

A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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THE CREATION OF CREDIT AND THE NATIONAL WEALTH

Although Government spokesmen have adopted an optimistic tone in their New Year messages, forecasts made by various economic bodies are essentially gloomy. The worst feature of the present position is the fact that in the period 1970-80 manufacturing output has fallen by 3 per cent. Britain's total output of goods and services has been estimated as likely to fall by 6 per cent in 1980 and 1981. This compares with a fall of 7 per cent in 1929-31, the worst years of the depression. Unless the Government succeeds in reversing this industrial decline, the outlook is grim.

Mrs. Thatcher has herself said that it is "goods and services which gives money its value". Consequently, a reduction in the supply of goods and services should mean that money supply would have to be further reduced and this, in turn, means deflation such as we had in the 20's and 30's.

The essential task, therefore, is to encourage the production of wealth, (i.e. goods and services of all kinds) and then to ensure that the flow of money is so regulated as to enable the increased wealth to be consumed with a reasonably stable level of prices. To give productive industry the necessary incentives to create more wealth means reducing interest rates substantially, reducing the burden of taxes and other imposts on the productive sector of industry so as to halt the present decline in the production of wealth and to replace this with steady growth.

Honest Money – An Essential Element

One of the most important duties of Government in the economic sphere is to provide an honest money system, one that establishes confidence in the stability of the purchasing power of money and can thus be used to facilitate the exchange of goods and services which the productive capacity of the nation makes available for consumption. As the eminent historian, Sir Arthur Bryant put it — "Money is the elastic instrument by which free men translate their needs into the production of the goods they require. The proper flow and distribution of money is, therefore, vital if a free society is to operate properly. If, in a free society, anything goes wrong with its financial system everything else will go wrong and freedom itself will be brought into disrepute and endangered."

A survey of the past 50 years shows that successive governments have failed in this main task. This is clearly shown by the deflation of the 20's and 30's and the inflation of the post-war years. At long last we have a government pledged to fight inflation and to put this at the top of its priorities. On 1st January in the course of radio and television interviews the Prime Minister replied to the question "So what were the keys to success in 1981"? – "First sound money, that means you do not print more money, you do not debase the coinage, you try to keep the supply of money in line with the goods and services that are produced. They are what backs money. You can call it monetarism, I call it sound money."

Mrs. Thatcher was undoubtedly right to stress that it is goods and services that give money its value, but her reference to "printing money" is somewhat misleading. It ignores the fact that the greater part of money is in the form of credit, it has no physical existence.

An Interest-Bearing Debt

Most of our money today is in the form of credit and it is created through the operations of the banking system. It is the method by which this credit money comes into existence which is worth concentrating upon. Under our present system it comes into existence as an interest-bearing debt and most of our present problems in the monetary sphere arise from this fact. In his book "Economics", Professor Paul Samuelson explains in detail how "the banking system as a whole can do what the small bank cannot do; it can expand its loans and investments many times the new reserves of cash created for it". Or, as the Radcliffe Committee on credit and currency put it "the credit creating capacity of the joint stock banks are today their effective credit base; an increase in the amount of liquid assets in the banking system may therefore make possible an increase in the banking system could "create credit", but today there is no shadow of doubt that they can do so as long as there are credit-worthy borrowers requiring loans.

This important aspect of monetary policy has been largely ignored. As long as ago as 1940 when surveying war-time finance, the Economic Reform Club's Research Committee put the following statement in a letter to Sir John Simon, Chancellor of the Exchequer — "the creation of such additional money and credit as may be necessary for the prosecution of the war should be the function of the State and the Banking System should be called upon to act in this matter as the Agents of Government and not as the lenders of money. It appears to my committee that this is a fundamental issue and that no satisfactory solution of our financial problem will be found until the Government in the above mentioned circumstances ceases either directly or indirectly to play the role of borrowers and to put upon the nation a consequent burden of debt without any such justification as exists when money is borrowed from genuine savings. There is not in the creation of such additional money any question of savings and there ought not, we suggest, be any question of lending." Needless to say, no satisfactory reply was received!

In this connection it is worth while to look back to an important event which took place in the early part of this century which will serve to illustrate the matter. When war broke out in 1914, Britain operated a gold standard system under which the money in circulation was directly related to the amount of gold held by the banking system. With the advent of war, the system threatened to break down and the government of the day was forced to declare a moratorium to prevent a run on the banks which would have caused chaos.

The Government took the initiative of printing millions of Treasury Notes, (so-called Bradbury's) and the Currency and Bank Notes Act (1914) was passed and became law. Thus, Treasury Notes of $\pounds 1$ and 10/- denominations became legal tender, and a debt-free and interest-free flow of money was provided to finance the war.

Situation Reversed

As a result, for a short time, the situation regarding the creation of money was reversed, instead of the Government borrowing money from the banking system, the banks were borrowing money from the Government. The Currency and Bank Notes Act of 1914, under which the Treasury Notes were issued was notable in two respects, first that Parliament set no limit upon the quantity of these notes and secondly that the Treasury was not required to keep as "backing" for them any reserve of gold.

Unfortunately, instead of extending the principle of a State-issued currency to that of State-issued credits for the purpose of war finance, the Government of the day took the decision to 'bridge the gap' between their total expenditure and the proceeds from taxation and genuine savings by once again "borrowing" from the banking system.

Commenting on the development of State-issued Treasury notes A.E. Feavearyear wrote — "it became evident that the new notes which were unlimited in supply, would be accepted without question. The banking reserves (of gold) which had been kept at 40 or 50 per cent of deposit liabilities in pre-war times, was allowed to fall at once to 20 per cent and later to as low as 8 per cent of deposits, yet there was no danger of demand for legal tender money (gold) because the Treasury met all such demands with Treasury notes (i.e. the new notes). The amount of banking reserve ceased to have any significance at all."

Dr. Leaf, a former Chairman of the Westminster Bank said of this Treasury note issue that it was "essentially a war loan, free of interest, for an unlimited period."

The True Principles of State Money

The eminent economist, Dr. W.A. Shaw wrote in his book "The Theory and Principles of Central Banking" – Great Britain during the years 1915-1916 discovered the true principles of State issue of paper money, and benefitted unspeakably by it all through the Great War. But so little did she understand what she had done, that after thirteen years of the practice of an automatic, self-regulating issue of full-price State paper money, she surrendered the right once more to a monopoly bank in 1928 (when Bank of England notes replaced Treasury notes)." "From the moment of that discovery until 1928 England afforded an illustration of the true, or ideal, paper money and its principles – A State paper money of full face value, guaranteed by a full cover redemption fund composed of securities; issued automatically; retired automatically; selfregulating; never redundant; never deficient; neutral in its effect on prices but rising equal to any strain upon it, and incapable of debasement by the community which purchases and uses it."

"The Treasury note answered this definition at every point"

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Although, during the second world war, there was no issue of Treasury notes, money borrowed during the war was on the basis of a Bank Rate of only 2 per cent. As we showed in the previous issue of BRITAIN & OVERSEAS, the effect of this was to save the Nation a vast sum in interest payments. It is interesting to note that the senior Government Broker, Mr. Thomas Gore Brown, who is shortly retiring after 7 years commented "The really big change in my time has been the terrible increase in the size of the National Debt."

Nation Saddled with Burden of Debt

Today we have a Minimum Lending Rate (successor to the Bank Rate) of 14 per cent. This controls the rate at which Government, industry and people can borrow. The Government is itself a huge borrower and to the extent that it does not borrow existing money from the lending public, it borrows credits from the banking system. It may be asked why, if the Government is really serious about reducing costs it continues a policy of borrowing at high rates of interest from the banking system the credit which it has every right to issue itself free of debt and from interest charges?

As a result of the Government borrowing credit from the banking system, which, as we have shown, creates it as an interest bearing debt, the Nation as a whole is saddled with an enormous burden of debt which not only falls upon present generations, but also on future generations as yet unborn, in the form of interest payments. Borrowing credit which is created by the banking system is clearly in a different category from borrowing actual savings of existing money from the public and other financial institutions which cannot create credit. In the latter case the lender actually forgoes the use of this existing money and, therefore, surrenders a claim to goods and services. In such cases a rate of interest can be justified, but this cannot be argued in the case of borrowing newly created credit from the banking system. In fact, the terms 'borrowing' and 'lending' are misleading in this context. The banks perform an essential service to the Nation and should certainly be rewarded for the services they render. But this is different from being able to charge interest on newly created money required for National purposes.

Surely the time has come for the Government to re-examine this question and to adopt a more realistic approach to the provision of finance for national purposes.

THE FALLACY OF THE MIXED ECONOMY

Summary of a talk by Lord Harris of High Cross to members of the Economic Research Council - 11.12.80

Lord Harris, emphasised the fallacy of a 'mixed economy', said to be based on consensus. There had been a cumulative shift away from private enterprise to the Government doing too much. A government did have essential functions, to create a framework for private enterprise and initiative, and to provide a floor below which no one should be allowed to fall. But that was very different from the Welfare State, where the Government provided not cash, which individuals could have used to buy what they wanted, but indiscriminate services, such as Health and Education. There was then always a momentum towards increasing the State sector, with politicians pushing proposals to gain votes, and bureaucrats pushing to enlarge their empires, both responding to pressures from producer interests, Unions and employers.

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Rent control was an example of State interference. It ended the supply of houses to let, and stimulated massive building of Council houses. That was now being partly remedied. The market economy allowed people to choose for themselves; and what they spent could be regarded as votes for producing more of those items, votes to which the market was quick to respond. The larger the market, the better it operated.

Four main points were:-

- (1) The aim was always to secure maximum benefits from scarce resources; (There was never enough to meet all needs)
- (2) No one could judge other people's preferences. Choice was individual and subjective;
- (3) The market as a voting mechanism gave better results than any other way;
- (4) The market gives producers the incentive to produce what is wanted, in contrast to the political system, where you don't get what you voted for.

Government has to provide some services, e.g. defence, but local government was often doing what could be better done privately, e.g. libraries.

In answering questions, Lord Harris scorned nationalisation. Coal was an exception, and mines should be handed over to the miners. Motorways and bridges should be financed by tolls. Monopolies were better when privately owned. Demand was always ahead of supply, but ingenuity could find new ways of meeting demand. The market had imperfections, but Governments magnified them. There were deformities in the political system. But the choice was between being fed on a perpetual table d'hote diet, or a la carte.

TECHNOLOGY AND DEVELOPMENT

The Role of Intermediate Technology by George McRobie Chairman of the Intermediate Technology Development Group Ltd.

The critical role of technology in economic development, and especially the importance of technology choice, was first brought into focus by the late Dr. E.F. Schumacher some 15 years ago. The essence of his argument is now familiar enough. It is that the highly centralised, capital and energy intensive technologies of the rich industrial countries have little relevance to the needs and resources available to poor people in poor communities. To meet their needs a new kind of technology must be discovered or devised – smaller, simpler, capital-saving, and non-violent towards local physical, and cultural, environments. It is only through access to such technologies, Schumacher argued, that the mass of the world's poor could work themselves out of their poverty, regenerate their rural areas and small towns, and achieve local and national self-reliance.

He named such technologies 'intermediate', chiefly because in terms of their cost-per-workplace they would lie somewhere between the £10,000 that it costs to equip one workplace in a typical rich industralised country, and the almost nil cost of the traditional tools of a rural peasant or artisan in a poor country.

The virtual absence of detailed, practical information about such intermediate technologies led Schumacher and a group of his friends to set up the Intermediate Technology Development Group in 1965. The Group's aim was, and is, to help to fill this 'knowledge gap'.

Fifteen years of work in this field have supplied the Group with plentiful evidence that the 'gap' is indeed very wide. The labour-saving, capital-intensive, highly sophisticated technologies, suitable for large-scale production in 'rich' markets, which are commonly used in the rich countries, are very well documented and easily accessible; but technologies applicable on a small scale by (or in) communities with plenty of labour and little capital, lacking technical and organisational sophistication, are, on the whole, poorly documented, difficult to get hold of, and in many cases even non-existent.

Intermediate Technology in Action

Today, with a permanent staff of more than 50, the Group is working on a range of intermediate technologies, spanning agriculture and water supply, building materials and methods, energy, transport and small industries. Supporting these programmes and exploring a dozen other subjects ranging from chemical engineering to co-operatives, are some seventeen technical

advisory panels. Between consultancies and field projects the Group is now typically working at any one time in at least 20 developing countries. It makes a point of operating through local organisations, believing that only by increasing local knowledge, capacity and conviction, will the appropriate technologies be implemented and disseminated. A long and growing publications list documents the practical experience and knowledge of self-help technologies amassed by the Group and many others outside.

Some salient features of the Group's work programme:

The construction and building team have pioneered small contractor training in Africa, and their techniques have now been adopted by the ILO in a training programme covering 12 African countries. Work on the small-scale, localised production of building materials has led to the development of improved lime-pozzalanas which can substitute for cement over a wide range of uses. Work is also well advanced on the small-scale production of Portland cement (30-40 t.p.d. as compared with 1500-2000 t.p.d. of a typical large plant). The scaling down of brick production has resulted in small plants of 10,000 bricks a day capacity, with capital costs per workplace of around £400, compared with £40,000 in a conventional highly-mechanised brickworks. Small plants have been set up in Ghana, Gambia, Egypt, South Sudan, Tanzania and the Caribbean. A technique has been developed for the village manufacture of fibre-reinforced cement roofing sheets.

Small-scale Technology

Small-scale water technology has included the development of improved technologies for rainfall catchment tanks, hand-dug wells, minor irrigation methods, and water-lifting devices. Work on improved farm tools and equipment is typified by an animal-drawn weeding machine costing about one-sixtieth of its tractor-drawn equivalent, and a hand-operated metal bending machine that cost \pounds 7, instead of the \pounds 750 for a more sophisticated version. Some 50 descriptions of farm equipment suitable for local manufacture and maintenance have been published as well as a comprehensive guide to commonly available equipment for the small farmers^{*}.

Equipment for building rural roads, and low-cost vehicles, are among the Group's transport development activities. Water transport innovations have been introduced in the form of a boatyard that turns out 20-ton capacity ferro-cement boats at Juba in Sudan, and improved fishing vessels in Sri Lanka.

The Group's energy team has developed highly efficient, low-cost windmills for low-lift irrigation; a small firm is now making and marketing these windmills

* See the IT Publications list, which includes some 80 publications, on a variety of small-scale technologies, embodying the results of Group activities over the past decade.

in Kenya and the device is being tested in several other countries. Other low-cost technologies in this field include a gas-powered pistonless pump; small-scale hydro systems which can reduce the costs of conventional systems by up to two-thirds; and a turbine which harnesses the kinetic energy of large, slow-moving rivers is under development, which promises to be a remarkably efficient and low-cost method of pumping water from rivers or canals. (A 3 ft diameter turbine of this kind can produce as much power as a 60 ft diameter traditional water-wheel.) Improvements in the efficiency of traditional wood-burning stoves is another part of this unit's work.

The Group's unit specialising in the promotion of small-scale manufacturing in developing countries now has some 40 projects in hand, many of which involve the scaling down of conventional technologies. These include plants for paper-making, glass, wool-spinning, mini-hydro, and small-scale minerals extraction.

These work programmes are supported and reinforced by several other units associated with the Group, which handle consultancy — which now provides a significant part of the Group's income — and matters relating to rural health, transport development, and the Group's publications.

Appropriate Technologies for Industrialised Countries

My final point concerns the adoption of appropriate technologies not only in the developing world, but in the highly industralised countries as well. There is a growing realisation on both sides of the Atlantic that much of our current technological development is very far from appropriate to our own needs and resources. We are becoming, sometimes acutely, aware that in the course of creating economies with the highest material standards of living in the history of mankind, we have also created the most vulnerable economies in the history of mankind; and where people are concerned, it would be hard to imagine anyone more dependent upon, but less capable of controlling, his economic environment, than the average individual in modern industrial society.

The industralised countries are now all, to a greater or lesser degree, in the grip of 'stagflation' – a combination of inflation, and economic stagnation. This slowing down or cessation of conventional economic growth is associated with growing unemployment. Exactly why unemployment is growing as fast as it is – there are now 16 million unemployed in Europe – is a subject of controversy. But what is certain is that people who are displaced by mechanisation and rationalisation are no longer being absorbed by other sectors of the the economy, because the economy as a whole is not growing as fast as previously, or at all.

It is now increasingly evident that inflation, which is worldwide, is not only a consequence of fiscal mismanagement, such as the over-expansion of the money supply; it is a symptom of a growing pressure on world resources a signal that the industrialised countries should start moving towards conservation rather than consumerism; and, I would add, a signal that we shall continue at our peril to neglect what might be called 'human ecology' – the effect of our technology and its supporting institutions upon people. There are many indications that the kind of technology we have developed in the industrialised countries is on a collision course with people, with the natural environment, and with the world's stock of non-renewable resources.

A crucial question is whether we can find ways of sustaining reasonable living standards, and generating satisfying and productive work for all of working age, in a world where cheap energy and cheap raw materials are rapidly disappearing from the scene. It is a world in which we shall have to minimise waste and make maximum use of all our indigenous resources as well as imported materials, by doing, in short, more with less. Above all, we shall have to develop our human potential, our human capital, instead of, as in the past, neglecting it.

Society progressively de-skilled

Over the past 150 years, but especially during the past quarter of a century, we have progressively de-skilled society. In both industry and agriculture, energy and capital have been substituted for human skill and creativity. We must now start to **re-skill** society, and we already know that one of the most effective ways of giving a free rein to human creativity and ingenuity is through the small enterprise. In Britain we are sadly deficient (in comparison with all other industrialised countries) in small firms and in the climate that enables them to flourish; yet this is a man-made climate, which can be changed.

So one of the principal and urgent tasks of our generation is to promote the growth of small-scale, local production. This would be right in human terms. It would also cut down on transport costs, by reducing the movement of goods and people.

The Intermediate Technology Development Group's experience shows that there are many opportunities within the existing level of demand to start small firms at quite modest levels of capital investment. Four years ago, we started a unit to promote appropriate technology in Britain, and as part of its activities we have been helping to form a network of Local Enterprise Trusts throughout the country, with the most rewarding results in terms of the variety of firms started, the variety of their products, and their creation of productive and satisfying jobs for local people.

One path towards more employment, and employment of a higher quality, is the decentralisation of economic activity, and the progressive re-instatement of human skills and ingenuity and creativity in industry, agriculture and services.

A parallel and complementary route towards a sustainable economy is the way of conservation, starting with energy.

The whole structure of industrial society as we know it today has been built on the basis of very cheap energy — which governs where we live, what we do, what we eat, how we move about, the whole pattern of our lives. The technology on which all this activity is based, and its supporting infrastructure, has rested squarely on the heedless exploitation of capital in the form of fossil fuels – very cheap fossil fuels. The era of fossil fuels has not yet ended; but the era of cheap energy of any kind has decisively ended.

Like any businessman who has confused capital with income, we now find ourselves in trouble. On the basis of cheap, highly concentrated and mobile fossil fuel, especially oil, we have created highly centralised modes of production and of living. In industry and agriculture and food production we have developed highly capital and energy intensive technologies — which has led not only to the pervasive substitution of capital and energy for human skills, but also to an increasing centralisation of economic power in our societies, an ominous trend if one accepts that economic and political power tend to be closely associated.

Conservation – the only course

As far as energy is concerned, the only rational course now open to us – the only 'course that is socially, economically and environmentally sensible and acceptable – is conservation. This implies not only the direct conservation of energy as presently used, but progressive policies aimed at minimising long transport hauls of goods and of people, and the development of capital and energy saving technologies of all kinds in the production of goods and services.

The choice which now inescapably confronts the industrialised countries is either to continue on what Schumacher called 'the onward stampede' with technologies that are ever more capital-intensive, centralised, people-excluding; or to take stock, and turn towards technologies that are smaller, decentralised, more frugal in their use of resources, people-involving – and therefore sustainable. In this respect, at least, the rich and poor countries of the world have more in common than is generally supposed.

It is not, then, a matter of one kind of technology for the rich, and quite another and inferior kind for the poor. As the recent Brandt Commission report has reminded us, prosperity – or survival – is, like peace, indivisible. Both rich and poor countries must address themselves to the task of creating technologies and life-support systems that enable their people to enjoy reasonable standards of life, on a sustainable basis. This starts with the understanding that there is nothing immutable about the established trend of technological development, and that it is perfectly feasible to alter course towards a more appropriate use of human knowledge and skill: one that results in technologies more in harmony with human needs, and with renewable and non-renewable natural resources.

As a contribution to facilitating such a change of direction, the Intermediate Technology Development Group is preparing to set up the Schumacher Centre for Technology Choice in London. The focus of its activities will be on the development and introduction of technologies appropriate to the needs of both developing and industrialised countries. It will be named the Schumacher Centre, after the man who wrote "Small is Beautiful", and who also, during his lifetime, did so much to demonstrate that it is also possible.

TAX REFORM

The Key to Britain's Industrial Revival

In putting forward tax reform as the key to Britain's industrial survival, Emile Woolf and John D. Allen are saying that the greatest damage to Britain's economic prospects is caused by taxation on employment.

This takes two forms, PAYE income tax and National Insurance contributions. By far the most pernicious of these imposts is PAYE due to the way it cuts into people's earnings at an increasing rate when productive efforts are at their best. National Insurance also acts as an inflationary element in employment costs.

The disincentive effect of PAYE taxation is little understood in industry. An example of this is the habit of chairmen in their annual reports regarding corporation tax as the only tax charge on the company, overlooking the fact that the taxation levied through the payroll is far greater.

Not that Mr. Woolf and Mr. Allen are calling for the abolition of PAYE: this is not practical due to the revenue implications. What they are suggesting is a shift in the incidence of this tax, so that it falls on the corporate side of the account rather than directly on wages and salaries.

They take their lead on this from the remarkable scheme initiated by Len Ferns in the Birkenhead firm of Stylewear, and since followed by a number of companies in the garment and textile industries. Mr. Ferns' approach was to transform gross payments into net payments overnight, taking on himself the responsibility for paying income tax.

Rise in Productivity

This is not so radical as it might seem, for the truth is that the employer pays the income tax in any case. By accepting this burden on the corporate side of the account, he leaves room for wage payments to expand and thus attracts a larger tax charge. What surprised Len Ferns but since confirmed elsewhere is the rise in productivity matching the increase in employment costs.

Taxation on employment does not only inhibit good industrial performance and high productivity. It acts as a brake on employment, inflating the cost of labour. Due to heavy employment on-costs such as income tax and National Insurance, many less profitable locations have become uneconomic to work leading to a contraction of employment.

This contraction of employment is seen working strongly in the service industries where the tendency is to eliminate employment as far as possible. This trend has led to the rapid growth of self-service in restaurants, hotels, filling stations and supermarkets. At a time of recession, this underlying restriction on employment shows itself as a steep rise in unemployment, creating an onerous charge on the Exchequer. When these charges are met by borrowing at high rates of interest due to the shortfall of tax revenue, the stage is set for economic collapse because of the industry's inability to carry the simultaneous burden of high taxation and high interest rates.

A New Approach

One aspect of the studies carried out by Emile Woolf and John D. Allen is the great precision of measurement made possible by new economic concepts in this field. This has led the authors to coin the phrase "economic technology" and under this heading they are developing a new approach to industrial economics which permits accurate forecasting of the effect of changes, such as a shift in the incidence of taxation.

In those cases where these techniques have been shown to work, benefits have accrued all round, notably in better wages for the workforce, increased profits for the employer and higher tax yields for the revenue authorities. Most pleasing of all, these methods engender a quite different pace of production and permit a rise in quality of the product combined with much greater efficiency.

A chartered accountant, Emile Woolf is an acknowledged authority in his field. His recent volume on Auditing has gone into a second edition after selling 15,000 copies. Earlier this year he was given an international award by Hartford University of Connecticut (USA) for his contribution to advancement of his profession. John D. Allen is Editor-in-Chief of Construction News, leading newspaper of the construction industry and one of the top financial performers in the Thomson Magazines group.

(The new edition of the publication will be available in January/February 1981 from Emile Woolf & Associates, 25 Old Gloucester Street, London WC1N 3AF).

High Cost Food

Britain's consumers paid $\pounds 2,250m$ more for food in 1980 because of the Common Market's high-price agricultural policy, the Common Public Accounts Committee has been told by Sir Brian Hayes, permanent secretary at the Ministry of Agriculture.

This calculation is a minimum figure. It was made on the assumption that if Britain started buying freely on world markets, she would pay high prices to traditional trading partners like New Zealand.

Use of Monetary Targets

INFLATION AND MONEY

In the Monthly Economic Letter for December, 1980, issued by Citibank, an interesting survey on the causes of inflation reaches the conclusion that — "The one common link among countries that have suffered from high inflation over the past 15 years is excessive money growth." The article points out that "Germany, Japan and Switzerland have met with a measure of success in arresting, and even reversing, the inexorable rise in inflation that continues to plague the industrial world. On the other hand, the United States, Britain and France have had notably less success." They ask "what might explain this divergence."

Among the explanations offered for inflation are OPEC oil-price hikes; bad weather forcing up food prices; changes in tax; unrestrained wage demands; inadequate investment and low productivity growth. But, they say, "none of these factors consistently explains inflation in more than one country or for more than one episode."

The article points out that only Germany, Japan and Switzerland have been able to slow inflation. The major contribution has clearly come from a slowing in the rate of monetary expansion. "In Germany, the Bundesbank reduced the annual rate of growth of the monetary base from 10.2% during 1969-73 to 8.7% during 1973-79. The decline in monetary growth in Japan and Switzerland has been nothing short of dramatic. Between the same two time periods, the annual growth rate of Japanese money supply (M2) fell from 21.2% to 12.5% and growth of the Swiss money base slowed from 12.0% to 5.4%."

Improvements in Performance

"The results on the inflation front are well known. Germany's inflation rate has come down from a high of 7% in 1974 to 4.0% in 1979 while in Japan price increases slowed from 24.5% to 3.5%. Meanwhile, Swiss inflation slowed from a high of 9.8% in 1974 to an average 1.9% by the end of the decade. These improvements in inflation performance did not come without cost. All three countries endured a prolonged two-to-four period of slow growth and persistent unemployment while domestic price expectations adjusted to a lower inflation outlook."

On the other hand the articles states "in France, Italy and, notably, the United States, such decelerations in monetary growth rates have not occurred. Needless to say, neither has there been any slowing of inflation in these countries. Indeed, if anything, inflation rates are higher today in all these countries than they were in the early 1970s."

"The fundamental cause of inflation, therefore, seems quite clear — and the increasing use of monetary targets by the major central banks suggests that it is equally well understood by the policymakers. The question, then, is why some countries are successful in containing inflation and others not. The answer probably lies in the political/institutional restraints faced by policymakers."

"Generally, the successful countries appear to be those where the electorate or their representatives have reached a broad-based consensus that inflation is to be avoided at all costs. Thus, in Germany, keeping inflation low is at the top of national priorities even if it occasionally involves tolerating higher unemployment. Similarly, Japanese business, government and labour seem able to agree on a national course of action."

"On the other hand, the countries that have shown limited success in their inflation fight appear to be beset with divergent interests in the domestic economy. Though there is a general agreement as to the specific actions that need to be taken, the necessary policies are invoked only in response to crises. The result has been an absence of policy persistence. Moreover, the problem has been further compounded in these countries by firmly entrenched inflation expectations in the domestic economy. Frequent stop-go cycles have tended to destroy market credibility in policymakers' willingness to persevere in the inflation fight."

Danger of Backlash

Referring to Britain's position the article says "Britain has instituted a new medium-term policy program to achieve a lasting reduction in its inflation rate. But recent indicators on the British economy suggest that the inflation war is being waged with the monetary equivalent of H-bombs. Such an abrupt policy change inherently carries with it a danger of backlash once domestic political pressures become intolerable. Then the backlash may well undermine the entire medium-term strategy. Though the Thatcher program has enjoyed a surprising amount of support so far, it is yet doubtful that a lasting consensus will be maintained. On this count it is too soon to look for a sustained, meaningful reduction in British inflation."

The article goes on to summarise present trends. They say "European inflation will remain high in the coming decade. But on the bright side, the high-inflation countries may be on the verge of ending the steady escalation in their domestic inflation rates. Inflation cannot be controlled until policy-makers and the public place the reduction of inflation at the top of national economic priorities. They must also be willing to conduct a sustained attack on inflation at its root cause – expansion of the money supply – because inflation, as is now obvious, is a monetary phenomenon."

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THE ADVERSE EFFECT OF HIGH BANK RATE

The following extract taken from "Modern Money: a Treatise on the Reform of the Theory and Practice of Political Economy" written by the first Lord Melchett and published by Martin Secker in 1932, provides an interesting commentary on a subject of considerable topical interest. Lord Melchett said of the monetary system "The real truth is that the whole monetary scheme is not only unsound but unworkable." In his book he advocated reforms in the financial system which are as relevant today as they were 50 years ago.

"It is true that a change from 3 per cent to 4 per cent will not produce any violent results, though this means that the effective rate, which is nearly always 1 per cent above Bank Rate, will be five per cent, but above 4 per cent the effect is much graver for smaller movements. It may take ten minutes to throttle a man. The first six will not do him much harm, the next three will take him longer to recover from, but it is the last one that counts."

"Once the Bank Rate goes above 5 per cent, which means an effective rate of 6 per cent... then the results are more severe. For merchants, traders and manufacturers in modern times have not the large margins of profit they had in days gone by. Mass production and the large volume of trade have had their effects of reducing margins of profit, and while volume on a narrow margin will bring in an adequate return for money, no large margin will be left, therefore the extra 1 per cent between 6 and 7 per cent has a far greater effect than 2 per cent from 2 to $4 \dots$ "

"There is another way in which a high Bank Rate conduces to depression. If a firm or individual has a bank loan against equities and the dividend falls with the course of the depression then if the rate of interest rises, the position occurs that while previously the dividend covered the bank interest and left a margin, the one having risen and the other fallen, the bank interest becomes greater than the dividend. The loan begins automatically to increase in the course of time, from interest charges which must be met out of other revenues (thereby reducing purchasing power) or else the shares must be forced upon an unwilling market, causing further declines and further forced sales, and again checking normal purchasing power."

ECONOMIC GROWTH IN B.C.

Economic growth in British Columbia is forecast to outstrip both the Canadian average as well as that in the United States next year. Real growth for B.C. is expected to increase by 1.8 per cent, compared to a decline of 1.0 per cent for Canada and a decline of 1.4 per cent in the U.S.

During the past 12 months in British Columbia economy created 65,000 new jobs, an increase of 5.6 per cent compared to the average job creation rate of 2.2 per cent in Canada as a whole. Unemployment fell to 5.8 per cent in November on a seasonally adjusted basis, the lowest figure for about 15 years, compared to 7.3 per cent Canada-wide. The Vancouver unemployment rate fell to 4.5 per cent.