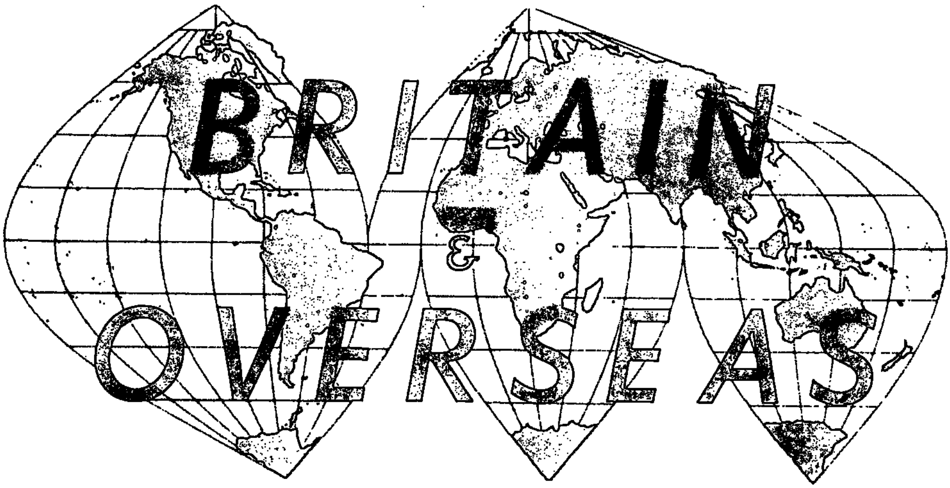

A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY
AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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THE SHAPE OF INTERNATIONAL BANKING AFTER THE DELUGE

by C. Gordon Tether

We have been hearing a great deal for some time past about the global debt crisis and the international banking upheaval it has spawned. But, in one sense, not nearly enough. The City columns of the newspapers have been giving much attention to the comings and goings of central bankers, commercial bankers, Finance Ministers and so on connected with the business of sorting out the mess. What has not received anything like enough comment is the background to the monstrous affair and its tremendous underlying significance.

For it is no exaggeration to describe it as one of the greatest economic events ever, with consequences that may well play a major part in shaping the world's destiny for a long time to come. It is also certainly the worst case of money being allowed to run riot since the South Sea Bubble, while its evolution has been characterised by an official neglect—a determination to turn a blind eye—that far exceeds that associated with the Falklands story. Moreover, unlike that, it will probably never be made the subject of an offical investigation.

Indeed, if past experience is any guide, every effort will be made to see that the scandal is tucked under the carpet as quickly as possible—with the inevitable result that the important lessons it is to teach us will go as unlearned as those associated with many other major economic and financial happenings in Britain's post-World War II history.

Altogether, it is quite a story . . .

How did it happen?

First we have to ask ourselves: How did it happen? How is it that the international banking system, in which British institutions play such an important part, finds itself under such pressure that it is suddenly in danger of suffering a complete collapse? To find the answer to that question, we have to go back a couple of decades or so to the foundation of that now immensely important element in the world's monetary system known as the Euroloan market.

It was at that time—in the late 1950s—that the financial experimentation which led to this innovation first getting under way was taking place. And for all its somewhat technical sounding name, I should explain, there is no great mystery about the nature of Eurolending business. It is simply an organisation, operating in the financial centres of the world, that is concerned with trafficking in "offshore funds". This is money that is deposited in banks in the financially significant countries, though owned elsewhere. At first all such activity was in dollars but now such other prominent currencies as sterling, the German mark and the Japanese yen are also involved.

Such business found favour for two main reasons. The first was that holders of—say—dollar balances held in American banks found that they could get more interest on such money by lending it to borrowers outside the United States. The second was that, by employing money in this international market rather than in particular countries, holders of funds were assured of greater freedom from governmental control.

Text of an address to the Economic Research Council on 27.1.83.

The growth of the new form of activity was relatively slow at first. Mostly the market was dominated by large business corporations—those with surplus funds lending it by this means to those that needed additional finance. However, as the 1960s advanced, governments and State agencies such as our own nationalised industries began to make more use of the Euroloan market as a repository for surplus cash or as a means of borrowing at lower rates than they would have to pay from their normal sources of credit at home.

A New Factor

With the opening of the 1970s, activity moved into a higher gear. The main reason for this was that the market began to get involved in the form of business that is at the root of its recent troubles—lending to sovereign borrowers and, in particular, to the governments of countries in the less-developed category. In the early stages, the new traffic was largely confined to the more advanced of the developing countries—Iran, Brazil and Mexico, for instance. But as the years moved on, the scene was changed out of all recognition by the injection of an entirely new factor into the mix.

This was the massive expansion in the inflow of new money produced by the oil prices explosion. The effect of the resulting steep rise in the export earnings of the oil-producing countries was to push their external payments into surplus in a spectacular degree. Those with large populations were able to expand their imports within the space of a few years, bringing their external accounts back into or nearly into balance. But others were in no position to do this and consequently found it necessary to start looking for ways of employing their surpluses—surpluses which together amounted to some $80,000 millions per annum.

The simplest way of doing so would have been to lend them to the countries whose external payments had been pushed into deficit by the rise in the cost of oil imports. But, for various reasons—political as well as economic—there was a reluctance to do this other than on a fairly limited scale. And so the alternative outlet provided by the Euroloan market began to find the facilities for the international investment of money it could provide becoming increasingly popular.

One of the consequences was a great upsurge of enthusiasm for lending to the less-developed countries. Even before the oil price leap, the Euroloan market had established itself as a more important source of capital for the Third World than the traditional ones—foreign official aid and loans from international financial institutions like the World Bank. By the end of the 1970s, it was providing the great bulk of the developing countries' greatly expanding external borrowing requirement.

The extent of the harvest that this turn of events put the American, British and other advanced country banks in a position to reap is evident from the behaviour of their deposit and lending figures. With the world groaning under the stresses the oil prices explosion and the onset of double-figures global inflation had imposed in all sectors of the economic field, the second half of the 1970s was characterised by a highly uncongenial banking environment. Record rates of inflation, high and extremely volatile interest rates, fluctuating exchange rates and huge shifts in external payments were the order of the day. It was a time when, in the ordinary way, banks could have been expected to be drawing in their horns rather than the reverse.

Foreign Assets Multiplied

Yet such was the ebullience of the Euroloan market at this time that, between 1975 and 1980, the foreign assets of the Western banking system were multiplied more than three times to reach the staggering total of $1,750,000 millions. And even though the global economic climate became even less congenial with the advent of Reagonomics and Thatcherism at the opening of the 1980s, the expansion of business continued for another year or so at an only slightly slower pace.

Never, it was true to say, had the banking community had it so good. Then, with a devastating suddenness, everything began to fall apart. The first sign that the bankers had been lending not wisely but too well came with the realisation in the second half of 1981 that Poland was encountering serious difficulty in coping with its foreign debt service. But this did not cause more than a mild stir in banking parlours because it was evident that it could be regarded as in the nature of a special case. The dislocation of economic activity within the country caused by the Solidarity upheaval and its aftermath had inevitably inflicted considerable damage on the external payments position. But it wasn't long before it became painfully clear that, if Poland had been in the nature of a false alarm, many more alarms that were anything but false were beginning to be sounded.

Something Seriously Amiss

That the rumblings in the smaller debtor countries that began to be heard after the opening of 1982 indicated that something was seriously amiss was confirmed in the middle of the year. This was when one of the major Euroloan market borrowers—Mexico—announced that it was virtually bankrupt and made it clear that it would have to default on its external debt unless it was granted a full-scale rescheduling of repayment obligations. At no great lapse of time, Mexico's lead was followed by other debtors—large and small—that had found themselves in the same position.

The list of those that have either expressly defaulted by announcing that they did not intend to make any repayments of capital in 1983 or would have no alternative but to do so if they were refused an early rescheduling of their commitments has grown very long. It covers between a third and a half of developing countries that have engaged in Euroloan market activity and will almost certainly become much longer still before 1983 is out.

So what went wrong? Why did banking institutions that are supposed to be operating with due regard to the need for prudence lend so much money to borrowers who have now been shown to be unable to make repayment. The fashionable explanation is that the business was derailed by two developments that were entirely unforeseen. One was the steep rise in the rates of interest

payable on the developing countries' borrowings provoked by America's involvement with ultra-deal money policies. The other was the severe drop in the export earnings of these countries resulting from the impact of the global recession on world commodity prices.

The international payments figures do, indeed, show that, between them, these two developments have caused a deterioration in the external payments circumstances of the afflicted countries in the order of $100,000 millions per annum over the past two years. But it should be understood that the damage inflicted on the developing countries by the jump in interest rates and the simultaneous fall in commodity prices would have been much less serious if other unhelpful factors had not been present in the picture.

One was the rapid spread during the 1970s of the so-called variable rates system—the practice of allowing borrowers' interest charges to move with the current rate of interest rather than be fixed for the life of the operation, as previously. Under the old system, a rise in interest rates would increase the cost only of new borrowing. So, if the dear money phase did not last for any length of time, the increase in debt service commitments would be relatively small even if rates had been temporarily carried to the giddy heights reached in the 1980s. With variable rates in operation, however, the cost of all borrowing—new and old—tends to rise in proportion to the change in the level of interest rates.

Another development that materially aggravated the blow the developing countries suffered at the hands of the rise in interest rates was the turn-around in the dollar. During much of the 1970s, the rise in interest rates in relation to the rate of inflation was relatively slow. What was equally important was that, with the dollar losing ground in the currency markets, the advance in interest rates was also slow in relation to the rate of increase in the dollar prices of the developing countries' exports. The net effect was that most borrowing was taking place at what were, measured in real terms, effectively negative rates of interest according to International Monetary Fund calculations, to the extent of between 7 and 11 per cent.

Situation Reversed

This situation was, unfortunately, dramatically reversed after the end of the 1970s. With interest rates soaring to unprecedented levels, inflation rates moving down no less impressively and the dollar developing exceptional strength, the interest rates the developing countries were asked to pay now became very positive—of the order of 7 to 10 per cent in real terms.

The effect of the big increase in the use of Euroloan market facilities by developing countries during the 1970s had been to reduce to about a fifth the proportion of their money obtained on concessional terms under foreign aid programmes and from international institutions. With the true cost of non-concessional borrowing being inflated in such a measure, it was hardly to be wondered at that it overwhelmed external payments positions already under pressure from the severe fall in commodity prices.

Not surprisingly, the banks were acutely embarrassed by the discovery that the carpet was being pulled from under their international lending business in such drastic manner. Having quickly grasped just how far-reaching the trouble could turn out to be and the grave nature of the threat to the banking structure such a development posed, they came to the conclusion that the first imperative was to prevent rocking the boat.

They quickly perceived that the worst thing that could happen would be for their international lendings to become the subject of formal defaults. For that would create balance-sheet complications that could get them into trouble with regulatory agencies in the countries in which they were based and thereby generate alarm among their depositors—a development that would inevitably intensify the crisis.

Considerable efforts have, therefore, been made to bring about the necessary re-scheduling of the defaulting debtors' commitments with a minimum of fuss. To this end, banks that were reluctant to put up the new money that re-scheduling exercises frequently require on the grounds that this could be tantamount to throwing good money after bad have been pressurised to think again. It was impressed upon them that unwillingness to risk additional loans in these ventures might well mean that a lot of money that could otherwise continue to rank as "good" could turn "bad"!

A third part of the attack on the crisis has taken the form of mobilising the assistance of central banks and international financial institutions—notably the International Monetary Fund, the World Bank and the Bank for International Settlements—in containing the threat to the banking system by getting them to provide bridging loans to defaulting debtors while re-scheduling packages were put together.

The assistance of these organisations has also been sought in connection with a fourth part of the rehabilitation process—trying to get the defaulting countries to re-structure their economies on the lines needed to enable them to cope with their obligations under the rescheduling agreements and thereby restore their credit-worthiness.

Needless to say, the greatest importance is being attached to making a success of this huge patching up exercise. On the assumption that the badly-needed global economic recovery eventually materialises, the developing countries will benefit in the course of time from a fall in the cost of interest charged on their foreign debt and from a recovery in export prices from their present depressed levels—the lowest, in real terms, for some 30 to 40 years. But, in the interim, the global debts crisis is going to be casting a shadow over the world banking scene of a decidedly worrying kind. So far, the lifeboat exercises have kept the situation under control. But no one can be quite sure that all the scenarios that can be envisaged could be taken care of in such satisfactory fashion.

One reassuring development is that, after adopting a somewhat casual attitude to the crisis when it first erupted, the corridors of political power in the countries that have the largest stake in the international banking business built up round the Euroloan market appear to be taking it more seriously. There is a natural tendency there to play down the extent of the danger for two reasons. One is that the more publicity it is given, the more difficult it may be to prevent it being complicated by new reverberations. The other is that the central banks are not unaware that they may be held responsible, in greater or lesser degree, for the mess, seeing that they are supposed to have been keeping their commerical banking families under suitable control. In these

circumstances, they prefer to have the spotlight focused on the efforts they are making to sort things out rather than on why they need to be sorted out at all.

It is, however, significant that the Brandt Commission decided not to mince words about the banking crisis in the memorandum it recently put out in support of the call for a new attack on the world recession. Indeed, it decided to concentrate on the financial crisis on the grounds that this is the part of the picture that must be given top priority in any reconstruction drive.

Bold Collective Action

It called for all the available stops to be pulled out to get things moving in the right direction on this front—increases in International Monetary Fund quotas, the liberalisation of World Bank lending, special issues to developing countries of the IMF's do-it-yourself liquidity known as the SDR and the waiving of the official indebtedness of the poorer developing countries. But it is also said—ominously—that the magnitude of the problem dwarfed the magnitude of possible solutions. Nothing less that "bold collective action" on a global scale would do, it concluded. And so far, it has to be said, there's no sign of that taking shape at anything more than a crawl.

One can be too pessimistic. Perhaps contemplation of the terrible consequences of an international banking collapse can be counted upon to ensure that all the steps that may be needed to prevent the worst coming to the worst will be taken should the situation continue to deteriorate. And it may be more useful at this stage to pass on to the question beyond the question occupying our attention now. Which is: what of the longer-term? Assuming immediate disaster can be averted, will it be possible thereafter to get the developing countries' debt problems reduced to manageable proportions?

The Organisation of Economic Co-operation and Development has gone on record as saying that the processes that have led to the present situation should be reversed with the phasing out of the global recession. This, it argues, would bring down the debtors' interest costs, push up their export earnings and, by thereby putting them in much better economic shape, enable them to start attracting foreign capital on an appreciable scale again. Things could, indeed, turn out this way. But much is clearly going to depend on the speed and strength of global recovery and these are matters that are still shrouded in doubt.

What of the Future?

Even assuming, however, that the international banking system can be steered to safety through the turbulent waters it is going to have to contend with for some time yet, it will obviously be necessary to ponder carefully the questions about its future posed by the story of the past few years. It is a pretty safe bet that the sobering effect of its recent experiences and the need to devote a lot of attention to licking the wounds they have caused will ensure that it will be keeping a tight rein on its overseas activities during the next year or two. But its conduct beyond that clearly ought to be conditioned by the answers to some highly pertinent questions raised by the Euroloan market explosion of the 1970s and its repercussions.

One such question relates to the desirability of allowing less-developed countries to go on relying so heavily for meeting their requirements of foreign capital on borrowing from this source. There is obviously a great deal to be said against featuring private money, made available at variable rates of interest, for projects that have often proved to be of highly doubtful value.

A second question of equal weight concerns the advisability of allowing an edifice like the Euroloan market to be injecting money into the world's financial markets on such a mammoth scale—and it is the case that, in recent years, the Euroloan market has been adding to the stock of money circulating in the world markets at a rate equivalent to $50 per annum for each of the world's 4,000 million people. Bearing in mind the diminishing differentiation between domestic and international money, such a situation must tend in any case to make nonsense of the greater importance now attached to control of the money supply at national level. There is also the question whether it did not play a major part—directly or indirectly—in the tendency for inflation to wax in the global sense in the 1970s.

Role of Central Banks

Another closely connected question concerns the role of central banks in relation to the growth of Euroloan business. We are currently hearing a great deal about the way in which the Bank of England is using its resources, its skills and its influences to prevent the British banking system being overwhelmed by the global debt crisis. But that must not allow us to overlook something else. This is that, notwithstanding the fact that is is supposedly the custodian of the nation's financial well-being, the Bank presided over the growth of the international trafficking by British banks that has put the whole system in peril—and with it, indeed, the international banking system as a whole.

The sin it has perpetrated in this way is particularly difficult to forgive for two reasons. The first is that its experience with Britain's own secondary banking crisis in the early 1970s must have taught it some important lessons of great relevance to what was happening in the international banking field a few years later. The other is that, as recently as 1979, the Governor of the Bank of England was giving assurances in public statements that the Bank was exercising full surveillance over the overseas activities of British banks, taking the view that the international markets were "primarily an extension of the domestic markets" and that, in this connection, the Bank—like other leading central banks—had long accepted the doctrine of "parental responsibility".

What has now happened demonstrates that the Bank's idea of "parental responsibility" clearly leaves much to be desired. And we are left with the question whether an institution that evidently sees itself as closely identified with the City and its institutions ever can be relied upon to safeguard the public interest in these matters in the diligent way it should. There is no difficulty in seeing that it is particularly necessary to be able to count on an arm of the government of the country behaving in a manner worthy of the trust reposed in it where esoteric matters are involved and politicians and public can be easily blinded with science."

If past experience is any guide, as I said at the start, we can expect great efforts will be made to see that the lessons taught by the banking traumas now being experienced are not ringed round. An indication of what we can expect is provided by the final paragraph of an article in a recent issue of the "Banker" by Mr. Robin Pringle, who used to be editor of that journal and now runs the "think tank", known as the Group of 30, that top bankers specialising in international finance have set up in New York.

The subject of the article is: "How the developing countries are coping with their debt," and this is its conclusion: "In sum, each of the main participants in the markets will learn how to manage their own areas of responsibility in such a way as to lessen the system's present liability to 'shocks', including those caused by periods of over-borrowing and lending. Certainly, it is in this direction, rather than by attempting to shift the control over the evolution of the banking system back into official hands, that means to reduce the instability of the system should be sought."

And this prompts me to put a suggestion to the Economic Research Council. We obviously cannot rely on those who should be examining the story of the latest Euroloan market tragedy and what it means to do so. Like many of the other major developments that have created serious problems for this country in the post-World War II period, it will be treated as "just one of those things"—unless that is, someone else takes on the job. Such an assignment, I would have thought, would be right up the Economic Research Council's street.

WHAT PRICE A CURE FOR INFLATION?

On 15 January 1983 'The Times' published an article by Anthony Burgess under the above title. In this contribution Mr. Burgess stated "Now it seems that there are no more 'Keynesians', and neither is there a new economic system which explains what is happening to the paper and base metal in our purses or pockets."

In an effort to spread a little enlightenment on this controversial subject, the following reply to Mr. Burgess was sent to 'The Times' on 15 January. It was thought worth publishing in 'Britain & Overseas' as it may be of interest to our readers.

THERE IS A CURE FOR INFLATION
A reply to Anthony Burgess

In his article published on 15 January Mr. Burgess declares himself "naive about money" and "totally ignorant about the new morality of money". This is not altogether surprising, for money is a topic which, in the words of a former Prime Minister, Harold Macmillan, is an area where myth and mysticism prevail.

In its present form our monetary system has demonstrated that it is incapable of giving the nation the services which it needs and which it is entitled to expect. It is even misleading to call it a system: it is haphazard, a hit-and-miss affair which has not shown itself able to cope with the modern world.

Periods of inflation followed by deflation have created intolerable conditions from which we still suffer.

However, Mr. Burgess is right when he refers to a period of relative stability in the purchasing power of money. As he says, the pound sterling had a value in 1939 which was not seriously diminished by the end of the war in 1945. The reasons are not far to seek and may provide some useful guidance for us today. When war broke out in 1939, the orthodox financial rules decreed that Bank Rate should be doubled from 2 per cent to 4 per cent. A small all-party group of M.P.'s associated with the Economic Reform Club initiated a campaign to get this decision reversed. Such pressure was brought to bear on the Chancellor of the Exchequer and the Bank of England that they reduced Bank Rate to 2 per cent and this remained throughout the war period. Thus, the war was financed on a basis of low rates of interest which had very beneficial effects. The difference in the cost to the nation of providing the finance necessary to prosecute the war was very substantial.

Secondly, the Treasury introduced the Treasury Deposit Receipt instead of the Treasury Bill, the difference being that the former could not be used by the banking system to give backing for the creation of credit which the Treasury Bill provided. In the words of the Radcliffe Report on credit and currency—"Treasury Bills have a special significance in that when held by a clearing bank they are 'liquid assets' for the purpose of 'the liquid assets ratio' ".

The two provisions, along with rationing, taxation and other controls resulted in a period of relative stability in the purchasing power of the pound sterling at a time when government required huge sums to finance a destructive war. Perhaps we can learn some lessons from these developments which will help to solve our current problems, even though circumstances are very different.

Under-use of Resources

There is no doubt that today we have a massive under-use of resources, both of manpower and productive capacity. These resources need to be activated if we are to solve current problems. There are many influential voices calling for varying degrees of reflation. Government spokesmen have made plain their view that to give way to these demands would undo the progress which has already been made in reducing inflation.

This underlines the inefficiency of the present monetary mechanism whereby new money comes into circulation as an interest-bearing debt. If Government is to increase its spending it has recourse to increased taxation which is already too high, or borrowing from the public which is already nearing its limit. There is only one other source, increased borrowing from the banking system if public expenditure is to be significantly increased. It is here where the trouble arises.

When we come to examine how the present monetary system works we come across a strange anomaly. While the Government has maintained its sovereign right to control and issue coins and notes through the Bank of England, this does not apply to the issue of credit. Notes and coins are only a small proportion of the total money supply. By far the greater proportion

arises from the creation of credit by the banking system. When the Government requires additional finance it "borrows" from the banking system, thereby incurring the need to pay interest. At present rates this amounts to a very considerable sum, in 1980 interest payments represented 10.6% of central government current expenditure.

From this it is reasonable to conclude that the power to increase the amount of credit money in circulation should also revert to the state where historically it belongs. If the Government had followed a policy of extensive fiduciary control and had itself issued credit, rather than allowing the banks to do so, it could have reduced the need for increased government borrowing, with consequent reduction of interest payments on the national debt. Thus, a degree of reflation required to bring unused resources into activity would be possible without increasing the rate of inflation.

A Currency Commission

There will be those who say that governments cannot be trusted to carry out this historic duty with full responsibility. In fact, there are good reasons for not making either bankers or politicians responsible for the issue of money and there is a case in reserving this task for a specially appointed body who would be charged with the task of maintaining the stability of the domestic price level. It is essential that, if confidence is to be re-established in the stability of the internal purchasing power of the pound sterling, some means of regulating the growth of the money supply should be established to keep the aggregate volume of spending adjusted to current economic conditions, thus avoiding both inflation and deflation.

To meet this need we should give serious consideration to the appointment of a Currency Commission comprising independent commissioners who would be appointed for a period of say ten years. They to be charged by statute with the task of so regulating the growth of money supply that it maintained the stability of the purchasing power of the pound. A report to the President of the United States of America which was submitted to Congress in 1954 expresses this requirement very succinctly:

> "Also required is a supply of money in keeping with the increases in physical volume of production and trade. Such a growing money supply is necessary to prevent the development of deflationary pressure, to maintain equity values and to keep the purchasing power of the dollar reasonably stable."

This proposal to set up a Currency Commission has influential support. On April 27, 1976 'The Times', in a powerful leading article gave support to the idea of a Currency Commission in these words:

> "Were such a policy to be introduced and followed serious inflation would literally be impossible. That would be good for investment, good for exports, and subject to moderation in wage settlements, good for employment as well. As a nation, stable money would make us richer than inflation can ever do . . . The adoption of this reform would do more than any other single measure to reassure holders of sterling about the future of the currency."

Surely the time has come to re-examine our totally inadequate money system and to institute, as a matter of urgency, those reforms which would bring our money system into the modern world, thus giving a lead to a world progressively sinking into a sea of unpayable debt.

AGRICULTURE: THE TRIUMPH AND THE SHAME
by Richard Body M.P.
Reviewed by Jim Bourlet

"But ALL countries subsidize their agriculture—so don't criticize us" is the current line of the protectionist lobby. Now even if this waste were as uniformly spread as they would have us believe, and it most certainly is not, correction must start somewhere and why not here in Britain? Surely an extra 5% or 10% on real National Income would be handy?

Add to this mere materialism the fact the grossly subsidising agriculture via price supports, intervention buying, import restrictions, tax reliefs, cheap fuel, rate relief, development cost subsidy, mortgage subsidy and much else leads to ploughing up land that should be joyful wanderland pasture for both animal and hiker, land which provided the inspiration of our great landscape painters: then add further the needless destruction of hedgerows and paths, the habitat of our widlife inheritance, in the scramble for ever more output—and public cash, and one had better wake up!

And so Constable must stand indignantly alongside Richard Body M.P. in his new book "Agriculture, The Triumph and The Shame",* an account for both the specialist and the layman of this amazing situation. The technical achievements of British agriculture are quite rightly noted and praised—our adaptable and hard working farmers do us great credit. But one is, quite frankly, reduced to something close to tears when reading, step by obvious step this account of our economic lunacy in pouring, over many years our scarce investment capital which could have made Britain a low interest rate industrial investment centre (the Japan of Europe?) into 'Concorde' style farming.

The farmer/pilot is hardly to blame and, as it turns out, does not get the benefit either which accrues instead to farm landlords, city land speculators and large companies supplying fertilizers and machinery. Any exceptions to this in the form of benefits to large grain farmers are more than offset by losses to smaller livestock breeders. Furthermore, unless curbs are placed on this "rake's progress" crisis and hardship must follow for the farming community.

This book is not just a criticism of current policies—the conflicting interests of land owner and land worker and the economic and political falsehoods of 'self-sufficiency' have much earlier origins. It is, rather, a reference manual and the statement of a case which not one of us has the right to ignore.

** Pub. Temple-Smith*
Price £2.95

THIS MONEY!
by Christopher R. Havergal

Although I am a keen monetarist I am a reluctant writer about it for fear of becoming too repetitious. The sheer volume of interesting monetary and fiscal material, which has decorated the last few editions of 'Britain and Overseas' has, however, impelled me to offer some more words to the long suffering editor.

The material seemed to illustrate vividly how fiscal and monetary organisations everywhere seems to behave remarkably like a many-headed hydra: for as fast as political surgeons remove ugly heads, new and sometimes even uglier ones spring up in their places, while the serpent itself continues to weave balefully through almost all human affairs. But even a monetary hydra has only one heart, and it is with that heart that I propose to deal in this article.

Money is at the heart of all civilisation and, as we all know, it is also the root of all evil unless it is properly controlled. Yet unless there is money to govern the exchanges of goods and services between citizens it would be impossible to organise even the Kingdom of God on Earth, despite the fact that the kingdom's exchanges would be motivated by love and not greed; for civilisation everywhere is the art of living in communities (national and local)—communities which are made up of complementary specialisers, as distinct from assemblies of individuals who attempt to live arduously and inefficiently as independent jacks of all trades. The only alternative to either is slavery—and the mere word is enough to damn that.

Let us then explore the implications of 'exchanges of goods and services between free citizens'; and I hope in so doing I may be allowed to concentrate on 'services' alone, because there can be no goods without the services necessary to win, bring or make them.

To serve in this sense is to devote (i.e. to give up or surrender) a portion of one's life to making or doing things that other people want (or demand) at the time they want them.

Put more precisely, 'to serve' is to divert a fraction of the 613200 manhours of our three-score-years-and-ten life packages, to making or doing things that will satisfy the hourly demands of people other than ourselves—so that the doer may be justified in making demands on other community members.

Expressing this hypothesis mathematically for a whole Economy:

$$S = QD$$

Where: S = The total productive manhours supplied to the Economy per hour.
D = The total productive manhours demanded from the Economy per hour.
Q = The symbol for the propotionality between S and D.

If the relationship is to be measured in terms of actual money it is clearly necessary to introduce some commodity—like sea shells, paper, or gold—which is capable of being unitised and controlled and used thereafter as a tangible accountable token of real value, namely of productive manhours (i.e. say perhaps 0.3 manhours to the £ in Britain. The exact figure would be readily calculable given the statistics), so that the chosen token (or currency) can be substituted for symbol D in the above equation. Thereafter the currency units would retain stable value for as long as their rate of flow through the Economy were to be held in step with the rate of manhour supply into the Economy (i.e. into the Economy's currency units). It clearly would be physically impossible for things to be otherwise. Thus close control of the money supply in accordance with this criterion would hold the value of Q at one; for, if that value were to come out at less than one the Economy would be inflating, and if more than one it would be deflating.

Irrespective of whether the reader likes this kind of monetarism, or not, I submit that this is how things are, for the simple reason that only what goes in can come out. Our problem is that this simple yardstick has, I believe, never yet been harnessed to govern any Economy; and you may well ask the reason why!

During the about three hundred years since the foundation of the Bank of England, commerce, politics, banks and trade unions have tangled and interacted with so much energy that the monetary system has become buried deeply beneath a residue of impenetrable complexity. As a result the supply of money can only now be influenced by 'putting the boot into' the whole contraption with heavy 'hobnailed' Bank Rates.

I have called them 'hobnailed' not only because of the resultant bankruptcies, but also because even low rates of interest tend to promote political imbalances. High rates do so excessively (e.g. at 10% p.a. compound, the money in the lending sector almost doubles every seven years, and at 20% it more than doubles every four years). To some this process may well appear as a kind of legalised robbery of one sector by another. Yet when even that kind of impost is compared with inflation, which robs *all* sectors ruthlessly and indiscriminately, many will settle for the lesser of the two evils—like at present. But it is not scandalous that mankind does not put his economic house in order, particularly now that we possess far more than enough electronic wizardry?

For the true wealth of all nations, of course, rests in the immeasurable riches which lie latent in each nation's complement of able bodied and able minded productive man and woman hours. These stand ready each hour of every day to win and manipulate the world's available resources into demandable goods and services for us all. The fact that so much of this great wealth in Britain now lies buried deeply under our own peculiar morass of intransigence, greed, envy, and economic ignorance is surely a sinister fact, of which I believe it behoves us all to take urgent note; for we are all tarred with the imbecility of it—and tar can be set alight.

Editor's Note:

Further information on Christopher Havergal's monetary theories was given in 'Britain and Overseas' Vol. 8, No. (2), and Vol. 9, No. (1), some copies of which are still available @ 50p per copy, from the ERC.

THE TAXATION OF INDUSTRY—FISCAL BARRIERS TO THE CREATION OF WEALTH

by Barry Bracewell-Milnes

Reviewed by Jim Bourlet

This is a closely argued, complicated and very thought provoking work—a Herculean seminar on the theory of wealth and its taxation. No review could possibly encapsule the conceptual journey involved and any criticisms face a high risk of rebuttal from some passage deeply buried in the text—for whilst nearly half of the 182 pages consists of detailed appendices there is no index to help one trace a particular word, person, tax or concept. It seems that one reads it all or nothing.

Who indeed is intended to use this work? One can imagine it as a valuable reading for advanced students of taxation and most certainly it should be read by those with imagination at the Treasury—or the C.B.I. but it is hard, frankly to see many others in the market whose patience probably would be better captured with a smaller, more prosaic, illustrated booklet.

The basic theme concerns the nature of wealth—and it's derived wellbeing. Wealth arises, the author shows not only from production but from scarcity and ownership as well. Taxation of wealth should do as little damage as possible to wealth creation but the present system appears to delight in attacking rather than husbanding this process.

From this premise the author makes a powerful defence of consumer and saver interests and attacks what he sees as our almost exclusive concern with producer interests. Perhaps however, it is churlish to comment that the overall message of the book, its political "note simpliste" is a call for lower taxation on industry.

All of which led this reviewer to ask, whilst reading ever more adventurously through the almost Hayekian illumination of concepts and words, "well what, for example, about VAT?" This, after all, is a tax introduced to enable us to comply with our European Economic Community partners which involves a huge number of collection points, a mini nightmare for most businessmen, a risk of a visit from the Customs and Excise authorities (much less pleasant to deal with any time than the Inland Revenue) and which has greatly assisted in turning us into a nation of cash paying, moonlighting, tax dodgers rushing frantically into 'Do It Yourself' amateurism. Laboriously providing for ourselves things that could be done more professionally and more efficiently by those whose specialisms are involved must surely be a great wealth destroyer?

Without an index one cannot be sure—there seems no direct reference to VAT but the book's conclusion is that taxes on industry should be abolished (by stages), government expenditure reduced that "all taxation should be raised in the form of a low equiproportional tax on consumer spending" i.e. VAT!

But what of other countries? Many comparisons are made with others in Western Europe and there is some reference to the U.S.A. But what about those other countries so eminently successful in the creation of wealth such as Japan, Australia, New Zealand, South Africa, Canada or Hong Kong. Lack of data apparently accounts for this strange concentration on European comparisons—which seems just as well because, as I understand it Japanese success owes a great deal to very low consumer taxation whilst the larger corporations pay the lions share.

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Price £9.50
Available from The Alternative Bookshop, 40 Floral Street, WC2 (with £1.50 p&p)

WESTERN INDUSTRY AND THE NEWLY INDUSTRIALISING COUNTRIES

The NICs (Newly Industrialising Countries) are not a major commercial threat to the advanced industrial countries such as the United Kingdon, the United States and Canada. This is one conclusion of a study on *"The Newly Industrialising Countries: Adjusting to Success"**, published by the British-North American Committee.

Even though several Western industries are experiencing some dislocation from the exports of the NICs—Hong Kong, Singapore, South Korea, Taiwan, Argentina, Brazil, Mexico, and India—Neil McMullen, principal author of the study, concludes that a resort to protectionism by the AICs (advanced industrialised countries) would be self-defeating. "Indeed, it would work against the interests of the AICs themselves", he states.

The study selects four major manufactured items exported by NICs—textiles and clothing, steel, motor vehicles and consumer electronics (with special reference to colour TV sets)—and shows the differences of both the nature of the challenge to domestic manufacture and the types of response by the nations and industries which feel threatened.

McMullen points out that unlike Japan, to which they are frequently compared, the NICs have consistently imported more manufactured goods from the industrialised countries as a group than they have exported to them. In 1974-76 their purchase of industrial goods from the AICs helped to reduce the effects of the worldwide recession. Moreover, most NICs are relatively open to foreign investment by firms from the U.K. and other AICs.

New NICs?

Those newly industrialising countries which are the largest exporters of manufactures today are the "bulk of the iceberg, not just the tip" and will remain the predominant exporters among developed countries in the 1980s. The implication is that the problems for countries like the United Kingdom of adjusting to manufactured imports "will stem from roughly the same countries as it now does".

**The Newly Industrialising Countries: Adjusting to Success,* by Neil McMullen, British-North American Committee, 1 Gough Square, London EC4. 01-353 6371. £3.50