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 Turning the Corner— the end of falling unemployment?

9-0 VOTE ON RATES

The unanimous 9-0 MPC vote to keep UK base rates on hold in January hides the fact that the MPC have conflicts of opinion on the strength of demand in the economy. Signs of better news in the United States are likely to underpin hopes of a global recovery. If we add in continued domestic consumption strength there are upside inflation risks towards the end of 2002.

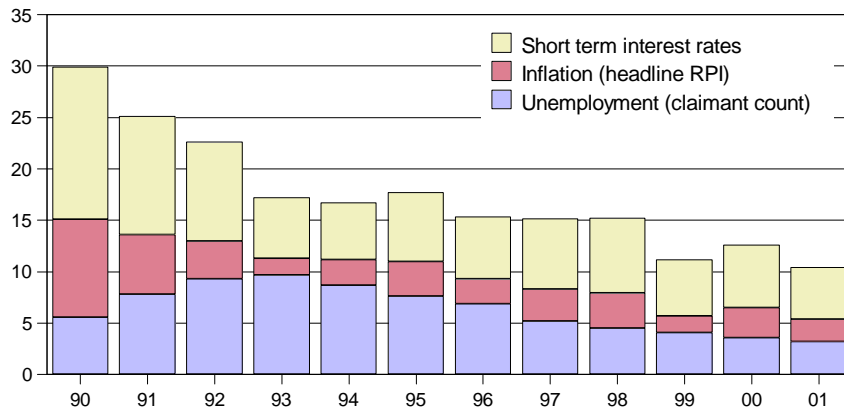
Other members of the MPC believe that inflation is fundamentally dead and that base rates can stay where they are or even edge a little lower. The best call is for rates to stay on hold for another few months.

2001—THE ECONOMY IN REVIEW

The world experienced its most severe slowdown in two decades during 2001— but the British economy weathered the storm and achieved the fastest growth of any G7 country. Newswires in September and October were swamped with stories of impending recession and retrenchment for the UK. But although output has softened and manufacturing is undoubtedly in decline, a technical recession has been avoided. Although monetary policy is likely to remain in neutral gear for the next few months, the financial markets are already expecting base interest rates to rise in the summer of 2002 to ward off the risks of overheating domestic demand. The Misery Index (the sum of unemployment, inflation and short term interest rates) declined to its lowest level for over twenty years in 2001! - evidence of a fundamentally sound macroeconomic performance)

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THE MISERY INDEX



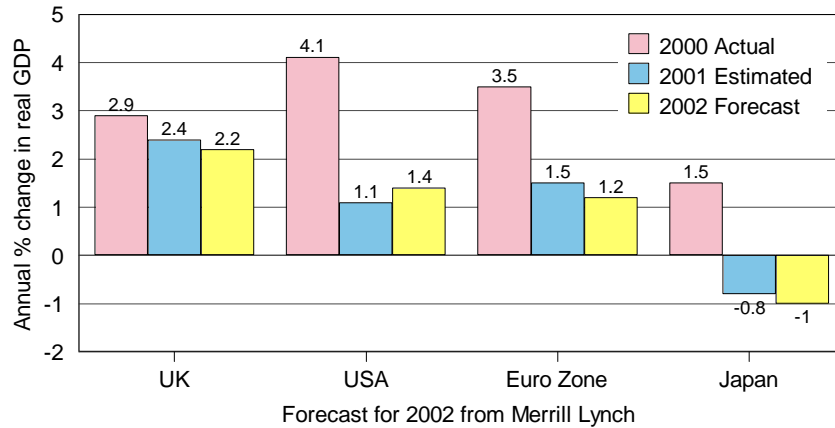
Special Report: Two Defining Moments in the 2001 Business Year

The cut and thrust of business dominates the headlines every day. Yet each year events occur in business that can genuinely claim to be of long-term significance to their respective sectors. The impact of September 11 and the preparation for the introduction of the Euro dominated most of the headlines. But, as part of this special Tutor2u review of 2001, we focus on two other business events that had long-term, fundamental implications for international business.

Microsoft Settles 3-Year Court Battle with US Government

The three-year court battle between US software giant Microsoft and the US Government, with the support of 18 US states, drew to a close in early November 2001. The two sides agreed an out-of-court settlement of their dispute over anti-trust issues. The agreement extracted some concessions from Microsoft but stopped well short of a break-up of the company - which would have been the worst case scenario for the software giant.

(Continued on page 3)

*(Continued from page 1)***ECONOMIC GROWTH RATES****AUTOMATIC STABILISERS**

These are changes to fiscal policy that occur automatically during business cycles and help to smooth the path of economic growth.

In a slowdown or a recession the government will inject money into the economy by paying more in welfare benefits without a change in policy.

During a period of expansion, the government takes proportionately more money out of the circular flow because of the nature of our progressive tax system.

Automatic stabilisers cannot prevent a recession on their own - but they can help to limit the scale of fluctuations in real national output and employment.

Consider the experiences of the UK and the average for the twelve member nations of the Euro Zone. The UK managed to achieve a soft landing in 2001. Growth is estimated to have dipped from 2.9% in 2000 to 2.4% in 2001 (barely different from the long run trend growth rate over the last thirty years). In the Euro Zone though, the pace of economic activity has slowed much more sharply. Real GDP growth in the Euro Zone more than halved last year and the anaemic growth rate is forecast to persist – raising fears of a rising unemployment.

Bucking the Trend

So how has the UK economy managed to achieve this relatively strong position compared to her G7 colleagues? Several factors are relevant:

- ? **Consumer demand** has remained strong. The acceleration in household spending has been maintained despite the collapse in consumer confidence about the economy. In part this is because people's perceptions about the general state of the economy have differed from their expectations concerning their own financial position
- ? **Monetary and Fiscal Policy** have both helped to stabilise aggregate demand. The Bank of England cut nominal interest rates by 2% during 2001, clearly believing that the risks to their inflation target were on the downside rather than the upside. Fiscal policy has also contributed to demand for goods and services. The government has been content to allow the automatic stabilisers to work their way through the economy in full (see the box opposite) and significant real terms increases in public spending on health, education and transport are starting to work their way through the circular flow of income and spending
- ? **Limited Job Losses:** Although business confidence has taken a hit in recent months, and the manufacturing and export sectors have been affected badly by the synchronised nature of the global economic downturn, the scale of business failures and job losses has been much milder than expected in some quarters. Short term changes in unemployment are important drivers of activity in the housing market and in persuading consumers to alter their spending patterns. The strength of demand for consumer credit and the record levels of borrowing linked to rising house prices are indicative of the fact that consumer sentiment has not yet been badly dented by the small rise in official measures of unemployment.

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**AOL-TIME WARNER
SUES MICROSOFT**

The lawsuit alleges that, beginning in 1995, Microsoft harmed Netscape in a series of illegal acts aimed at promoting Microsoft's Internet Explorer browser at the expense of Netscape Navigator.

The suit seeks injunctive relief sufficient to prevent further anti-trust injury to Netscape, and an award of treble damages to be determined at trial.

BUNDLING

Bundling is a marketing ploy of giving away a relatively cheap product with a relatively expensive one to attract customers. Bundling can have the effect of tying the consumer to both products and is particularly prevalent in computer manufacturing where the product comes with specific items of software already pre-loaded

Under the agreement, Microsoft agreed to several restrictions, including a panel of independent monitors to oversee its conduct and review its accounts. Most importantly, the agreement obliged Microsoft to provide rival software firms with information to allow them to develop competing products, and ensure those products work with the Microsoft Windows operating system.

The US Department of Justice claimed that the restrictions "will stop Microsoft's unlawful conduct, prevent recurrence of similar conduct in the future and restore competition in the software market, achieving prompt, effective and certain relief for consumers and businesses".

Breaking Up is Hard to Do

For its part, Microsoft successfully challenged the idea that it should be broken up into two separate companies. This course of action was initially seen by the US courts as the best way to prevent Microsoft from abusing its "monopoly" position.

The US Department of Justice alleged that Microsoft had used its domination of the operating system market to restrict competition. Microsoft licensed its operating system more cheaply to computer makers such as Dell and Compaq, if they exclusively installed its software. When IBM refused to drop sales of its own rival operating system and software packages, it lost millions of dollars worth of sales by not receiving the crucial details of Windows 95 until 15 minutes before it launched. Other PC makers had computers with it installed and ready to ship.

Bundling—A Barrier to Competition

But the key competitive issue was the way in which Microsoft forced its Internet Explorer (IE) browser to leadership in a market that had previously been dominated by Netscape's Navigator. Microsoft not only gave away IE but also "bundled" it into its Windows operating system, forcing PC manufacturers to pre-load it on to their computers. Through this strategy, Microsoft quickly gained half of the browser market, and now dominates it with an 80%+ share.

Microsoft defended the accusations by claiming it faced a significant competition (for example from the merger between AOL and Time Warner) and, in any event, consumers benefited from free browser software.

In Summary

In summary, the terms of the settlement required Microsoft to change its behaviour in the following areas:

- ? Give computer makers more flexibility in configuring their systems and in selling and promoting non-Microsoft software
- ? Release technical information at the same time and equally to other software vendors as it does to its own personnel
- ? Charge a uniform price for the Windows operating system to the top 20 computer makers
- ? Charge the same price for past supported versions of Windows as it does for the most current version of the operating system

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ENRON– THE WORLD’S LARGEST CORPORATE COLLAPSE

US energy giant Enron was once the world's most admired company. Now it has become the biggest failure in US corporate history in December 2001. Its collapse, with debts of \$15 billion, has prompted a host of investigations, including a criminal one into the actions of the Enron senior management. Enron auditor Arthur Andersen is also under scrutiny for its alleged failure to identify the impending collapse of Enron and for not disclosing the complex financial dealings that caused it.

Enron's Debt Mountain

The story of the Enron collapse and scandal has moved quickly. When Enron reported its third quarter results in October 2001, it revealed substantial, previously undisclosed debts, sending its share price tumbling. The US financial regulator - the Securities Exchange Commission ("SEC") – immediately launched an investigation into Enron and its results. Enron then admitted it had significantly inflated its profits, sending shares even lower. Deep in debt, Enron was unable to secure the necessary funding to continue trading and, accordingly, filed for bankruptcy on 2 December 2001.

A criminal investigation been launched because it is a possibility that senior executives at Enron were involved in fraud. In order to hide its debts from the Enron balance sheet, the firm used complex financial partnerships in order to conceal debt. Many of the company's executives allegedly secured substantial profits by selling their shares shortly before the share price collapse and bankruptcy.

The main losers in the scandal are Enron's 20,000 employees who are estimate to have lost billions of dollars in their pension plans and share option schemes. They were barred from selling shares in the period immediately prior to the collapse. Most of the pension fund assets were invested in Enron shares.

Corporate Failure

Enron was a complex business. On the one hand, it is a traditional diversified utility, owning power plants, water companies, gas distributors and other units involved in the relatively straightforward delivery of services to consumers and businesses.

But Enron was also a huge "market-maker" in the US, meaning that it acted as the main broker in energy products, taking on financial commitments far bigger than its actual core business.

The size of these dealings made Enron one of the biggest energy companies in the world, with sales of \$101bn in 2000. It also expanded into the liberalising utility markets of Europe, particularly in the UK where it acquired a power station in Teesside and Wessex Water.

Exposure to Debt

Due to its bankruptcy, Enron has left behind \$15bn of debts. Many banks around the world are exposed to the firm, from both lending it money and trading with it. JP Morgan has admitted to \$900m of exposure, and Citigroup to up to \$800m. Some banks are proceeding with legal action, and the New York based Amalgamated Bank is suing Enron top executives for \$15bn. It seems likely that smaller firms that dealt extensively with Enron could go bust soon, too.

Collapse in Shareholder Wealth

On an individual level, many employees have lost their jobs and seen the value of their pensions - which had been invested heavily in Enron's own stock - wiped away. And Enron's shareholders have seen shares which were worth \$85 just a year ago become virtually worthless.

The Enron collapse has also focused attention on the role of auditors to companies quoted on public stock exchanges. The SEC has announced a review of auditing and accounting standards aimed at preventing the future non-disclosure of company debts and transactions.

THE MICROSOFT ANTI-TRUST CASE

FT Special: Microsoft Anti-Trust Case

<http://news.ft.com/ft/gx.cgi/ftc?pagename=View&c=Article&cid=FT38ID0UIOC>

The US Court Judgement

www.usdoj.gov/atr/cases/f9400/9495.htm

Microsoft Press Statements re Class Actions

www.microsoft.com/presspass/legalnews.asp

AOL-Time Warner

http://www.aoltimewarner.com/index_flash.adp

THE COLLAPSE OF ENRON

Enron Homepage

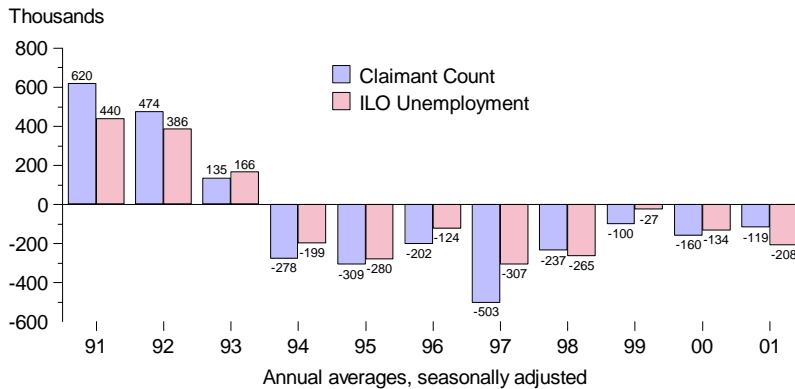
www.enron.com/corp/pressroom/

FT Special –the Impact of Enron

<http://specials.ft.com/enron/index.html>

A TURN-AROUND FOR UNEMPLOYMENT

ANNUAL CHANGE IN UK UNEMPLOYMENT



Claimant count unemployment averaged 3.2% in 2001– but by the end of the year the labour market was clearly reaching a turning point– with successive monthly rises in the stock of people claiming unemployment benefit. Economists at JP Morgan forecast that unemployment will rise to 3.6% in 2002 even though the British economy is forecast to grow at or around 2% this year. This is a good example of the argument that unemployment can rise,

even when national output is expanding. The economy needs to create sufficient new jobs to absorb new entrants into the labour market together with those who decide to re-enter the market for paid work. And even when the economy is growing, there are always industries undergoing structural change, and others where productivity improvements have reduced the total demand for labour in their industry.

Claimant count unemployment fell by 119,000 last year and the LFS jobless total dropped by 208,000. Long term unemployment is now at its lowest rate for many years with just 91,000 people aged over 25 unemployed for over 18 months (compared with 290,000 in 1997). Long term youth unemployment has declined from 154,000 to just under 40,000 over the last four years. The employment rate for the economy stabilised last year– but it is still one of the highest among industrialised nations.

UK EMPLOYMENT RATE HAS STABILISED

