campaign of the provisional Irish Republican Army to eject the British from Northern Ireland.

It takes a brave man, then, to call for a new republic – with a small R, but big civic values – rooted in universal republican ideas and ethics.

After the monumental binge of the past decade, in which Ireland's financial and political elites alchemically transmuted the real Celtic Tiger boom of the 1990s into a vast property bubble, Fintan O'Toole argues that "the republic is still an idea that can frame the search for public morality in a despairing Ireland".

Indeed, unless politics and public life are radically transformed, he believes, there is no way out of the financial pit Ireland's cronyist elites have dug, which all too many Irish citizens happily leapt into. "Irish people have had a crash course in the nature of self-serving elites," he says, with their "notion that no self-respecting patriot could be expected to get out of bed for less than €250,000 a year plus a pot of gold at the end of the pension rainbow." To this O'Toole counterposes "a republican ethic of citizenship in which excess is not worshipped, rules are agreed to and kept and responsibility is taken – for ourselves and our society".

This is a trenchant critique, written with style and passion, fluency and sardonic wit. (O'Toole is an admirer of Swift, from whom he took the title of his best-selling polemic of last year, *Ship of Fools*.) A columnist on the Irish Times, O'Toole is an important voice in the debate reverberating across Ireland. Unabashedly on the social democratic left, he tends to polarise opinion in what is still a conservative country.

An admired literary historian and critic, he is patronised by rivals and critics who suggest it would be better if he had stuck to that. Yet Ireland's vibrant literary world seems to have had a keener sense of where the country was heading than the cheerleaders of the Celtic Tiger – not just the builders, bankers and gombeen politicians who brought the country to its knees but the economists, commentators and so-called risk analysts who pulled on the green jersey to egg them on.

O'Toole suggests the Celtic Tiger frenzy filled the God-sized void left by the decline of the Roman Catholic church, and its quasi-theocratic control of sexual morality and social mores. "The Celtic Tiger wasn't just an economic ideology. It was also a substitute identity. It was a new way of being that arrived just at the point when Catholicism and nationalism were not working any more."

Enough is Enough
How to Build a New Republic
By Fintan O'Toole (Faber, £12.99)

Now there is a new vacuum – the long-ruling Fianna Fáil is finished as a national movement if not as a party – and leadership, especially of the aspiring middle classes who had most to lose in this bust, is up for grabs. "There is a calculated judgment that the Irish people will take all the pain of shrinking public services, mass unemployment and forced emigration in order to pay off the gambling debts of their betters and that Ireland will remain politically stable," says O'Toole. He does not believe this. What does he propose?

He retrieves the short, bell-clear Democratic Programme of the first Dail of January 1919 – Ireland's first genuinely representative parliament – which stated that "all right to private property must be subordinated to the public right and welfare".

There is an echo of Orwell in O'Toole's repetition of the word decency and his assault on public squalor. Drawing on Tony Judt, the historian who issued a call to social democratic arms just before he died this year, he contrasts Ireland's recent history with postwar reconstruction across Europe: "that vast public enterprise of putting a floor of decency underneath the feet of every citizen is one we have never experienced".

He paints a picture of a highly centralised Ireland with an unaccountable executive and MPs devoted to clientilism rather than legislating. For example, the complex bill to reform the central bank went through the Dail in slightly over the hour before lunch, without a single minister present from the Department of Finance. The need, he argues, is for real local government, locally funded, freeing members of the Dail to focus on national affairs.

Other needs would include unravelling the cat's cradle of board membership through which three dozen people dominate almost all Ireland's private and public corporations, and for public appointments procedures to cut through tribal loyalties and build up an intellectual immune system. A republican agenda indeed.

The writer is international affairs editor

Europe is edging towards the unthinkable

Wolfgang Münchau

A correspondent whom I respect challenged me last week. It is easy to criticise eurozone governments, he wrote. But how about some constructive advice?

OK. The following actions would solve the problem. But the chances are you are going to hate them.

First, I would favour some immediate debt restructuring for Greece, Ireland and Portugal – the three countries with the most unsustainable debt trajectories. This could involve haircuts, debt-for-equity swaps or other schemes. What matters is that the liabilities of the public sector are reduced to a sustainable level.

On its own, this would not be a solution at all. On the contrary, the bond markets would seize up completely. Investors would quickly conclude that all European debt – except German – was insecure.

For the plan to work, it would take two further steps. First, we have to find a way to separate national debt from financial debt. I would change the remit of the European financial stability facility, the sovereign bail-out fund, and charge it with the restructuring and downsizing of the European banking sector. Banking must be taken away from the member states.

That would alleviate the pressure on sovereign debt but would not solve the problem. For that, I would turn all outstanding sovereign bonds, existing and new, into a common European treasury bond.

Since a single bond constitutes the core of a fiscal union, you also need a functioning institutional set-up. You need, of course, a eurozone treasury, lots of rules and democratic control. What I am proposing is a regime change. It would require a new European treaty, no doubt. But it would end the crisis. And it would end all speculation about the longevity of the euro.

Meanwhile, back on earth, let me assure you that my proposal stands no chance of success. For a start, Angela Merkel, the German chancellor, would not allow it. The German constitutional court would not allow it either. The proposed treaty change would almost certainly be defeated in some referendum if it were agreed. And member states would never countenance ceding control of their banking sectors.

So how about some realistic suggestions? I think we have moved beyond a situation in which the "realistic" technical fix can do the job. If we had the luxury of not starting from here, as the Irish joke goes, a much less invasive solution could have been found several years ago. One could have constructed a system based on policy co-ordination.

If we had the luxury of not starting from here, as the Irish joke goes, a less invasive solution could have been found

One could have established credible bail-out, default and exit rules. But the European Union chose not to act during the euro's fair-weather decade. The longer you wait, the more radical the solution has to become. Today, the eurozone must deal with a simultaneous – and interacting – financial and governance crisis. The radical nature of my proposed solutions is merely a reflection of the mess we are in.

So what is going to happen? The eurozone has only one strategy for now, the bail-out, shortly to be followed by the bail-in. Axel Weber, president of the Bundesbank, last week made a revealing comment when he offered his macro-arithmetic of the crisis. He said the various bail-out funds added up to €925bn. The maximal possible financial risk in the eurozone is €1,070bn, leaving a small gap of €145bn. The implication is that the eurozone would somehow find the petty cash to make up the difference in a worst-case scenario.

This is very typical of the complacency with which European policymakers approach this crisis. How can we be so certain about the maximum damage? Every day last week, the markets seized on another country. On Friday it was the turn of Spain. Who knows, this week they might go after Italy and Belgium.

There are other accidents waiting to happen. Ms Merkel and Nicolas Sarkozy, the French president, were last week putting the final touches to their new bail-in rules, to introduce collective action clauses in sovereign bond contracts. I would not be surprised if at least one member state rejected the Franco-German diktat. For example, I cannot see how Spain or Italy can conceivably support them. To use a seasonal analogy, it would be like turkeys voting for Christmas.

Another accident waiting to happen could be a decision to appoint an unknown technocrat to lead the European Central Bank when Jean-Claude Trichet retires next autumn. As Mr Weber is skilfully manoeuvring himself out of contention, there is a danger that the EU may once again settle for a less well-known candidate, similar to Herman Van Rompuy, who in his first year as president of the European Council has failed to provide leadership during the crisis.

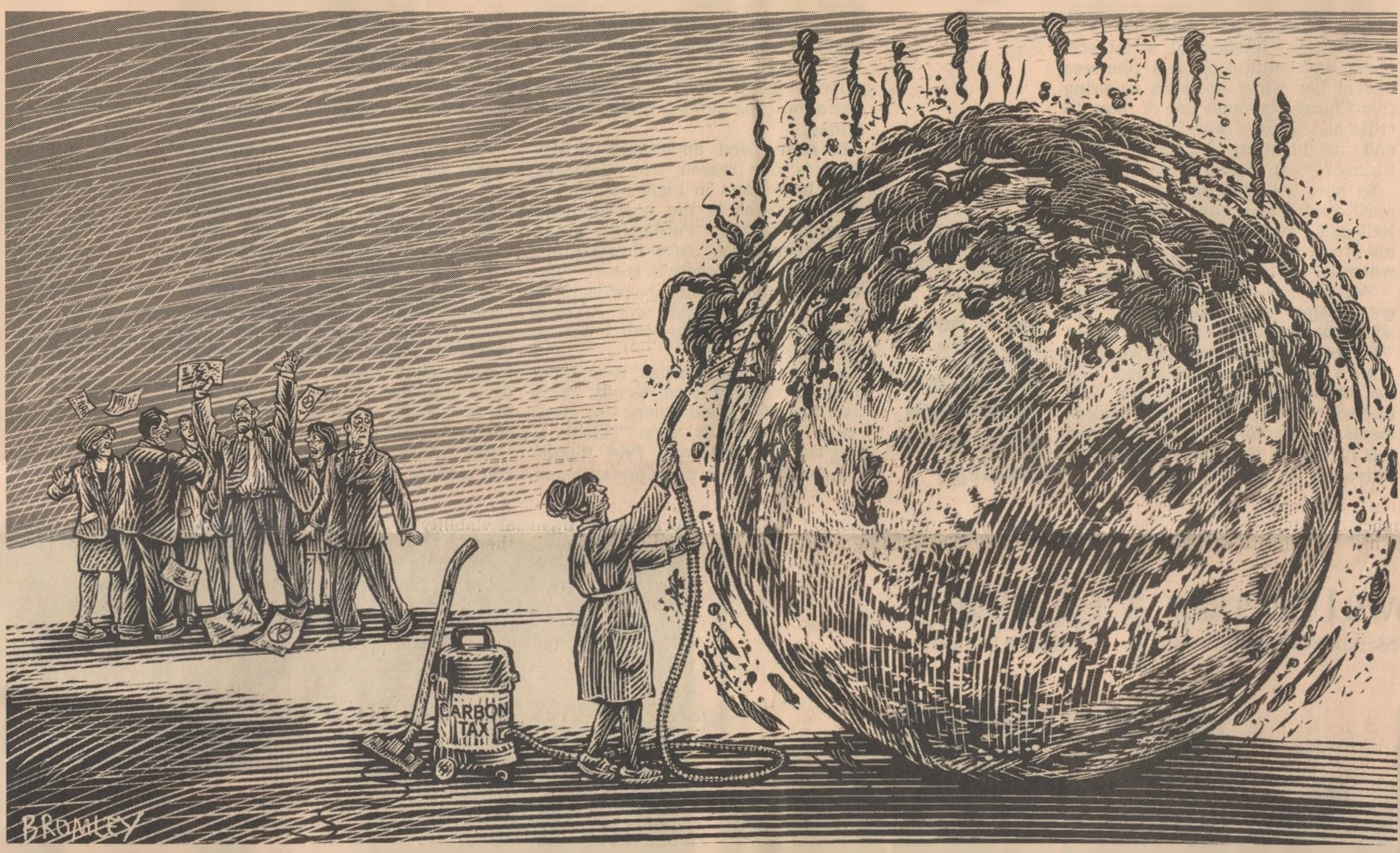
A more immediate accident could be an unco-ordinated decision to wipe out Irish bank bondholders. If that happened, eurozone sovereign risk premiums would go through the roof. This is why I am proposing to separate banking risk from sovereign risk – and to pool the latter. I think bondholder bail-ins are a good idea. But they cannot work on their own.

The eurozone is manoeuvring itself into a position where it confronts the choice between two alternatives considered "unimaginable": fiscal union or break-up. If you are saying my proposals are unrealistic, you are making a very strong statement indeed – one with implications that I somehow find unimaginable.

munchau@eurointelligence.com

Stop talking and start taxing carbon

Clive Crook



Expectations for the international climate change talks in Cancún are low, but not low enough. The failure of the previous gathering in Copenhagen ought to have ended any remaining doubt: the quest for a binding global treaty to cut carbon emissions, at least for now, is over.

Lately, though, this search has been worse than merely futile. It has made incremental action on a pressing global issue harder. Far from advancing solutions, gatherings such as the one in Cancún have become part of the problem.

This goes back to the Kyoto approach to carbon abatement. The defects that yielded the fiasco in Copenhagen were there from the start: grandiosity, exaggeration, complexity and, most of all, ineffectiveness. The Kyoto Protocol, which expires in 2012, did almost nothing to deflect long-term global emissions of carbon from the path they were on to begin with.

Especially in the US, the overselling of the process, the alarmism deemed necessary to excite support, and the harnessing of climate science to a pre-determined policy agenda, have all combined to turn public opinion against stronger action. That might have been all right, if the climate bureaucrats had been able to get on with it regardless. (Ignoring voters is easier in some countries than others.) But the other great flaw in the Kyoto approach – its focus on the maximally contentious issue of burden-sharing – ruled out that as well.

To be sure, an effective climate-change regime has to be global, since what matters is the global stock of atmospheric carbon. An efficient regime also needs co-operation, to ensure that reductions happen where they are cheapest. Equity matters too: how much can the rich countries rightly ask the poor to contribute? Even so, holding everything hostage to a minutely specified global agreement on burden-sharing was a fatal error.

The way forward is lightly co-ordinated national policies that can be offered to electorates as serving national as much as global interests. Even in the sceptical US, feasible options present themselves. But this more workable approach does pose dangers of its own.

In the US, cap-and-trade was dead even before the midterm elections. The Obama administration plans to rely on regulation instead. The Supreme Court has ruled that the Environmental Protection Agency (EPA) can regulate carbon dioxide as a pollutant, and the agency is getting ready to issue rules for utilities and other big emitters in the new year.

Republicans will resist, through new legal challenges, congressional inquiries and countermanding legislation (which would probably encounter a presidential veto). The problem is not, as most Republicans say, that the entire venture is misguided, but that this micro-regulatory approach will be costly. The bureaucratic overhead will be huge, as producers vie for waivers and other special treatment. Effort and resources will be misdirected.

The second front in the administration's campaign, after regulatory action, will be the so-called competitiveness agenda, which is all about encouraging clean-energy innovation and "green jobs". On the demand side, throw in tax reliefs and other incentives for energy-saving investments by businesses and consumers, and you have an industrial policy that is capable, its advocates say, of doing the rest.

Bureaucratic overhead and misdirection of resources will partly neuter these initiatives too. In addition, the green-jobs motif is false advertising. (Governments should have learnt by now that it is better to be straight about these things.) Industrial policy cannot create net new jobs. Rather, it promotes the creation of certain kinds of new jobs by discouraging the creation of others. And you do the unemployed no favours by inducing them to train for green jobs if the demand for their skills then fails to materialise, as many are finding.

Where, then, should the government concentrate its efforts? No prizes for guessing the answer: introduce a carbon tax.

In the US, many dismiss this as a political impossibility. They are wrong. Whether the country likes it or not, with or without an effective climate change policy, Americans will eventually have to pay more in taxes. The state of the public finances decrees it. However you do the political calculations, this unpopular outcome is inevitable. Therefore, start measuring a carbon tax against the relevant alternatives. At worst, a moderate carbon tax would be no more indigestible than higher income taxes or other revenue-raising options.

And, in every important way, it would be the best climate-change policy as well. Crucially, it would work, which is quite a distinction for proposals in this field. A recent paper for the Brookings Institution by Warwick McKibbin, Adele Morris, and Peter Wilcoxen compares a carbon tax (starting now at $30 per metric ton of carbon dioxide, rising at an inflation-adjusted 5 per cent a year) with a system of tax credits (similar to some already in force) for energy-efficient investments by households. The carbon tax would raise roughly $150bn a year, and cut carbon emissions by 60 per cent in 2040. The efficiency incentives would *expend* roughly the same amount of revenue, in order to cut emissions by less than 2 per cent.

Compared to EPA action, a carbon tax is simpler, more transparent, less susceptible to rent-seeking and more economical in bureaucratic overhead. It also provides an indicator around which future international co-operation could be organised and explained. After their break in Cancún, if the US and other governments want to get serious, this is where they should look.

clive.crook@gmail.com

CLIVE CROOK'S BLOG

Read and post comments on this column by going to **www.ft.com/clivecrook**
To follow Clive's blog, go to **www.ft.com/crookblog**

It is risky to rely on oil profits for our pensions

Vivienne Cox

As the true financial impact of the Deepwater Horizon crisis on BP becomes clearer, including plans potentially to reduce the regular dividend from next year, an inconvenient truth about the exposure of our pension funds (and pensions) is emerging. Quite simply, the funds we hope to rely on when we retire are highly dependent on the dividends paid out by high-carbon sectors, especially oil and gas.

I appreciate that the political climate for addressing these issues is rather different now than it was a year ago when the countdown was on for the Copenhagen climate change talks. Now, with the follow-up conference starting in Cancún on Monday, the appetite for concerted global action is reduced.

Yet, looking at BP, we can appreciate the extent of this exposure to high-carbon sectors. Before halting its dividend amid the furore of the Deepwater oil spill, the company alone is widely acknowledged as having accounted for £1 in every £6 of dividends paid to UK investors. If you count Shell and BP together, they have historically created 20-25 per cent of total annual UK dividends.

Having profitable companies able to pay dividends at this level is valuable. However, even though I am an ex-BP employee myself – I worked there for 28 years until last year and ran its gas, power and alternative energy sectors – I think it is a risk to rely on cash flows from these high-carbon investments for the long term.

Fossil fuels will continue to be used for a long time, and increasingly the risks associated with their use are becoming more evident: risks associated with climate change, physical risks associated with drilling in deeper water and in more technically challenging environments; and the geopolitical challenges arising from the concentration of resources in a few countries. Historically, investors have underpriced or largely ignored these risks, whether oil spills or the effect of greenhouse gas emissions. Finally facing up to these risks and pricing them appropriately is becoming unavoidable. It will be critical for improving the appeal of low-carbon investments relative to high ones.

But, as investors, fund managers and policymakers wake up to these systemic risks and seek alternatives, there are few options of the size required to displace high-carbon investments. Without credible options it will be too easy to continue with the status quo and so build up systemic risks and their associated consequences for the future. So, in addition to pricing properly the risks that high-carbon investments face, whether voluntarily or through mandatory requirements, we must create low-carbon investment opportunities that meet investor needs.

Even though I am an ex-BP employee myself, I think it is a risk to rely on cash flows from high-carbon investments

For this to happen at the scale and speed required, a number of things must happen in tandem. First, companies such as BP can transform their business models so their activities help drive rather than hinder a global low-carbon transition. Existing players can continue to create value for investors by evolving in response to the threats and risks associated with a dependency on the high-carbon economy. The oil companies need to rebalance towards gas, which produces fewer emissions than oil. They also need to open up their infrastructure and distribution to other providers. There are plenty of people who may be better at the development and production of new fuel sources, but they need access to the market.

Second, many more low-carbon innovators and new entrants, boosted with the help of well-designed policy frameworks and carbon pricing, need to expand quickly and create opportunities for investors. Ensuring that the policies are in place to prime new sectors for sustained growth will be vital.

Third, we need to find better ways of financing low-carbon infrastructure. One possible way to achieve this would be creating a liquid market in "green" infrastructure bonds. These long-dated corporate bonds, issued on the back of operational cash flow produced by low-carbon infrastructure and at a sufficient scale to be liquid, could be attractive to a range of investors looking for diversified financial returns in the long term. Without them, we will not be able to find the capital required for the transition to alternative energy, whether offshore wind farms in the North Sea or solar farms in California.

This strategy – one that generates the dividends needed to fund growing pension liabilities, while also delivering the capital for a global transition to a clean, green, low-carbon economy – is essential. If low-carbon investments cannot generate the stable long-term returns needed by pension funds and institutional investors, we will never be able to access the pools of capital deep enough to finance the estimated $46,000bn in additional investment required by 2050 to tackle climate change.

The writer is chairman of Climate Change Capital, the environmental investment and advisory group

The City's masters need to stay above the fray

Alistair Darling

As the world's centre of economic gravity shifts remorselessly to the south and to the east, we in Britain need to ask ourselves where we are best placed to compete. Financial services will clearly be part of the answer. London is one of the major financial centres and, frankly, it has to remain so. Yet its pre-eminence is not guaranteed. The need for strong, independent regulation has seldom been greater.

First, we must make it clear that we want to keep this industry. There are plenty of other countries that would like the business and foreign banks will be making decisions in the next few years that will have far-reaching consequences for London. We need to be clear that we want them to do business here and that we are determined to create the right environment to enable them to do so.

That does not mean craven submission to whatever the banks want. Regulation needs to be far tougher and more intrusive. Contingency plans need to be drawn up now in case of a bank's failure. The real problem today remains sorting out the toxic assets still held by too many banks in Europe.

Second, we need to look at London's reputation. Here the position of the Bank of England is becoming increasingly important, not just as a traditional central bank responsible for monetary policy, but also as a regulator.

Reputations matter. It is imperative that the independence of the Bank remain absolute. It cannot afford to enter the political fray. Of course the governor is entitled to his views on the government's fiscal policy. I never had any problem with Mervyn King expressing a view. But when members of the monetary policy committee and, it seems, the Conservative chairman of the Treasury Select Committee believe that a political line has been crossed, then the Bank must think long and hard about what it says. To become identified with one political party would be fatal to its reputation.

The independence of the Bank must be absolute. To become identified with one party would be fatal to its reputation

At a time when the Bank is about to take on the highly sensitive business of regulating banks and other financial institutions, this might be an opportunity to look again at its governance.

I started this reform but it needs to go much further. The MPC has been a success precisely because it is a committee where each member is listened to and where he or she has a vote. The regulatory side requires a different approach. But there must be a more open and transparent means of reaching decisions.

The concept of a governor rather than a chairman is perhaps an anachronism. The Bank is operating in a very different world to that of 1946 when it was founded in its present form. There needs to be more participation in decision-making from people both inside and outside, perhaps mirroring the MPC.

Getting this right is vital for London's future. But so too is the world's perception of our attitude to the financial industry.

Recently I met a very senior executive of a foreign bank. He confided to me that he was at heart a conservative. No surprise there, you might think. But he went on to say that in some ways today's Con-Lib government was, as he indelicately put it, "worse than you lot". He felt the abolition of the Financial Services Authority was a political gesture and in that he is right. He also believed that government rhetoric – particularly the increasingly empty rhetoric of Vince Cable, the business secretary – was achieving nothing concrete and even damaging our reputation in the eyes of the outside world.

We face two years of uncertainty until the regulatory system is overhauled – this at a time when the regulators should be spending every hour of the day asking themselves whether banks across the world are secure. The woes of the Irish banks are not an isolated problem. The stress tests applied in the summer do not pay nearly enough attention to the inter-relationships in the banking system. This is no time to engage in a regulatory restructuring driven largely by politics.

Whether we like it or not, we need banks. London's position is critical for the whole of the UK now. Getting the reforms right and positioning ourselves correctly in the future could have a profound consequence for our fortunes for generations to come.

The writer is MP for Edinburgh South West and a former chancellor of the exchequer

Business Education

Dean's mission to find an MBA strategy for the 21st century

The new head of Kellogg school recognises the need to embrace cultural change to enable it to become a global player, writes Della Bradshaw

Sally Blount is getting down to business. As the newly appointed dean of the Kellogg school at Northwestern University near Chicago, the chic 48-year-old professor is taking the school back to its roots as one of the few top US business schools that focuses on teaching management rather than finance and economics.

Fast-talking and forthright, and a specialist in negotiation and behavioural decision-making, Prof Blount says she is perplexed about how MBAs have been hijacked by the finance industry.

"One of the things that interests me is how the MBA has become associated with market making," she says. "At Kellogg, only 20 per cent of graduates go into financial services" and teamwork and collaboration come top of the skills list. "Kellogg has figured this out. Our challenge is what comes next."

There will clearly be a new direction based on Prof Blount's vision that Kellogg should be a world-class global business school. Unlike many of her peers, she is unafraid to point out that the two-year premium MBA degree may be usurped by the one-year upstart, even at Kellogg.

"Over time, we will be shrinking the two-year and expanding the one-year programme," she says. Today there are close to 100 students on the Kellogg one-year MBA, which runs from June to June. The two-year programme enrols 500 students. The big difference is that the majority of the students on the one-year programme (56 per cent) are from outside the US.

As a result, Prof Blount talks about taking the Kellogg one-year MBA outside the US and teaching it in overseas locations.

That would be in contrast to Kellogg's existing overseas strategy, which relies on partnerships with schools in Canada, Germany, Hong Kong and Israel solely for the Executive MBA degree.

Prof Blount describes these partnerships, signed by former dean Don Jacobs, as "a great late 20th century strategy". But now things have changed. "We've got to be creative; the world has changed. I'm open to a lot of models. I want to find the right answer."

She is four months into the job and, she acknowledges, is still earning the trust of the faculty. There needs to be a cultural change at Kellogg, she says, to enable the school to become a global force. The shift involves faculty, students and particularly administration. However, she accepts that "it takes years to change culture".

But changes outside the business school will force changes inside. "The world is global," says Prof Blount, adding, "except perhaps for [in] higher education". She says globalisation will lead to the emergence of 25 global cities – intellectual, social, economic and cultural capitals. She sees one of her wider goals as ensuring that Chicago becomes one of those 25 cities and plans to work with the city and neighbouring business school Chicago Booth to make that happen.

So how will Kellogg expand overseas? Prof Blount says that some of Kellogg's overseas expansion will involve bricks and mortar, while elsewhere it will involve partnerships.

"My guess is that it will be a different decision in different regions." But she is in no doubt about one thing: "We need money for our global play."

As a private business school that has traditionally paid its own way, Kellogg cannot rely on the endowments of a Harvard or a Stanford, nor can it rely on the state funding of a University of California school.

Sally Blount: 'We have to broaden the MBA curriculum' Shaun Curry

'One of the things that interests me is how the MBA has become associated with market making'

A first saving has been to reduce the size of the proposed new building on the Evanston campus. The money saved will be invested not overseas but in Kellogg's second US campus in Miami, a campus established by Dipak Jain, Prof Blount's predecessor, and a potential centre for more executive education programmes, a key money-spinner.

Retaining and appointing faculty stars is one reason why academic costs have risen in higher education in general, as is the high-intensity teaching method. "Face-to-face learning is expensive," says Prof Blount. On one level Kellogg will reduce overheads by putting more basic lectures online. "Basic courses will go electronic and face-to-face will be more nuanced."

Moreover, she intends to supplement her highly paid faculty stars with business practitioners – or clinicians, as she calls them. This is a long-term project, and Prof Blount acknowledges that these practitioners need to be taught the best way to teach – possibly an industry-wide initiative. "It's not easy to walk in off the street and teach . . . The Socratic method of teaching doesn't come easily to business people."

This will be part of the dean's plan to enhance the MBA curriculum, by including sociopolitics as well as business.

"We have to broaden the business school curriculum. We have to educate leaders who go back and forth [between business and government]."

As well as putting more basic courses online, the classroom learning will take a different format. In the new Evanston building there will be added investment in smaller classroom facilities, rather than the large lecture theatres, so that the school can introduce classes of 40 to 50 students at a time and work groups of 15 to 20 people, a policy increasingly adopted by US business schools.

But unlike many top US schools, and perhaps because of the increasing emphasis on the one-year degree, Prof Blount says Kellogg will not seek to enrol younger students. "I believe people need work experience," she says. "If we have the best curriculum, the best students will follow."

Where new programmes are introduced it is likely to be executive short courses rather than a specialist degree for students in their early 20s. Apart from the obvious revenue implications, Prof Blount is clear about the educational benefit of teaching older students. "You don't learn everything by the time you're 30," she says.

Although Prof Blount is clearly eager to get moving at Kellogg, she is also deeply thoughtful about the role of business and business school. "Business is the dominant social institution of our age," she says, "[although] you can agree or disagree that that is a good thing." She says business needs people who are not making money every day – professors – to stand outside the system and reflect on what is happening.

A social scientist by training, she believes that managers are still novices at creating effective organisations and have to face vast levels of complexity on a daily basis. She argues that technology, properly harnessed, can help deal with that complexity.

"Our technology knowledge outstrips our ability to create robust organisations," she adds. It may be a policy she employs as she drives to place Kellogg on a strong global footing.

Sally Blount: CV

Originally from New Jersey, Sally Blount studied at Princeton for a bachelor's degree in engineering systems and economic policy.

- Joined Kellogg in 1988 for a master's degree and then doctorate, both in organisational behaviour.
- Moved to University of Chicago, (Chicago Booth), in 1992 as assistant professor and later associate professor of organisational behaviour.
- In 2001, joined Stern School of Business at New York University, becoming vice-dean and dean of the undergraduate college in 2004.
- Appointed adviser to the president and provost of NYU for global integration in 2007.
- Became dean of Kellogg school at Northwestern University in July.

VIDEO: UNDER FIRE

Sally Blount of the Kellogg School of Management, the first woman to be appointed dean of one of the top-tier US business schools, on why there are so few female deans at business schools.
www.ft.com/kellogg