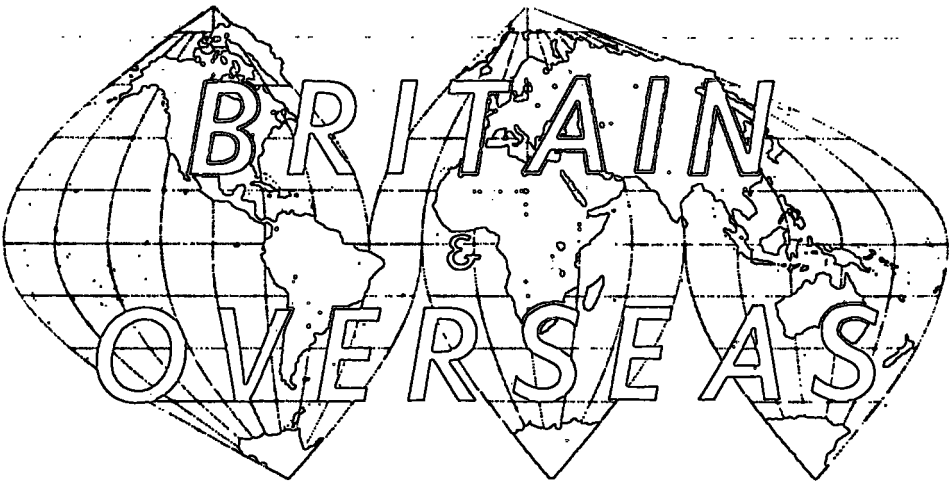

A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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LETTER TO THE CHANCELLOR OF THE EXCHEQUER

The Treasury Reply

A reply to the letter sent by the Chairman and Hon. Secretary of the Economic Research Council on 13th July has now been received. It said—

> "The Economic Secretary has asked me to thank you for and to reply on his behalf to your letter of 13th July 1983. The Economic Secretary was grateful for your agreement about the need for the Government to stay within the forecast public sector borrowing requirement. But he does not accept your analysis of the nature of credit creation and the role of the banking system. He regrets therefore that he cannot agree with your proposal".

It seems strange that a Government which is so committed to the reduction in Government spending and is currently seeking every way of cutting expenditure on health, education, defence, housing and other areas, seems to ignore the one area where, as is shown in "Government Debt & Credit Creation" there are substantial savings to be made. As the Prime Minister pointed out in an economics debate last October "Gross interest on public sector debt was estimated at nearly 15 billions this year, more than the Government was spending on defence, education or health".

In the discussion and debates on this important subject, commentators in the press, television and radio have ignored the proposals made in this publication. The only reference we can trace was in *The Times* when Gordon Tether wrote about it shortly before his column was discontinued by the Editor.

It is hoped to produce a further publication on this important topic showing the amount of saving in interest payments which could be obtained over the next five years if the technique of issuing Treasury Credits proposed in "Government Debt and Credit Creation" were to be implemented. A preliminary survey has shown these to be very substantial.

Monetary Policy in Limbo

Speaking at the Lord Mayor's banquet in the City of London on 20th October, the Chancellor affirmed the Government's determination to reduce inflation further through tight control of state borrowing and monetary growth. His remarks were strongly supported by Mr. Robin Leigh-Pemberton, the new Governor of the Bank of England. The problem is that the fight against inflation has brought with it substantial under-use of resources of both manpower and industrial production. Some new techniques are required if anti-inflation policies are not to reduce still further the production of real wealth.

In an article in *The Times* on 20th October, Francis Williams commented — "Monetary policy is now in a kind of limbo". Mr. Lawson commissioned a review on the conduct of monetary policy which was headed by Sir Terence Burns, his chief economic adviser. This, writes Francis Williams, "has been billed as the most thorough and comprehensive look at the Government's economic strategy since the Conservatives came to office in 1979". Its deliberations are a closely guarded secret. It would be interesting to know if any

consideration was given to the proposals made in "Government Debt & Credit Creation". As Professor A. Allen Schmid of Michigan University put it in an article in the *Journal of Economic Issues* — "There is no technical reason that the Government should pay banks interest for the privilege of writing cheques to command unused resources".

THE INTERNATIONAL DEBT PROBLEM

by Brian Reading

This story has now been told so often that it is remarkable for so many to come to hear it again. But then perhaps, as when we were young, it has become a favourite — "Go on, Daddy, tell us that story about how international bankers got egg on their faces".

Unfortunately, it is a fairy story and quite untrue. The bankers, as yet, have not got egg on their faces — they ducked. Instead they are today involved in an unparalleled exercise in the art of prestidigitation — persuading the world that the banks are rescuing the debtor countries, Mexico, Brazil, Argentina, Venezuela, etc., when in truth these countries (or their governments), are rescuing the banks.

Consider Brazil. One year ago, when it ran into trouble, it owed $86bn. and was paying $8bn. a year in interest charges. If this year's resolution of Brazil's problems is successful, it will end 1983 owing $94bn. and paying $10bn. in interest charges. While if the success is repeated in 1984 it will end next year owing over $100bn. and paying $12bn. in charges. The debtor countries are not being let off one penny of their obligations, they are simply being given more time to pay and being charged more for the privilege. They are also being lent new money to pay the interest on the old, hence their debts are getting larger. Any fool can see that it is not their problems which are being solved, but the banks. And any fool can see that these so-called solutions, like sweeping the yard with a broom, simply push a pile of trouble into the future.

Deficits not Eliminated

At least one group of people have seen through the banks' act — American Congressmen. This is why they are reluctant to agree an increase in IMF subscriptions. But then the proposed subscriptions increases are themselves a farce when you think about it. The IMF is not increasing the amount which an individual country can borrow. It will not lend more to the same number of countries, but the same amount to more countries. The IMF thus envisages a queue of potential borrowers extending as far as the eye can see. And why not? Consider its solution to the debt problem. **Each debtor is required to export more and import less. A moment's thought shows that this cannot solve the world's debt problem. Deficits are not eliminated but simply transferred to other countries, through a process which is profoundly deflationary.**

Text of a speech by Brian Reading to the Economic Research Council on 11 October, 1983.

We cannot look to the IMF for a resolution of the world debt problem — it places too onerous a burden on borrowing countries. We cannot look to the banks, who have shown not the slightest intention of reducing the burden of debt for borrowing countries. And we cannot look to governments who see, all too clearly that taxpayers' money would be used to bail out big city bankers rather than starving Brazilian peasants. The resolution to the world debt problem will not be found in the IMF building in Washington, in luxury hotels where bankers meet, or in Paris where governments assemble to discuss debts. The solution will be determined on the streets of São Paulo, Santiago or wherever in Brazil, Argentina, Chile, etc. This is where the issue is now being decided.

How did we get here ? Where are we now ? What is likely to happen next ? I have rather jumped to my conclusion. It is time now to look at the problem in greater perspective.

The seeds were sown in the "Great Prosperity" as it should be called — the two decades following the end of the Korean War in 1952. Throughout this period world commodity prices fell — not only relative to industrial produce prices but often absolutely. As a result industrial countries term of trade steadily improved versus primary producers. Rapid growth was enjoyed as great industries grew up, crunching cheap materials with the help of cheap energy to supply the needs of the post-war consumer revolution. The rich-developed countries grew steadily richer until people forgot what hard times could be like. Encouraged by Governments, whose ability to control events was grossly exaggerated, the wage-earner and consumer, the bankers and the businessman believed that good times would never cease.

The End of an Era

By the end of the 1960's the writing was already on the wall. Commodities were getting scarce and prices began to rise. Inflation everywhere had begun to accelerate and cycles of activity in different countries were being synchronised. The upshot was a commodity price explosion in 1972–3 followed by the oil price explosion of 1973–74. This actually marked the end of an era, although it did not seem so at the time.

The oil crisis caused the debt problem. The oil countries did not spend all the money that they earned and had to lend it. Initially the burden of deficit debt associated with the oil countries' unspent surplus fell on the shoulders of the countries who imported the most oil. These were the rich-developed countries which together account for 80% of OPEC oil exports. The rise in oil prices operated on their economies like a tax, it deflated demand. This additional deflation occurred at a time when the synchronised cycle had everywhere already started to turn down. The result was a very short, but very sharp, collapse in industrial countries' activity in 1974. Industrial countries' imports from primary producers fell. Commodity prices declined. In consequence the deficit which had been passed on in higher oil prices to industrial countries was then passed on in lower commodity prices and lower sales to the developing world.

When the developing world ran into balance of payments difficulties the response should have been for them to cut back their activity, their growth rates and buy less imports from the industrial world. The recession in mid-70's would then have been deeper for longer. Instead, in effect, although without admitting it, the industrial world did a deal with the less developed countries. The banks and industrial world would lend the less developed countries the money with which to go on buying imports from the industrial countries and, in due course, when times got better and commodity sales and prices picked up again the primary producers would be able to export to the industrial world to repay the debts.

This deal worked. Indeed it was part of a general deal by which the Government's industrial countries cheated lenders and in particular OPEC lenders out of their funds. The solution to the first oil crisis was quite simply inflation. The inflation was brought about by domestic expansion within industrial countries as Governments ran up big budget deficits in order to counter the recession and by expansion of money internationally as the banks re-cycled petrodollars to the primary producers. The solution indeed did work. Recovery came through by 1976–77, inflation eroded the real price of oil and it eroded the real value of the debts which were being incurred. The burden of debt among developing countries was no higher by 1979 in real terms or as a proportion of their exports than it had been before the crisis started. Inflation was not the problem, it was the solution to the problem and so when the second oil crisis explosion occurred everyone thought that there would merely be a repetition of the same solution.

In fact, the opposite happened. Whereas the first oil crisis shock had been validated by increased inflation, the second oil price shock was negated by austerity and tight money policy. In the first occasion, had the banks not lent money to the less developed countries and had the recession been therefore longer and deeper, the oil price would not have been sustained and it would have fallen in absolute terms instead of being reduced merely in real terms as a result of inflation. On the second occasion the negation of the price rise has occurred through the depth and length of the recession. However, any forecasters looking ahead in 1978–79 who had correctly predicted what was going to happen in 1981/82 — 20% plus prime rates in the US growth and recovery occurring with interest rates still above 10%, inflation down to 3%, unemployment over 10 million in the United States, over 12% in Britain, over 10% throughout Europe. Anyone who had accurately predicted these things would probably have been locked up as insane.

Major Readjustment

The result of falling commodity prices, falling commodity sales, high nominal interest rates has been to make the burden of repaying debts vastly greater than anyone, borrower or lender, ever supposed it would be and quite rightly they had no reason to believe that the future would be as it had turned out to be and the mistake was made, quite genuinely, on both sides. It is therefore inevitable that there has to be some major readjustment by borrowers, or lenders, to the changed circumstances. But as I said at the very beginning of this talk it is

not inevitable, or essential, that the whole burden of that adjustment should fall upon the borrower. Yet this is precisely what the present so-called rescues presume.

I want now to talk a little bit about where we might go from here. It seems to me we can look at it from either the lender's or the borrower's point of view. From the lender's point of view there is the economic environment to consider, whether it can improve sufficiently to allow the debtors to meet their obligations, and secondly, there are the mechanics of a rescue operation and whether these can continue to work efficiently.

People like Morgan Guaranty in their financial world survey have examined with computers the type of world growth needed in order to lift the burden of debt off the developing countries. They come to conclusions like provided the world economy grows by 3% per year from now to the year 1995, by about the year 1990 most major borrowers will be back into current account surplus. This type of arithmetic begs the question of whether in a world in which borrowers are being forced to deflate industrial countries could achieve the type of growth which is presupposed.

However, two points must be made. The first is that the approach to surplus in a country's balance of payments totally transforms its position as a debtor. Consider Mexico. A year ago when Mexico had a current account deficit nobody wanted to lend to it, that is to say, when it needed money it couldn't get it and indeed when it couldn't repay money, everyone demanded that it should. Now consider the position of Mexico today. It has moved back or appears to be moving back into current account surplus. Those people who are clamouring to be repaid their debts can now see that interest will be paid on them and are no longer clamouring for such repayment. On the contrary, it is now being said that Mexico's credibility is being restored and it should soon be able to come back to the financial markets of the world for more money. The move into current account surplus, the ability to pay interest and repay some debt removes the need to repay any. It is, yet another, striking example of the way in which banks wish to lend only to those who do not need to borrow.

For the main however if we are to look to the improved economic environment to resolve the debt problem we must, inevitably, look to the United States. The problem has been enhanced by the height of US interest rates and by the strength of the US dollar. There are arguments which purport to claim that US interest rates are not really very high. These arguments are based upon two fallacies. The first is that the interest that the borrower pays is not high because there is tax relief for consumer borrowing in the United States of America. But there is no tax relief for the international borrower who pays interest rates based upon US levels. The second case is that judged against the long term rate of inflation suffered historically, interest rates today in real terms are not so high. This one begs the question of whether with positive real interest rates in the past, which we never had, there would ever have been as fast inflation in the past.

High Interest Rates

It is the high real interest rates which will prevent there being a repetition of the fast inflation. Fears of inflation indeed negate the fact of inflation but perhaps more important, the strength of the dollar and the high level of US interest rates have both seemed to depend upon the size of the US budget deficit. The US authorities have been draining money from the rest of the world with high interest rates in order to finance that deficit and this capital inflow has in consequence kept the dollar strong in spite of the fact that the US current account had been going deeper into deficit. We have now for some time had the paradoxical situation in which bad news for the American economy, a bigger deficit, more inflation, faster money growth than expected, is good news for the dollar because it will drive interest rates up. Good news for the American economy — a smaller deficit, less inflation, slower money supply growth, is bad for the dollar because it drives interest rates down. Well, we now face some really rather good news. The US budget deficit is looking as if it will turn out to be considerably less than the Cassandras had feared. It was always difficult to decide to what extent the deficit was the result of the depth of the depression and to what extent the deficit was the result of structural factors, that is to say the growing number of old people on pensions, the change in the tax system to relieve people of high incomes of a certain amount of taxation and so forth. More simply it has been hard to say how much of the deficit will go in good times and how much will stay whatever happens. Well, the latest news is that the part of the deficit related to activity seems to be larger, that means that for any forecast growth in the US economy the budget deficit falls by more than was expected. In addition to this the growth of the US economy had been under-estimated and the economy is far more pliant than had been anticipated. In consequence it now looks as if the 1984 fiscal deficit will be around 130 billions instead of 200 billion plus. A change of this magnitude is bound to affect the interest rates to bring them down and with lower interest rates, indeed, we can already see this, the dollar will start to weaken. Given time, lower interest rates and a weaker dollar will significantly reduce the burden of servicing and repaying debts for developing countries.

Time is, of course, of the essence and this is also true of the mechanics by which immediate debt problems are tackled. The situation at present is that everyone who is in any way concerned with lending money to a country which gets into difficulties must combine in the solution to those difficulties. There are no groups of creditors, be they banks or international organisations who are willing to stand back and forgo their claims unless and until all others are prepared to do likewise. Equally there is no group, be it banks, governments or international institutions, that are prepared to pitch in with new money to help out a country in difficulty unless all pitch in proportionately to their exposure. This indivisibility of rescue operations inevitably makes each such operation a highly protracted affair. The process usually begins with bridging finance from a few of the banks who are most exposed or a few governments' central banks through the banks international settlement. While the bridging finance is given the country concerned usually places a moratorium on capital debt repayment but tries to go on at repaying interest. The IMF

is then called in to give its seal of approval on a loan, it sets the terms which a country must meet but it also constructs a package which is designed to supply all the country's needs over the coming twelve months. This package will usually involve rescheduling of maturing debt and the provision of new money usually in the form of a medium-term loan from the banks. The bank's loan is dependent upon the IMF and upon its terms being accepted by the debtor country. The IMF assistance is dependent upon the banks coming forward with their money. Every part of the parcel depends upon every other part of it and any failure at any stage brings the whole process to a collapse.

There are several ways in which the mechanism for rescuing debtor countries can break down. The first is that it simply takes too long to put into operation. While the negotiations are going forward a country may be falling into arrears in its payment of interest on existing debt. If the arrears get more than 60 days then banking regulators may require that banks write those debts down in their books. Within anything from zero to 90 days thereafter the banks must report the fact that they have written down in their books and at that stage a crisis can begin.

Secondly, a problem can arise if a group of banks or indeed some governments of some countries refuse to join the loan rescue operation. This could have occurred at times with, for example, German banks which have made good provision against loan losses in Latin America and still remember with some bitterness the efforts of the Americans to cause Poland to default.

Loss of Confidence

The third possibility and a serious one is the effect on confidence should the IMF "increases" be refused by the American Congress. Such "increases" are of little practical importance. They are none the less of immense psychological importance. At present markets can still believe that somewhere out there is a long-term way out of the debt problem but banks will not go bust but governments will manage things. Were the IMF subscription "increases" refused then that opinion that there is a solution out there could be damaged. The effect this has is in the money markets. The big American money centre banks raise funds on the markets to finance their lending and new medium-term credits to the less developed countries. They do not, like British banks have a countrywide branch network collecting in deposits. If then there is a loss of confidence in the market concerning the solution to the international debt problem, the small and medium-sized banks will run for safety out of lending money to centre banks into lending Treasury bills or whatever and the money centre banks will be struggling to obtain funds and will have to pay penalty interest rates to do so. That is the mechanics of the confidence crisis in the money centre banks and one which would require rapid and effective action by the Federal Reserve to resolve.

For all the doubts that I have expressed about the workings of the system, fundamentally I have no doubts whatsoever that from the lender's point of view, somehow banks and governments will succeed in muddling through and at the end of the day they will react swiftly enough. Where my doubts

really lie is with the borrowers. I said at the beginning of my talk that that problem would be resolved not in the Western World but on the streets of the developed countries' cities. This is because the effect of the economic environment on the living standards in those countries is already sufficiently pronounced to cause domestic unrest. Whatever happens with IMF terms there is going to be trouble from the economic failure of the buying countries. The governments of many of these countries are not, moreover, capable of handling any severe trouble.

In Brazil the move towards democracy is taking place — an old and sick President retains a weakening grasp on power. Brazil has agreed to IMF terms one of the most important of which is to reduce the mandatory indexation of public and private sector wages to inflation. At present or until recently indexation was 100% of the rising prices. It has been reduced by Presidential decree to 80% of the rising prices. When you realise that inflation is running at an annual rate of 150%+ you can appreciate that indexation of only 80% of the rise in prices will cause a dramatic decline in the real incomes of wage earners. There is almost universal opposition and particularly in the newly-elected Congress to this act. Yet it is this act which is the touchstone and the centrepiece of the IMF rescue operation and if it is lost the rescue is lost. The President has imposed the 80% indexation by decree. The decree requires positive approval from Congress if it is to continue after two months. If Congress does not give that approval, and that seems unlikely, it is still within the power of the President to overrule it and continue to impose the 80% indexation. But an old and sick President whose grasp on power is relaxing is unlikely to take on that task. It seems to me highly likely that the rescue, or so-called rescue of Brazil, will fall down. Similar problems also arise in Argentina, and in Chile where dictatorships are also on the way out. In each case the new civilian administrations will be under intense pressure to repudiate the debts of their predessors. **As I see it, it will be extraordinarily fortunate if we get through this winter without at least one of these countries, if not several of them, being forced over the brink into disclaiming their debts.**

Change the Rules

What will then happen? Well, broadly what I have described before in the event of failure of the IMF to get its subscription increased. There will be a run on the money centre banks and the money markets of the US. There will be a period of some turbulence during which the authorities will have to counter the rise in interest rates which will appear on all instruments except the safest.

It is possible that technically some major banks will be bankrupted. It is doubtful, in the extreme, whether the authorities would allow this to happen. Instead the regulators will, I think, inevitably change the rules so that debts can be written off over a protracted period of time. After all, when you think about it bank reserves are a ludicrous concept. The capital reserves of a bank are technically the money it would have left if it closed its doors tomorrow, paid off all its debts and collected all its credits. Now since it is not closing its doors tomorrow there is no point in knowing that number and it can just

as well be positive or negative so long as the bank continues in business and continues in business on a current basis profitably. The American banks currently are highly profitable. There is no reason why anyone should close its doors. The banks can as well operate with negative reserves as with positive.

In conclusion, I may say that I am profoundly confident that we will not see any repetition of the 1931 world financial crisis — and this if only because today we know something they did not know then — that there was a 1931 crash.

THE COLLAPSE OF NATIONAL "INSURANCE"

by Dr. Bernard A. Juby, MRCS, LRCP

Once again the future of our pay-as-you-go National "Insurance" Scheme rears its uncertain head. The Government Actuary's report (National Insurance Fund, Long Term Financial Estimates OHMS 451 19th July 1982) gives strong indications either that the money is going to run out or that tax-rejection will increase. The number of people over pension age and entitled to a flat-rate pension will rise from the present 8.98 million to 11.25 million in twenty-five years time. Unemployment remains high and the number of pensioners has risen by 10% in the last ten years, with nearly a quarter of all households being "pensioner only". One in six of the total population is already of pensionable age and in the past ten years the population increased by only ½% while those under the age of sixteen — the future work-force — fell by 12%.

Total receipts for the National Insurance Fund rose from £7.5bn to £11.4bn in the period 1975–76 to 1978–79, while the estimated cost of retirement expenditure for 1982–83 is £13.5bn.

In 1948 there were 15 people at work to "support" one pensioner and by 1985 this ratio will be down to 2.5:1 — a state of affairs which clearly cannot go on, although it will take between 20 and 40 years to turn the present scheme round to a fully-funded one.

But there is always the problem of the existing pensioners while one is doing it. As Arthur Seldon wrote in *The Great Pensions Swindle* (1970), "(The) problem of paying current pensions is the bugbear of pension policy reform". For example, it would cost something like an additional 14 pence in the pound on basic rate income tax were we to make the change overnight, and this would not make any provision for the future increase of the burden.

Fundamental Change Required

Fortunately there is another way forward and the sooner we make a start the better it would be. The USA, whose system is similar to our own, has already started raising taxes (contributions) and reducing benefits to paper the cracks but a fundamental change is required. As soon as possible government must begin to allow people to convert some of the money they pay in state contributions into private fully-funded pension schemes. These can be tailored to the requirements of the contributor and offer a wider range of cover than the blanket, flat-rate pension currently provided by the state, irrespective of need. The state scheme must be made to compete on a parallel with the

private sector. Payments already made into the state scheme could be frozen as a form of paid-up policy or even credited as a transfer value. The former would be paid as a proportion of the ultimate state pension at retirement age while the latter would be paid directly into the private scheme as a lump-sum starting contribution.

In this way it could tie in with the current proposals for early leavers and those switching from employee to self-employed status (or vice versa) and who are disadvantaged as a result of current pension scheme practice. An added bonus would be a much greater flexibility between the employed and self-employed categories, allowing more people to branch out on their own without fear of the loss of pension rights or the safety margin of unemployment pay should the venture fail. The Conservative Government recognised this latter fact in its Finance Bill 1983 by its new provisions for a guaranteed income during the first year of a new venture.

The percentage of the current N.I. contribution that would be allowed to be "contracted out" is primarily a political decision and depends on the amount of income tax that would have to be raised additionally in order to bridge the difference between the revenue collected and the state's current pension liability. An immediate increase of 14p in the pound in basic rate income tax would be politically inexpedient at any time! However there are ways of softening the blow.

For example, any new employee or self-employed person just starting out on his or her career could be allowed to set aside each year, say, 10% of the total contribution required by the state scheme for that year towards a private pension. If the ratio remained unchanged throughout their working lives they would receive the full amount of the private pension together with 90% of the then current flat-rate state benefit at retirement. This percentage could be incrementally enlarged at regular intervals, say every 3–5 years until the whole of the state contribution was channelled into the private sector. At 10% every third year we would have a fully-funded system within 30 years and the 14p in the pound tax requirement would be reduced to 1.4p and be more acceptable politically. A truly courageous government would start at a 20% option, levy a 3p in the pound additional rate and have a fully-funded option within 15 years. Contributors, seeing *their* money building up in a *personal* fund for their future benefit, or the benefit of their dependents, would be much readier to accept the additional taxation provided that they knew the reason — namely that the N.I. Fund is in a mess, that something must be done to help the existing pensioners, and that this is the best way to tackle it.

Option

While it would obviously be better for all contributors to start in this way there would be no pressure, other than economics and prudency, to do so. Citizens would have the option of remaining wholly in the state scheme (in competition with the private market but at increasingly disadvantageous terms as the benefits of contracting out became obvious in financial terms). Anyone approaching retirement now could have the option of remaining in the state scheme or deflecting the agreed percentage into a private scheme for a short while, while others between the two extremes would have their existing contribu-

tions entitlement "frozen" as a paid-up policy. This could either be held by the state and paid proportionately at retirement or, as previously stated, paid as a lump sum "starter premium" into the private pension fund.

Just as existing company pension funds have to have the approval of the Inland Revenue then similar, general pension funds operating within this system would also have to be approved. Similarly, contracted-out "subscribers" would have to show that they had in fact paid out the required sums (c.f. motor car insurance) and this could be readily achieved by means of receipts being submitted each year. The Inland Revenue's recently acquired computer for PAYE accounts should make this monitoring a relatively easy one.

One added bonus of a fully-funded scheme is that the current £13.5bn which simply washes in and out like the tide, would thus be released via the pension funds for investment back into private industry — an objective demanded by unions and industry alike.

The Americans, with their similar scheme to ours, fear that theirs will collapse through lack of funding. Has the UK Government the courage to grasp the nettle and try to prevent ours from a similar fate ?

CRUCIFIED — ON A CROSS OF CREDIT

by M. A. Cameron

In the years around 1900, one William Jennings Bryan, thrice US Democratic nominee for President, in demanding the free coinage of silver, declared that America was being "crucified on a Cross of Gold". Today, it is not hyperbolical — as it was with gold — to suggest that the countries of South America are being crucified on a Cross of credit.

Consider the facts. Excessive lending of created credit by ten of the largest American banks to Brazil, Mexico and Venezuela, to mention only three countries, has resulted in outstanding loans now totalling $37.5 *billion*; for seven out of these ten banks, their share of these "unperforming" loans is well over 100% of each bank's equity. If any one of these debtor countries were to default, others would almost certainly follow; and the whole structure of international finance could collapse.

The IMF, BIS and the US Federal Reserve are helping as lenders of the last resort. But the IMF, in the effort to restore solvency, is imposing on the borrowers conditions which will sharply increase taxation, put tariff barriers on imports and cut Government spending, *e.g.* on welfare and education; this in countries where extreme poverty alongside riches is already causing social unrest and serious riots (*e.g.* recently in São Paulo). The London *Economist* of 30th April 1983 headed its article on Latin America "The Breaking of a Continent", saying plainly that "Latin America is bent double with the effort of transferring resources to the developed (*i.e.* wealthy) world". One illuminating sentence in that article reads: "In the crazy world of 1980–81, sober-suited bankers were chasing scapegrace adventurers in Latin America" (pressing them to accept loans and more loans. But many of the said adventurers promptly shot back what they had been lent into high-yielding dollar securities in the US, with negative results for their own countries.

Export Credit Agencies

Moreover, there is another factor at work. Most developed countries in the OECD have their own Export Credit Agencies, set up by Governments to encourage their exporters by insuring them against failure to get paid for their exports. At the end of 1982, these agencies had covered the risk on around $150 *billion* of export credits to developing countries. But any system of insuring trade debts depends for survival on debtor countries being able to find enough foreign currency to enable their importers to pay their bills. If such foreign money can only be obtained by borrowing, the central banks of the developing countries must be able to get foreign credits; and if these dry up, there will be widespread defaults to existing trade creditors, who will be forced to seek recompense from their Export Credit Agencies. Even therefore if (as suggested by Lord Lever (*Economist*, 9th July 1983)) the various OECD Credit Agencies set up a central body to coordinate and (with IMF help) attempt to control necessary lending, another pressure will be applied to already hard-pressed developing countries. The depth of poverty in the South American countries which have been encouraged by private banks in America and elsewhere to go on a spending spree, was vividly illustrated in the BBC Panorama programme on 20th June 1983. Is there an answer ?

Guernsey State Notes

In 1816, just after the Napoleonic Wars, Guernsey (Channel Islands) was in a bad way, very little trade, serious unemployment, and no money. But a committee of practical men, set up by the States Parliament, found the answer. Building materials were available locally, and there were plenty of sturdy young men looking for jobs. So they decided to monetize their assets by issuing £4,000-worth of State notes to be spent on coastal preservation, a church and a public monument. This self-created money would be redeemed from taxes in three stages up to 1818, when the whole issue would be cancelled. The scheme worked. Roads were improved, the church repaired, and essential sea walls built without incurring any bank interest. Then a covered market was built, financed by a further issue of State notes, redeemable over ten years, out of import duties and revenue from shops; and further issues of State notes were authorised in 1824, 26, and 29, by which time 48,000 Guernsey pounds were in general circulation. People traded in their own local currency with confidence and enthusiasm; and though there were two domestic banks each able to issue its own notes, the States currency was preferred, since people knew that the use of debt free money meant a considerable saving in taxes. In 1826, a complaint *was* filed with the Privy Council that the States had exceeded their rights by increasing their annual income without Royal consent; but the States administrators were able to provide such a lucid and competent account of their actions that the complaint was not sustained. The following lines appear in the Guernsey reply:

> "It is said that the powers of the human mind in society lie at times torpid for ages; at others, are roused into action by the urgency of great occasions, and astonish the world by their efforts. This has in some measure been verified in this Island".

US Greenbacks

In 1861, President Abraham Lincoln faced the problem of paying the cost of the Civil War against the Southern Confederacy. He was clear (and stated this) that

> "the privilege of creating and issuing money was not only a Government's supreme prerogative, but also its greatest creative opportunity. If these principles were faithfully observed, money would cease to be the master and would bcome the servant of humanity".

So he persuaded Congress to authorise the printing of his "Greenbacks", US paper dollars backed directly by the US Government, so that they incurred no debt and bore no interest. Nearly $450 million in notes and coin was spent into circulation between 1861 and 1863. The amounts were declared legal tender for all debts, public and private; and in 1866, when the war was over, the Treasury started withdrawing the Greenbacks from circulation by accepting them in payment of taxes; so that despite pressure from banking interests which had overruled Lincoln in the latter years of his Presidency (Greenback issues were halted in 1863, when the National Banking Act provided that future supplies of currency were to come from the private banking houses), the US emerged from a debilitating war with a manageable Federal Debt of $2,678 million. But European comment can be judged from the following in *The Times*, 1860:

> "If that mischievous financial policy which had its origin in the North American Republic during the late war in that country, should become indurated down to a fixture, then that Government will furnish its own money without cost. It will pay off all its debts, and be without debt. It will have all the money necessary to carry on its commerce. It will become prosperous without precedent in the history of the world".

However, in 1908, a meeting of top bankers on a private island off the coast of Georgia produced the Aldritch Currency Report, which went on to win approval from Congress; and in 1913, Congress, forgetting what the greatest American President had said, set up the Federal Reserve Bank — to "*lend* money to the Government", who could have been creating it. Yet US Government debt was well contained in the years leading up to World War I, when the country was effectively meeting essential expenditure out of current taxation. But by 1919, six years after the founding of the Fed, and after that war, America was paying interest on a debt of $25,000 million; twenty years later, after World War II, the figure was $270,000 million. In 1982 it was $1,000 *billion*.

So when the continent of South America seems likely to be broken by the reckless overlending of commercial banks chasing larger profits, and now forced to "re-schedule" these loans and lend more to save themselves from collapse, it seems not unreasonable to suggest (*a*) that these banks should be firmly told that further loans are not required; and (*b*) that the debtor countries will now create for themselves the currency and credit needed by their citizens. Exporters to these South American countries could be informed that their products would be welcome; but that payment would now be made only in credits in the local banks, which could be used to buy locally produced goods, services and raw materials, but could not themselves be exported. The amount

of currency and credit provided in these countries for their own citizens would be governed (*a*) by stable prices, and (*b*) by maximising employment. Does this make sense ?

WAGES AND UNEMPLOYMENT

by Cdr. J. F. Standish

Two matters exercise economic and political thinking today: inflation and unemployment. It has for a long time been evident that the fundamental economic problem has been the continual rise in wages which, while not commensurably adding to real spending worth, has grossly inflated costs which in turn make our goods and services increasingly expensive at home and abroad. This fact alone is a deterrent to employment, but it also gives impetus to machines which have the effect of displacing labour.

If wages rise by 10% per annum, the effect is that they double themselves in about seven years and quadruple themselves within fifteen years. Any other rate of increase or decrease is commensurate.

Labour costs, *i.e.* wages, are the only real costs. Materials cost nothing until they are extracted, processed and distributed, and these three activities are primarily governed by labour costs. Therefore, it is evident that the only way to grapple with the economy and to abate inflation is to control the cost of labour. If the minimum wage rate for any job, as at present established, were reduced annually, the cost of new recruits to commerce and industry would be progressively if gradually reduced while that of those already in jobs would be stabilized or later adjusted, with the effect that real spending power would be maintained at the time when the cost of living is being reduced. Thus unemployment would tend to fall since the cost of employment would be ameliorated, and the charge on social services would likewise be lessened with a corresponding beneficial effect upon taxation.

Economic gradualism has much to commend itself, being relatively painless domestically while it does little to disturb exchange rates internationally. For almost a century before the last war wages and prices remained almost static while the nation continued to prosper, and that desirable state of affairs should be regained. Alternatively, we become progressively and paradoxically a population of penurious millionaires.

COMMON MARKET QUOTES

Farm Support Scandal

Contrary to popular myth, the cost to Britain of the EEC budget is but a fraction of the true cost of agricultural production . . . The main cost is measured by the large amounts that consumers have to pay for food. The price of UK farm products is between one-and-a-half and three times world market levels. It is an example of "fiscal illusion" to ignore costs that are paid by consumers across the shop counter rather than by the Treasury at the farm gate.

Not that there is a shortage of exchequer contributions. Some £0.8m is being paid by the Government for direct UK farm aid over and above what is paid through the CAP, and agriculture, unlike industry, is entirely exempt from business rates. . .

Taking all effects into account, two economists have estimated (see *Agriculture, the Country and Land Use*, by J. K. Bowers and Paul Cheshire, Methuen, 1983) that the real cost of CAP agricultural support in Britain is upwards of £3bn or over £10,000 per farmer . . .

The moral is that instead of simply asking for "money back" from the EEC, the British Government should become an advocate of a cheap food policy on a national and international scale.

Extracts from Economic Notebook by Samuel Brittain in the Financial Times, *13/10/83*

Bill to Block EEC Cash Ready if Talks Break Down

The Government is understood to have drafted a contingency Bill and a supporting White Paper which could be used to block British contributions to the European Community budget in the event of a breakdown of talks on the future of Community development.

Anthony Bevins, Political Correspondent, The Times, *21/10/83*

EEC Freeze

EEC Agricultural Ministers must today consider tightening their belts. The Common Agriculture Policy (CAP) has been eating up more of the Community budget, and at a two-day meeting in Luxembourg the Ministers will be forced to consider rationing.

Ian Murray, Brussels, in The Times, *17/10/83*

Farmers Oppose EEC Levy

The National Farmers' Union gave notice yesterday that it will oppose any EEC measures which it considers discriminate against British dairy producers. It describes the idea of a "super-levy" on increased milk production as unacceptable.

Agriculture Correspondent, The Times, *19/10/83*

EEC Surpluses "to feed poor"

Farmers in Britain and the rest of Europe should be encouraged to continue with large-scale production despite European food surpluses worth nearly £3 billion, according to Sir Richard Butler, President of the National Farmers' Union.

Sir Richard has launched a strong defence of the food surpluses which have plunged the Common Market into a major financial crisis over payments to farmers. . . .

The Common Market's growing food mountain now includes about 485,000 tons of butter, 900,000 tons of skimmed milk powder, 5 million tons of wheat and 630,000 tons of barley. The European wine lake has grown to more than 605 million gallons.

David Brown, Agriculture Correspondent, Sunday Telegraph, *16/10/83*

£62m EEC Aid for the Regions

Britain is to receive £62m from the EEC's regional fund, representing more than a third of Brussel's latest allocation aid. Among projects to be helped will be the Glasgow Exhibition Centre, which will receive £11.2m and the Swansea Grand Theatre which will get £2.7m of aid.

Ian Murray and Edward Townsend, The Times, *20/10/83*

Howe Leads Tory Fight for Europe

Sir Geoffrey Howe, the Foreign and Commonwealth Secretary, has been asked by the Prime Minister to take charge of preparing the Conservative Party's manifesto for the election next June to the European Assembly in Strasbourg.

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