

HOW TULIP MANIA BURST THE ECONOMIC BUBBLE (or do we scent chaos in the market?)

Scottish journalist Charles Mackay wrote a book called *Extraordinary Popular Delusions and the Madness of Crowds* in which he attempted to find some rationale behind the herd instinct which seems to bedevil markets. Sound familiar? Well, Charles Mackay published his findings way back in 1841 and although more recently some of his conclusions have been debunked, his basic ideas still attract support.

Mackay was writing about what many argue was the first “economic bubble”...Tulip Mania...which engulfed the Dutch economy in the 1630s. It centred around an exotic bulb brought from the Ottoman Empire which became a “must have” purchase in the fashionable salons of Europe, almost regardless of price. The inevitable happened; the price rose to the point at which the market collapsed.

Surely this could have been seen coming? Mackay contends there is something in the “madness of crowds” which means that even if the problem was foreseen, the signs could still be ignored. Tracking back the current global meltdown we find the modern day equivalent of Tulip Mania exemplified this time not by a colourful tuber but America’s sub-prime mortgage market and the complex financial instruments wrapped around it. An economic bubble just waiting to go pop. People were encouraged to take out loans they could not afford to pay off houses which became worth less and less.

We’ve been there before. Just over a year ago Northern Rock went to the Bank of England for liquidity support. An aggressive business strategy of increasing market share in the mortgage and loans sector left it vulnerable. Northern Rock was exposed to short term loans on the international money markets; the sub-prime failures and the subsequent collapse of those same money markets made money much more difficult to raise. Word got around and despite reassurances from the Bank of England and the Treasury, customers turned up in their droves. On the 14th of September 2007 an estimated £1billion was withdrawn. Three days later the government and the Bank guaranteed all deposits and shares rose 16%.

Another bubble waiting to burst? Not that the event was without warning flags being lifted. Earlier in the year the Bank of England itself had pointed out that developments in the US sub-prime market had not only exposed vulnerabilities in new credit derivative markets but highlighted the “difficulty of valuing instruments on the basis of only a few years experience.” But was anybody actually listening?

Moving swiftly on to the present day and an unusual spectre; delegations from the UK Treasury and local councils going to Iceland in an attempt to unfreeze billions of pounds in assets held in the failed banking system. Over one billion pounds is owed to local authorities, other public bodies and charities. In addition talk at Westminster was of using draconian anti-terrorist legislation to seize Icelandic assets in the UK. Surely a new departure. Not that any of this should have been a surprise. A House of Lords debate earlier in the summer advised caution in chasing these returns from novel suppliers. But again, was anybody listening?

In the light of all of this, McLuhan’s global village looks increasingly like it is built on shaky foundations. Not just a scent of chaos on the markets, but a return to old fashioned protectionism. Already the emerging economies are taking steps to build walls around their trading positions and what else is the effective nationalisation of the banking system but outright protectionism. Whither the Free Market?

Now more than ever is there a need for some sort of radar mechanism which scans the horizon, tracks incoming problems and then formulates a strategy to cope. What we are observing is a fundamental failure in intelligence gathering coupled with policy decisions based on inadequate or misunderstood information.

Are we any better prepared for next time? In turbulent conditions it surely pays to invest in a storm warning system and a raincoat. And someone should keep an eye on the radar.

For more information, visit the [MediaLINK](http://www.linkassociates.com/medialink) website or call Mike Hogan on 07771 962911/ 01332 222299.