

BAILLIE GIFFORD

Edinburgh Book Festival 2011

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Baillie Gifford has been involved with the Edinburgh Book Festival since 2001. Our motivation in the past has been primarily to support one of the city's most valuable local cultural events. However, in the search for new sources of information, our investors are increasingly focusing on academic works and authors to gain more thoughtful views than those typically available from the financial community. During the 2011 Edinburgh Book Festival, we held small group discussions with several visiting authors in the Baillie Gifford library, covering topics as diverse as the fall of Communism in Poland, the Libyan revolution, the history of Russia and what China might look like in a few years' time. All these countries are undergoing important changes with long-term implications for the world economy. We hope that the insights we gathered by talking to these expert commentators will help us to become better investors, and more able to go against the western-focused, gloomy tide of short-term stock market commentary.

The following reviews of four of this year's events underline the extent to which the authors can enhance the firm's research.



Nick Thomas, ICD Director and Partner
Nick is the Deputy Chair of the EAFE Alpha Portfolio Construction Group (PCG). In addition to his duties as a Client Director in the Institutional Clients Department, Nick is responsible for the Baillie Gifford library. This holds over 1,000 books of broad interest to staff, and the list of titles is updated frequently. The firm encourages staff to use the library to help with research and for their personal development. In addition, many of our investment teams hold structured reading days, when they discuss books that are relevant to the investment process and enhance the firm's overall research efforts.



Why Indian Growth May Not Match China

Widespread use of the BRICS (Brazil, Russia, India and China) acronym leads many commentators to talk of the outlook for the group as a whole. However, this creates a false impression of the diverse prospects for each of the component countries.

Nowhere is this more apparent than in the comparison of China with India, as Sir Mark Tully explained when he addressed a small group from Baillie Gifford in a private session during a visit to the Edinburgh Book Festival.

Tully spent more than 30 years with the BBC – 20 of them as bureau chief based in Delhi. His latest book is *India: The Road Ahead*. During the discussion, he spoke of his experiences, and the changes that have taken place in recent years. He also offered his views on the growing importance of India's role in the world, and acknowledged that many of the comparisons with China are ill-judged and do not reflect the cultural differences between the two nations.

The key distinction between companies in India and those in other parts of the world is the existence of promoters. Many observers regard their presence as having a negative influence on the management and development of the enterprises involved in this practice, and on the Indian corporate arena as a whole.

However, Tully believes that the involvement of a promoter need not be a deterrent to an investor looking to take a holding, saying "To the outsider, this appears to be a denial of shareholder's rights to companies, but it seems to work. I believe one would be ill-advised to rule out investment in a company just because it had this."

Nevertheless, Tully acknowledges that the existence of promoters and the dominant positions of several large organisations are a cause for some concern. He agrees that this situation creates a barrier to progress among Indian companies and limits career opportunities for talented individuals. Consequently, many are driven abroad.

"The environment for young entrepreneurs is not as good as it might be because of the presence of these conglomerates", he says, although he concedes that the situation is becoming more favourable, adding, "What has changed is that even the promoter companies have realised that they can't simply promote family members or friends."

"I once asked students at the Indian Institute of Technology why they went abroad and they said that, if they stayed, they would have to work for the government, which is a disaster area, or they would go into a family business where promotions favoured family members ahead of skills. Now, management has become much more professional, even in the promoter-led companies, and opportunities for young people have improved."

However, while previously non-existent positions are now opening up, concerns persist over the quality of the country's graduates and the availability of schooling for many young people.

"Education is a huge problem in India", admits Tully. "Many universities churn out graduates who are virtually useless. The number is increasing but some of the people have been so badly educated that they are almost impossible to train. This situation underlines one of the other problems in India, the issue of governance and the delivery of services by the government."

"When economists talk about the demographic dividend of India – 50% of the population is under 25 – they forget that this will be a demographic disaster if education does not improve."

He has first-hand experience of the issues that create barriers to development and believes that they will continue to stifle confidence in India over the coming years.

"I don't agree with the view that India will automatically become successful", he states. "Vajpayee (former Prime Minister) said, 'India's roads do not have potholes, India's potholes have a few roads.' One of the real problems is that Indians have implicit faith that somehow everything will turn out right on the day. You saw this at the Commonwealth Games when there was a total lack of preparation but, on the day, everything was all right."



Above: Mark Tully talking at the Edinburgh Book Festival.
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"The idea that India will be a great power and nothing can stop it feeds into that. The biggest pothole is the delivery of governance and the performance of government. Even with the reforms that have taken place, India is still one of the most difficult countries in the world in which to do business."

And, as far as he is concerned, there are other significant differences between the respective business environments that are preventing India developing at the same pace as China.

"Not only does China have a favourable balance of trade, but India's is almost entirely made up of raw materials, and China is exporting a whole lot of manufactured goods. This is an opportunity that India has failed to cash in on – production of the sort of things that China is producing. This is a missed opportunity to employ a lot of people."

While these factors are unquestionably a drag on the country's ability to match the growth that is evident among other emerging economies, Tully does see progress and believes there have been successes of which the country should be proud.

"Despite all its failings, India has huge achievements to its credit – where it is, its unity, its democracy, its economic development", he insists, pointing to arguably the main area of social development when he adds, "The number of people who have become literate or have risen above the poverty line is enormous."



Adam Michnik – Polish Optimist

As a co-founder of the independent trade union Solidarnosc, which was at the heart of the 1989 revolution in Poland, the author Adam Michnik played a key role in the collapse of communism.

His involvement led to him being imprisoned on several occasions for allegedly attempting to overthrow the socialist system. After 1989 when Poland regained sovereignty, he served briefly as a member of parliament but later turned his attention to journalism, and is now editor-in-chief of Gazeta Wyborcza, Poland's second largest daily quality newspaper.

During a recent trip to the Edinburgh Book Festival, Michnik visited Baillie Gifford – to discuss his latest work, *'In search of Lost Meaning – The new Eastern Europe'*.

In a wide-ranging talk, he recalled the events leading to those momentous changes in Poland and across Eastern Europe, outlined the key post-communism events, and explained why the outlook for his country is positive.

His most serious brush with the communist authorities, led to Michnik spending three years in prison after martial law was imposed in Poland in December 1981. During his detention, he wrote an essay, 'Letter from Gdansk Prison'. Following his release, he entered politics and took part in the Polish round table talks of 1989 between the government and the opposition. Those

negotiations represented the first step in the transfer of power from the totalitarian state to the people, and the re-establishment of democracy in Poland and across Eastern Europe.

"In 1980, the working class had its last great revolution in Europe and showed the Communist Party a red card. Suddenly, a new quality emerged. People came out of hiding and took off their masks."

Understandably, Michnik recalls the pre-revolution era with disdain, stating, "Life in communist Poland was full of lies, and was under the police dictatorship. People were conscious of the Soviet domination. There was a sense that Poland was ruled in an incompetent way by incompetent people. But, of greater importance was the fact that people were living their lives in their private hideouts."

Eventually they revolted and, by virtue of their actions, created a new mood of optimism, as Michnik explained, saying, "In 1980, the working class had its last great revolution in Europe and showed the Communist Party a red card. Suddenly, a new quality emerged. People came out of hiding and took off their masks. This brought out the best in those people. Poland was never a more beautiful country – neither before nor since."

Although their new-found freedom was hard earned, the people of Poland did not rush into celebrating it. "The problem in our countries was the de-communisation of the consciousness", Michnik explained. "The essence of communism was that a human being was owned by the state – I call it the prisoner syndrome. When you are in prison, all you dream about is freedom. One day you are out and you see the world with no steel bars – coffee shops, flowers, lawns, everything is there. You spend the whole day walking around and then, in the evening, you realise you have nothing to eat, nowhere to sleep and nowhere to have a wash. In prison, you had all these things."

"This kind of duality is what existed in the communist countries. In Poland, the working class went on strike for their freedom. However, the working class was also the first victim of the transformation of the system. Businesses had to change or go bankrupt."

While the Polish people have now grasped the freedom Michnik and his contemporaries fought to achieve, the step towards creating a fully functioning modern country remains elusive.

"Our slogans in Poland 20 years ago were revolutionary and progressive. Now, 20 years on, we see that corrections are needed", he admitted. "Market fundamentalism is not going to resolve the problems of national health service, education, ecology and culture. But, if you ask me if I am a pessimist or an optimist, of course I am an optimist."

He outlined his grounds for optimism stating, "I think Poland is moving slowly in the right direction. The most important issue now is to stop the growth of populist political organisations which are anti-free market and authoritarian. Public finances need to be reformed."

"We have great vodka, fantastic horses, beautiful women but we still don't have a trademark product. But it seems that political elites are getting there. I believe that it is a question of investing in science."

"My general assessment is that Poland is a great success. Looking at it objectively, the past two decades are the best in the past 400 years of Polish history."

Nevertheless, he sees much of that Polish success occurring outside the country and believes that achieving the next phase of development will require the repatriation of some of the country's achievers and their skills.

"If I travel anywhere in the world, I see Poles in central positions and they are very successful. We have to find a way of translating all of these successes into Poland's success. In the past, the Germans referred to the Polish economy as a failed economy. Now, it has changed. We are in a global economic crisis, but Poland is doing well. I don't know what Poland's big success will be because there are developments in many areas – one good example being astronomy."

Throughout his talk, Michnik displayed a sharp sense of humour, deep national pride and unerring optimism for the future. And combining all of these attributes, he summed up the outlook for Poland, saying, "The Finnish have Nokia, the Swedes have Volvo. We don't yet have such a product. We have great vodka, fantastic horses, beautiful women but we still don't have a trademark product. But it seems that political elites are getting there. I believe that it is a question of investing in science. I am quietly optimistic."



Opposite Page:
Adam Michnik book signing at
the Edinburgh Book Festival
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History Repeating Itself as China Takes Over

Ian Morris is a professor of classics and history at Stanford University in the US. His latest book is *Why the West Rules for Now – the Patterns of History and What They Reveal About the Future*. In it, he argues that geography and natural resources have shaped the distribution of wealth and power around the world in the past, and considers how they will have an important part to play during China's rise to prominence. However, Morris points out that changing leadership need not have a negative impact on the displaced economies, which can continue to enjoy strong growth.

During a visit to the 2011 Edinburgh Book Festival, Morris delivered a session at Baillie Gifford's offices and addressed some of the areas that are currently influencing our thinking and investment decisions, most notably the economic growth we are seeing in China.

Morris explained the rationale behind his book, saying, "The only way to understand the forces that have shaped the history of the world is by looking over the very long run – in my case around 15,000 years, to the end of the last ice age. It also needs a global scale. Otherwise, you are only getting a part of the picture."

"The rise of China will lead to Europe finding itself lower down the global order of economic growth. Nevertheless, Morris insists that the region will continue to see strong expansion."

His assessment of the cycle of global leadership took him to the 18th century when Europeans discovered that they were taking over the world but were uncertain why this was happening. The most popular explanation was that the ancient Greeks had invented a form of civilisation, which made Europeans better than the rest of the world. Over the 19th and 20th centuries, this feeling of superiority became less prevalent, and Europeans became less comfortable about making such claims.

Morris believes that the three things that explain the current state of the world are biology, sociology and geography. He said, "Biology means understanding what we are – clever chimpanzees. Basically, we want the same things as the not so clever chimpanzees, but we are much better at getting them because we have bigger brains."



Above: Author Ian Morris.
© Edinburgh International Book Festival 2011.



"Sociology refers to areas covered by the social sciences which explain how large groups of human animals behave together (this is often very different from how we behave as individuals). We need to understand some of the insights which have come from fields such as economics, sociology, anthropology, and demography, where sociology and biology overlap."

"Biology and sociology put together give a view of all humans in all places, but this does not tell why one part of the world came to dominate the rest of the world. For that, it is important to understand why, despite the animals being so similar and the way their societies work being so similar, some parts of the world experience a very different history than other parts of the world. Geography is basically the motor behind this. Geography is the one word answer to the title, 'Why the West Rules for Now'."

Geography, he claims, determines how societies develop, and defines how successful they are at imposing their wills on intellectual and material environments and getting the things they want. The geography in which people live is constantly changing as the societies change. A lot of the book traces this through history.

For example, 500-600 years ago, North West Europe was a backward place, a long way from the centres of action in the Mediterranean, the Middle East and China. The Atlantic at that time functioned as a barrier between the new world and the old world. Crossing that divide was very difficult.

The situation began to change as social development gathered pace. This was particularly true of the East Asians, who made institutional and technological breakthroughs, such as new ships, compasses, maps and rudders. When these discoveries reached North West Europe, they allowed Europeans to discover the New World. However, for the Chinese, the vast Pacific still acted as a barrier.

The industrial revolution was a response to new incentives building up in North West Europe to mechanise production and avoid the high costs of labour arising from the Atlantic economy. Initially, this gave North West Europe global dominance. As the 19th century progressed, crossing the Atlantic became easier using steam ships and railways. As that happened, the centre of gravity moved from Europe to North America.

In the late 19th and early 20th century, the Pacific Ocean was drawn into this process, pulling East Asia into the American-dominated global economy in much the same way that America had been drawn in. By the end of the 20th century and in the early part of the 21st century, there are indications that global dominance was shifting from the West to the East.

Morris suggests that social development is diluting the importance of geography. The trend, he believes, is unstoppable. "If the rates of development continue across the 21st century, which is a conservative assumption, two things will happen – Eastern social development will catch up with the West. In addition, the overall levels of social development will have risen.

The rise of China will lead to Europe finding itself lower down the global order of economic growth. Nevertheless, Morris insists that the region will continue to see expansion. He argues that the net growth is of greater importance than the fact that Europe is no longer leading the way. A similar situation will arise as the US is overtaken by China.

"Europe is likely to see rising standards of living for a long time but will see its place in the world sliding", he explained. "Despite having lost the number one spot to the US, Europeans typically live longer than they did 60 or so years ago and typically earn five times as much in real terms, while their health is spectacularly better. The 21st century will see similar changes between the US and China – China's gain need not mean disaster for the US.

"The question of why the West rules for now will become less important over time and issues that concern us now will change so much over the next century that they will no longer be issues", he added. And, underlining the anticipated acceleration in the pace of change over the coming years, he concluded, "Mobility of labour looks likely to increase for several decades and then decrease as technology continues to develop. Our lives will be lived more and more on digital platforms. It is a common view that we will merge more with the technology. This is why I say that the changes over the next 100 years could be greater than the changes over the next 100,000 years. The creation of virtual communities has gathered momentum over the past few centuries and it is really accelerating now."



Little Sign of Change in Russia

Martin Sixsmith spent almost 20 years as a foreign correspondent with the BBC, and worked in Moscow at the end of the Cold War. He subsequently became a civil servant, operating as Director of Communications for high profile politicians including Harriet Harman, Frank Field and Alistair Darling, and worked in industry before returning to his civil service position.

Sixsmith has written several fiction and non-fiction books, with Russia being a common theme, and was an advisor to the political sitcom 'The Thick of It'. During 2011, he presented a 50-part radio series, '*Russia: The Wild East*', accompanied by a book, which he discussed at this year's Edinburgh Book Festival.

During a private session with Baillie Gifford, he shared some of his experiences and explained why he is generally negative on the economic outlook for Russia.

He recalled the euphoria that surrounded the events of two decades ago when the political landscape of Russia underwent a seismic change. "The highpoint of my career was in August 1991 when the coup happened and Gorbachev was first deposed then came back", he said. "However, within four months – by the end of 1991 – the Soviet Union had collapsed and the Communist Party was no more. There was a great sense then that things were going to change in Russia."

He referred to the triumphal nature of the Christmas address from George Bush senior, in which the President suggested that American values had defeated the menace of Communism, adding, "The implication was that from that point, Russia was going to be a liberal, Western-style democracy."

However, Sixsmith's subsequent years in Russia and his work on the recent radio series and accompanying book have emphasised the misplaced optimism that existed around that time. And, his current assessment suggests that, while the wheel of Russian economics has revolved, little has changed in the underlying situation.

"The lesson of the book is that if you look back in Russia, things change only to remain the same. So, after those ten years of experiments with liberal market democracy in the 1990s, under Boris Yeltsin, things have reverted to type in the past 10 or 11 years, under Putin or Medvedev", he added.

"I am not an economist, but I do know that in the 1990s vast fortunes were made. Then, in 1998 when the economy collapsed, vast fortunes were lost. If I were investing in Russia, I would want to invest on a short-term basis, take the profit and put it in the bank because these ructions seem to come around with alarming regularity", he suggested. "The other thing that strikes



me is that Russia is still oil and gas addicted. Putin has done well because, by the end of the 1990s, energy prices rose dramatically, and he was able to rescue the economy which Yeltsin let go to rack and ruin. Putin just got lucky and has had a window of 10 or 11 years in which to rebase the economy, diversify and try to shrug off this oil addiction. It strikes me that he hasn't done it, and as soon as oil and gas prices start to weaken a bit, it makes Russia very vulnerable."

While there are signs of strength in certain aspects of the Russian economy, Sixsmith believes there are still many areas of concern, not least that so much of the country's wealth rests with such a small proportion of its people.

"I am in the gloomier camp on the outlook for Russia", he admits. "The wealth is in 5% of the population, and the other 95% are probably worse off than they were under Communism. Under Communism, everyone had a basic level – you were guaranteed an apartment, guaranteed heat, guaranteed gas and electricity, and you were guaranteed a job."

"If you were willing to work – and everyone was willing to work – you could bump along. Now, a lot of people have fallen through that safety net. A middle class is broadly fair and broadly stable. I don't think Russia has that."

Referring to the content of his book, he explained that this unfair distribution of wealth is a thread woven through Russian history and dating back to the Tsars.

"It was always the case that there was a small ruling,

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autocratic clique at the top, and the people at the bottom. Russia never developed the mechanisms for civil society. There was no judicial system that everybody could rely on. There was no sense of being able to take complaints through various levels – to town councils, then provincial councils, then to regional councils – you just could not do that.

"Russian leaders acknowledge it themselves. Gorbachev constantly said, 'We've never had a law-governed society'. And, Medvedev keeps saying 'we must end legal nihilism, we must make ourselves more humane in the way we govern.' He keeps saying it, but nothing has ever changed."

That situation is the basis for Sixsmith's lack of optimism over the economic outlook. He points to the need for legal reform and the damaging impact of corruption.

"You can build up great wealth, you can get very rich, but you have no guarantee that your property will remain your property", he asserted. "Look at the example of Mikhail Khodorkovsky – one of the eight or nine big oligarchs – who built a massive personal fortune through acquiring the Yukos oil company in Yeltsin's rigged auctions in the 1990s. He then made a fantastic job of building that up into a really efficient, world class, transparent and well governed company."

"Then, in 2003, he had a tiff with Putin, they had a big bust up in the Kremlin in February 2003 and Khodorkovsky accused Putin of corruption. This was shown on national television. Six months later, Khodorkovsky landed at an airfield in Siberia and his plane was surrounded by KGB/FSB men wearing masks and carrying machine guns. And he was taken back to Moscow."

That incident, Sixsmith believes, illustrates the culture of control and the insidious dishonesty – the scourge he sees as the biggest barrier to implementing an equitable economic system in Russia.

"Corruption now appears to pervade every part of the public sector and there are millions of people who have a vested interest in its preservation", he concluded.



Top Image: Building under construction, Moscow.
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Above: Author Martin Sixsmith.
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Baillie Gifford’s recommended reading list from the Edinburgh Book Festival:

- Martin Sixsmith, *Russia: a 1,000 year Chronicle of the Wild East*
- Adam Michnik, *In Search of Lost Meaning: the New Eastern Europe*
- Chan Koonchung, *The Fat Years*
- Ian Morris, *Why the West Rules for Now*
- Mark Tully, *India: the Road Ahead*
- Hisham Matar, *Anatomy of a Disappearance*

Editor:



Colin Renton
 Colin Renton is an investment writer in the Institutional Clients Department of Baillie Gifford. He joined the firm in May 2007 having spent the previous seven years in similar roles with two other investment managers. Colin has more than 20 years experience in financial services and holds professional qualifications from the Chartered Institute of Bankers in Scotland and the Chartered Insurance Institute.

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