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

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EDWARD HOLLOWAY 1906 - 1985

Memorial Service - St Margaret's Westminster
Tuesday 25 February 1986.

Address by Lord Ezra
President of the Economic Research Council.

I feel very honoured at having been invited to deliver this Address on Edward Holloway. There are many here who knew him much longer than I did. I was invited to become President of the Economic Research Council in May of last year in succession to my old friend, Dick Beeching, and it was only since then I was in regular contact with Edward Holloway and was able to appreciate his special qualities.

In preparing this Address I received much help from Mr Damon de Laszlo, Chairman of the ERC, Lord Killearn, Vice President, Mr Martin Cadman, Committee member, and from Lord Beswick and Lord Tranmire. I mention the names of these distinguished personalities to emphasise the wide impact which Edward Holloway made in his lifetime – which indeed cut across party lines, as he had Conservatives, Liberals and Socialists among his admirers.

He was born in Russia in 1906. His father was then employed in the Indo-European Telegraph Company, which Edward himself joined in 1922. But he left it in 1925 when it was taken over by what is now Cable & Wireless – thus demonstrating that there is nothing new about take-overs.

What determined the rest of his life for him was the economic and financial crisis of 1931. He then committed himself to the study of monetary and fiscal problems with a view to finding ways of mitigating the turbulence of economic developments in modern society. He was profoundly affected by the unemployment in the thirties and disturbed by what the apparent inevitability of the economic system was doing to individuals. He felt that it was the weaknesses of the monetary system which led to many of the distortions in society.

He threw himself vigorously into movements which could help to resolve these problems. He formed the Prosperity League in North London in the early thirties and founded the Economic Reform Club in 1936. This built up a membership of some 2000, covering the whole country. In 1959 it merged with the Economic Research Council of which Edward Holloway became Hon. Secretary in 1955, a position which he occupied with great distinction until his death in November 1985. He devoted himself also to other related causes, such as the Commonwealth Industries Association, of which Lord Tranmire was Chairman for many years.

As if all these activities were not enough he stood for Parliament, in the Liberal interest, in 1945 and 1950; and he wrote his first book on monetary policy, entitled "Money: the Decisive Factor". He completed his second book on the subject just before he died, entitled "Money Matters" and with the intriguing sub-title of "A Modern Pilgrim's Economic Progress". This will be published later in 1986.

One of his most important initiatives was to launch a "National Recovery Programme" in 1967 with the support of 19 leading industrialists and economists. It underlined the need to regulate the money supply and to reduce the volume of Government spending. These have become familiar objectives in more recent times. At the suggestion of the Duke of Montrose he visited Southern Rhodesia in 1963 and submitted a report to the Government there on how the economy of that potentially wealthy area could be developed.

But he will mainly be remembered as Hon. Secretary of the Economic Research Council, of which Mr Patrick de Laszlo and more recently Mr Damon de Laszlo have been the distinguished Chairmen. Those who worked with Edward in the ERC have been uniformly impressed with his courtesy, patience and dedication. Lord Beswick, who is unfortunately ill and cannot be here, wrote to me to say that although he had only known Edward Holloway for a relatively short time, he was impressed with "his deep integrity and the unselfish and generous way in which he supported causes which he considered right and true."

I feel that is a fitting tribute.

A WORLD FIT FOR BANKERS AND BROKERS TO LIVE IN.

By Brian Reading.

The Economic Research Council's President Lord Ezra, together with Lord Aldington and others, are much disturbed by the decline in British Industry. They think that it will continue unless the Government does something about it. I do not wholeheartedly agree with their diagnosis, prognosis or prescription. But there is a reverse side to this coin which undoubtedly deserves our attention. The City of London, at the pinnacle of the service sector of the economy, is prospering and will prosper mightily thanks to liberalisation and less Government interference.

The City's explosive growth over the next decade is likely to dominate our economy's development. It will compare in impact with the explosive growth in oil production over the past decade. If anything, it will have a more divisive effect upon society. It will make the City richer and the country poorer. It will cause massive income disparities between those in industry competing with bowl-of-rice-a-day Korean button-pushers, and those in finance selling their services to the highest bidders on Wall Street, Throgmorton Street or Chiyoda-Ku. The process has already begun. There has been an outcry of late at the six-figure pay cheques which the services of some traders in their twenties now command – pay dictated by international, and not domestic, standards.

This is no reason why any government, right or left, should intervene to halt the City's economic success. Indeed ironically it was intervention to eliminate the City's former restrictive practises which caused this bonanza. But there will be good reason over the coming decade for intervention to ameliorate the social consequences for a divided nation. I will return to this issue in a subsequent piece. but for the moment, let me explain what is happening.

Few people have not heard of the "Big Bang". This has been timed for 27th October this year. On that day the London stock market will scrap its system of fixed commissions, and will end the distinction between jobbers (ie, principals who trade on their own behalf but only with brokers) and brokers (i.e, agents who trade on their customer's behalf with jobbers).

In the short term, the "Big Bang", like most explosions, could produce a blood bath. Thereafter commission rates for large share trades are forecast to tumble, as market members compete fiercely for the available business. Business will become concentrated in the hands of the largest institutions who make markets at reasonable rates in fair weather or foul. As in America after May Day 1975, when fixed commissions were scrapped on Wall Street, lots of small and medium sized stockbrokers will go broke and some of those traders' whopping salaries will be slashed. But the big bang is not an isolated explosion. It is part of a barrage of bangs which has already started to rubble through the City and will continue to do so for some time to come. Other reforms include:-

Stockmarket membership	From 1st March outsiders were allowed to become members of the London stock exchange. Merrill Lynch and Nomura led the way in.
Stockbroker Ownership	Stockbrokers need no longer be partnerships but can be companies owned 100% by anyone, including banks (This is illegal in the USA under the 1933 Glass-Steagall Act). So far 64 UK brokers have sold out, making fortunes for many of their partners.
Stockmarket Computerisation	From October the stockmarket will be fully computerised and ultimately linked up with markets in the USA and elsewhere.
Building Societies behaving like banks.	From January 1987 building societies will be freed to behave more like banks. They will be allowed to turn into companies, take over and be taken over even by foreigners. They will be controlled by a brand new *Building Societies Commission.*
A new system of regulation to stop cheating.	In about February 1987 a new regulatory system will start to operate covering all financial services and markets. It will be run by a statutory *Securities and Investments Board (SIB)*, which will vet rules established and enforced by *Self Regulatory Organisation (SROs)* and *Recognised Investment Exchanges*. For the first time the burgeoning Euromarkets in London will be brought under regulatory control.
Anyone will be able to open a bank.	The 1979 Bank Act is to be amended to scrap the existing two-tier banking system. Hence forth anyone with £5m to spare will be free to open a bank. But a new committee will reinforce and oversee the Bank of England's regulatory powers and it will have more and sharper teeth.

This is not a comprehensive list of reforms. An Inquiry is looking into the way Lloyds of London works to see whether the 1982 Lloyds Act of Parliament should be amended. Some people think Lloyds should come under the SIB. Changes are planned in personal pension arrangements. Pensions are to become portable. The Government's state earnings related pension scheme, SERPS, is to be reformed. People will be allowed to set up personal pension schemes. And so on, and so forth.

At first sight it is hard to see what all this will mean. But the principles are simple. Britain has a formal financial system still organised in a way suitable for the 18th Century age of quill pens, leather-bound ledgers and person-to-person conversation. The financial system is the mechanism by which funds are transferred from those who own, earn and lend to those who owe, borrow and spend. This is called financial *intermediation.*

Intermediation can be *institutionalised*, which is where say a bank or building society stands between lender and borrower. Such institutions set borrowing and lending rates.

They lend out only what comes in at those rates and change them infrequently. Half the time, they turn away potential borrowers, the other half they can't find enough of them. They work in bricks and mortar buildings, which they open to the public for business during specified and limited hours. In dealing with institutions, you always know what rate you will be charged, but not whether you will be able to borrow.

Alternately intermediation can be *securitised.* This is where lenders buy financial claims issued by borrowers. Markets bring borrower and lender together. Each gets the best price going at the time they borrow and lend. Markets never turn anybody away, prices quickly adjust to equate demand with supply. But markets are consequently volatile and uncertain. To operate in them you need fast and reliable information. Before modern means of communications, the only sensible way of doing business was for everybody to get into a large room together and all shout at the same time. That's why stock exchanges, commodity exchanges etc, are customarily built around trading floors. If you could not get into that room it was best to use your local bank instead. In dealing with markets you always know you can lend, but not at what rate you can do so.

18th Century markets were regulated by putting people into boxes according to the one kind of business they were restricted to doing. They then formed clubs to stop members cheating each other and to help them cheat everyone else.

In this 18th century environment *regulation by compartmentalisation* became the norm. To stop people cheating they were put in little boxes and told they could only do one kind of business. Stockbrokers could not be jobbers, bankers could not be brokers, building societies could not be banks, and so forth. Each group of people, performing the same function, formed a club, often to own and manage buildings in which they did business. Lloyds is a prime example, and until 1979 that is about all the Lloyds Council did do. The clubs then made up rules to stop members from cheating one another. Cheating outsiders was not merely tolerated but positively encouraged.

Today this 18th Century financial system in Britain is being replaced by a 21st Century system. Essentially this is where anybody (British or foreign) is free to do anything, provided they obey statutory rules against cheating their customers. This system is *regulation by information.* All financial operators and markets are required to keep and report comprehensive information of deals undertaken, at what prices, for how much, for or with whom and when. Such information is anyway needed for settlements and already collected. Computerisation makes it possible to handle it on a vast scale and with perfect recall, enabling the authorities to spot, prove and punish cheats.

The revolution in the manner in which the City of London operates is timely. The world financial system is rapidly changing. Abolition of exchange controls in all major countries means that people are now free to lend or borrow as much as they like, for as long as they like, in whatever manner they like, at the best terms they can get, anywhere in the world. Moreover thanks to modern means of communications and computers they can do so quickly, easily, cheaply and knowledgably.

Borrowers and lenders are no longer forced to go into home-town banks or building societies and accept whatever terms these institutions care to offer. Shares need no longer be traded in shouting matches on stockmarket floors. Increasingly financial intermediation is becoming securitised and globally unrestricted as to place and to time.

No major institution, reacting to 24-hours-a-day global news, dare do business in only one country and for only 8 of those hours.

Round-the-world 24 hour trading of the top international securities is already a reality. It has to be. For example, recently a New York broker sent a circular through the post to clients recommending they buy Walt Disney Co. shares. It arrived while New York was closed. Smart operators made a killing buying in London before breakfast. The same thing happened following a Court ruling after hours affecting Philip Morris Inc shares. No big institution, reacting to 24-hour-a-day global news, now dares to do business in only one country for only 8 hours a day.

1. The last Japanese gets up after the first American goes to bed. London overlaps Tokyo then New York. It has competion all day from one or the other centre. Tokyo's mornings and New York's afternoons are competition-free.

2. Financial intermediation will never become wholly securitised and both New York and Tokyo will continue to benefit from their larger domestic hinterlands.

3. While London can hope to get more than its fair share of international business, it is most unlikely to compete away a major share of the other regions' domestic business.

London has, nonetheless lots going for it. The US financial system is an organised shambles. It was never designed to do anything. It emerged in ad hoc solutions to financial crises. The Glass-Seagall Act, for example, was passed in a single morning session of congress in 1933, with only one copy available and that with manuscript corrections. In the afternoon, Senator Glass addressed both Houses to tell Senators and Congressmen what they had just done. Banking and broking remain seperate in the US to this day. America has an excellent regulatory system necessitated by its archaic financial market structure.

Japan, by contrast, has an excellent financial system perfectly designed to do a job which no longer needs doing - mobilising a maximum of savings for postwar industrial reconstruction. It still depends largely upon regulation by compartmentalisation, and intemediation through institutions.

London is the only major financial centre offering the prospect of a fair free-for-all. Major financial institutions are fundamentally honest. They will welcome the freedom to engage in whatever business they like without resenting the regulatory requirements for prompt and detailed information and record-keeping. Moreover, at the end of the day it is this basic honesty which must keep them from cheating - no amount of regulations ever will.

London is the centre in which the dominant financial conglomerates of the 21st century will tke root and grow. Already such conglomerates are being put together – by Citicorp and Security Pacific, by Merrill Lynch, Nomura, our own Mercury International and Natwest. London will be their nursery and as they grow they will bring business to it.

The City at present has around 3 - 5% of worldwide financial business (but a higher percent of international business). It will never get 33%; Britain's domestic markets can never compare with America's or Japan's. But if it got 15% of world business by the mid-1990s, which is itself expanding every year faster than industry is growing, that indeed would mean explosive growth for London. This should give somthing for Neil Kinnock and his friends to think about.

CONSERVATIVE CONCERNS.

The Case For Alternative Conservative Policies.

By Sydney Shenton

Mrs Thatcher declared in 1979, "The mission of this government is much more than the promotion of economic progress. It is to renew the spirit and solidarity of the nation".

Recently a leading Conservative financial editor has lectured and written that with success in four out of six main areas, Mrs Thatcher has done enough to win continued support. He argues that she has been successful in the following four sectors: the value of money, developing the private role in industry and commerce instead of the state, the welfare state, and finally cutting the Unions down to size. He claims she has lost in only two, education and the creation of wealth. Not all of these areas are of equal importance and significance but they form a useful way to examine performance from which we can arrive at some judgement of the prospects of the lady and her policies.

Most reasonable people would give full marks for the reduction in the authority of autocratic trade unions. Whilst government, management and unions need to improve and pull together if we have a hope of improving our awful economic prospects, many would argue that it is the Unions who have clearly inflicted severe damage upon our peformance. Restrictive practices, excessive pay demands, and an almost total Luddite approach with a multiplicity of Unions have made competitive conditions much more difficult for even our best and toughest managers. The government has introduced sensible and reasonable legislation step by step, bringing the Unions within the rule of law. Recognition of this vital and necessary change must be fully given. We have to make sure with improved performance elsewhere we can hold on to this new position. If labour obtains power, their so called New Deal, looks like retaining the compulsory ballot provisions but emasculating other measures including allowing secondary picketing which would put the clock back with a vengeneance.

The next area in which victory has been claimed is the reduction of the state role in commerce and industry. There is no need to waste time on privatisation, although the money gained seems to evaporate in the year it is gained. Whilst management has more to offer in the private sector, it seems an exaggeration to claim this as a significant gain.

As regards the value of money, some success has been obtained here but it must be looked at very closely. A great deal of the improvement has not been due to clever policies but to a severe decline in commodity prices due to the recession. The idea that by getting inflation down everything else will happen automatically is now completely discredited everywhere except in government circles, and it can now be seen that aiming for a low and non-accelerating inflation rate would have enabled other measures for a lower level of unemployment. To make inflation reduction a constant priority over other economic objectives makes no practical or moral sense. The government gets some marks in this area but far from 100%.

The fourth sector of success is claimed to be the welfare state. The one thing I nor many others dreamt of was that a conservative government would spend oil revenues on unemployment and other social benefits. Never has so much been spent on so many to do nothing. The government has increased spending on the Health Service in real terms, but there has been no improvement in management or administrative efficiency. Despite money being spent on staffing and salary levels, hospital beds and equipment have suffered, and despite this expenditure morale is appallingly low. This cannot add up to success however you look at it.

The admitted failures, education and prosperity, outweigh in importance and social implications the claimed victories.

As regards education, after the impact of the compulsory comprehensive system it would be difficult to imagine how matters could get worse but declines in standards and other factors have proceeded at an increasing rate.

Children leaving school are in increasing numbers positively illiterate. Up to a few years ago boys and girls with aptitude were proceeding through a secondary system to become graduates in a wide range of sciences and arts subjects some with great distinction, now completely closed and denied to them. How is it possible for things to become implacably and continuously so much worse? All sectors and lobbies have contributed to this disreputable state of affairs and one thing for certain is the government has injected an inept touch and mismanagement which have accelerated the decline.

The vital area, that of the creation of wealth, acknowledged as a failure, has to be the most important socially and economically, and whilst unions and management are critical sectors, it must be government who takes the lead and sets up the conditions for the country as a whole to operate. It is simply not acceptable to claim that our troubles are the same as the rest of the developed world. Under world recession "why have we done so much worse?" is the question that must be asked.

What is essential is a thought-out, consistent and coherent approach to industry in which the government declares its strategic priorities and allocates its investment in education, and research and development, and, absolutely vital, considers our human resources as part and parcel of the aims. In other words it should make industry the subject of a united patriotic endeavour. Now this is precisely what the most gifted and successful industrialists in the land have observed operating in Japan, Germany and other competitive countries. This is what they strongly suggested we should emulate to the House of Lords Select Committee. How is it possible that the Chancellor should immediately dismiss such reccomendations as irrelevant special pleading?

...Regretably there seems little hope of a better grasp of what is needed, and however talented and gifted our Prime Minister, her Achilles heel, from the overwhelming evidence, is clearly her amateur and inadequate grasp of economics. Whenever advisors are appointed they are carefully selected so as not to question her already formuated views when what, of course, was needed was someone to carefully review for her cohesive and properly appraised alternatives. This situation is going to have a lasting and damaging effect on the Conservative Party.

I never conceived it would be necessary to quote from John Stuart Mill's famous essay on Liberty for the benefit of a Conservative Prime Minister. 'All human grasp of truth is provisional and imperfect. Nobody is infallible. The best hope of arriving at the truth is by unfettered informed debate and taking action and modifying behaviour in accordance with the consensus of such opinion.'

THE TWISTS AND TURNS OF MONETARY POLICY

Professor C Goodhart, a former Bank of England adviser and now at the London School of Economics, addressed members of the Economic Research Council in March. His theme was "monetarism in retreat".

After the Chancellor himself has criticised and suspended the £M3 target last autumn, its re-adoption for 1986-87 at a higher target range is hardly regarded as a strict basis for financial discipline. As for little Mo, this consists overwhelmingly of currency carried about in pockets and store tills; why fluctuations in the small change of the financial system should be a good indicator of future developments in the wider economy has never been convicingly explained. Indeed much of the use of such cash is probably for rather shady activities in the so called Black Economy.

The UK is not unique in finding monetary targets less useful than, say, 4 - 5 years ago. Canada, Australia, the USA and Japan have all become disillusioned. Only West Germany holds the faith in undiminished form.

The rise and subsequent decline of monetarism has been rapid and spectacular. Its advent followed the break-up of the Bretton Woods fixed exchange rate system in 1973. Under the resulting system of floating exchange rates there was no longer any external constraint on domestic financial policies: many politicians and economists welcomed the removal of external discipline for the UK because it allowed a more expansionary policy to be adopted. The problem with such a policy is that people learn to foresee the inflationary consequences, so that exchange rates, prices and wages move to anticipate future inflation.

A greater proportion of any expansion of aggregate nominal demand becomes wasted in worse inflation and less goes to increase output.

The Western World soon learnt that there was a need to replace the old, external fixed exchange rate discipline with new self-imposed domestic discipline to constrain the growth of prices. The authorities had to commit themselves to an objective that really was in their power to control and that in turn could maintain predictable leverage over the growth of nominal incomes.

Monetarism took centre stage by arguing, firstly, that the authorities were undoubtedly in a position to control the money supply and, secondly, that there was a stable and reliable relationship between movements in the money supply and in nominal incomes. So strong was this latter faith that in the initial Medium Term Financial Strategy, Sir Geoffrey Howe was prepared to lay down firm targets for £M3 for several years into the future. The Bank of England warned against this degree of restrictive pre-commitment but to no avail.

Monetarism was adopted to deal with the inflationary strains and stresses of the later 1970s and early 1980s. But these same events were causing far-reaching adjustments to the structures of the financial system. In the face of these structural changes the old stable relationships between the growth of the money supply, however defined, and the growth of nominal incomes became much more fragile. Prior to 1979, if £M3 grew at a given rate, nominal incomes would then grow at a rate of 1 - 2% higher. Since 1980 this relationship has ceased to hold, with £M3 having grown at average rates of 13-14% while the growth of nominal incomes has fallen to around 7%.

There are perhaps three options for the future conduct of monetary policy.

(1) Continue with monetary targets in the hope that a stable relationship between money supply and nominal incomes will re-emerge.

(2) Establish targets for the growth of nominal incomes. The targeting of nominal income growth also presents problems however. Statistics for nominal incomes are only available after considerable time lags – much longer than for money supply. Forecasting nominal incomes is also a problem.

(3) Return to a system of fixed exchange rates. This option still has the disadvantages for the UK which were so acute in the 1960s such as the lack of autonomy in economic policy and the need to make exchange rate adjustments in a manner which does not undermine the rationale of the system. Moreover the huge growth of international capital flows, with their resulting presures on exchange rates has made a fixed rate regime unworkable.

It is clear that in the late 1980s there is no option for the conduct of monetary policy which can be pursued with the confidence with which monetary targetary was adopted in the 1970s.

EEC REFORM: REMOVING THE INHIBITIONS

By John Coleman.

A couple of years ago there was a great deal of talk about reform in Europe – meaning the EEC. The Conservative Party produced the Conservative European Reform Group, which has a membership now probably approaching a hundred Conservative MPs, and Sir Geoffrey Howe as Foreign Secretary made the point that because Britain's membership of the community was 'irreversible' the structure of the EEC had to be reformed.

Unfortunately the European Economic Community has always shown itself to be highly resistant to reform even in the smallest degree and sometimes its so-called reforms turn out be be merely a means of strengthening its rigidities. This is the case with the present package rejected by the Danish Parliament. Few nowadays seriously deny that true European unity is the desired goal but there are basically two ways of approaching this goal. We can hammer out of existence – 'harmonisation' is the Common Market jargon for this process – all the differences between the member countries and strive to turn Europe into a single productive machine; or we can take full account of the differences and co-ordinate them into a system from which all will benefit. The former is an impoverishing process, rather like the kind of socialism that aims to beat everybody down to the level of the poorest. The latter is an enriching process. One will put Britain in a straitjacket. The other will restore her to her position of flexibility in the world.

Everyone recognizes that the institutions of the EEC are full of anomalies and nonsenses, but they are not the real core of the problem for Britain. As a result of joining the EEC Britain was hit by three powerful blows: (i) An influx of European manufactures which has led to a massive deficit in trade in manufacturers currently running at between nine and ten billion pounds annually, (ii) An enormous increase in food prices, and – this is a point that has not yet been properly appreciated – (iii) A massive inhibition in Britain's trade in manufactures with the food producing countries outside the EEC. The effect of all three were cushioned by interim arrangements which came to an end in 1978.

Britain could probably have absorbed blows (i) and (ii) provided that the way had been clear for trade with those countries outside the EEC who took our manufacturers in return for food, and there had been a loosening of governmental, bureaucratic restrictions by other countries within the EEC market in such areas as insurance and high technology. Sir Winston Churchill highlighted the fundamental problem about Britain's relationship with the rest of Europe when he said that if ever Britain had to choose between Europe and the High Seas for her trade, she would always have to choose the High Seas. He knew that Britain's industrial base could not sustain being geared to the Continent only, and that indeed is what is fundamentally wrong with Britain's present membership of the EEC.

The other countries, France in particular, have indicated that since Britain joined knowing the rules, she must abide by them. They have a fair point. They have gained a twofold short-term advantage up to now: they have been able to support their agriculture largely at Britain's expense and they have been able to capture a large share of British markets in manufacturers; but it must be clear to them that this is a situation that cannot go on for long unless Britain's wealth-creating sector, the traditional industrial base, can expand in some other direction.

It is now late in the day to deal with the problems that should have been dealt with when Britain joined. Had Britain been free to continue selling her manufactured goods to the food producing areas of the Commonwealth and the Third World, and to expand that trade as those countries developed, Britain's great traditional industries would have adapted and remained intact, her people would have remained in work and sufficient wealth would have been created to sustain on a sound basis the trade which the rest of the EEC, including the giant British companies who have moved their plant and capital onto the Continent, now enjoys. The fact that it is still enjoying that trade is largely because North sea oil has provided the wealth to go on buying Continental goods.

As oil revenues run down this will cease to be the case unless the rest of the EEC is prepared to take steps to enable Britain's wrecked indusrial base to be regenerated. If this is not done the EEC will be cutting its own throat as well as Britain's; not exactly a good recipe for a healthy Community! The steps that have to be taken will certainly mean exempting Britain from many of the provisions of the Common Agricultural Policy, in fact, reforming it into a Co-ordinated Agricultural Policy.

It always was rather absurd for British industry to imagine that it could capture a large share in the Continental markets. They were already well provided by their own manufacturers, and even if Britain had been spectacularly successful in this direction it would actually have been harmful to Europe and created higher levels of unemployment there. Traditional British industries should have turned to the middle range technology markets of the food producing countries of the world. These had a real need for Britain's manufactured products and Britain had a real need for their food and surely that's what good business is really about.

What is now needed in Britain is surely a grand effort – in the spirit of Winston Churchill – by both pro- and Anti- Market factions to bring about this great change, this great reform in European affairs. It would ensure the continuance of the EEC but in a form that would enable an economically strong Britain to hold her head high in independence within partnership in Europe. It would ensure a better, more outward-looking, more outward-flowing Europe. It would give Europe its true link with the Third World. Time will sweep away the bureaucratic nonsenses, the headless stamps and the characterless passports, of the small-minded Euro-busybodies who hope to superimpose uniformity on the great nations of Europe. The way will open for Britain and the rest of Europe to make a significant contribution to removing some of the perils of the North-South rift which many now see as an even greater danger to the future of the world than the present superpower conflict.

The food producing countries of the Commonwealth and Third World are crying out for trade rather than aid so that they can stand on their own feet. With a flow of real trade supplying real needs in real markets, not fancy goods in over-saturated markets, Britain, Europe and the World would all benefit.

LOANS NEED DEPOSITS

By D.A. Bell.

It is easy to become so absorbed in the important problem of credit creation by banks as to overlook the other side of any operation in which this is involved and Deryck Artingstall's note (Britain and Overseas, Spring 1986) on building society depositors seems to be an example of this. It is quite true that the granting by a building society of a mortgage creates credit, but most of the deposits will come in the form of cheques drawn on bank current accounts, either accounts of individual depositors or of employers who have paid the wages from which cash is deposited, and thus represent a reduction in bank deposits to balance the increase generated by the mortgage. The position may be clearer if instead of looking at money and credit (M1 in technical terms) one thinks about purchasing power in the market for goods and services. By depositing with a building society money which would otherwise have been spent, the depositor reduces the amount of free purchasing power in the market and this is deflationary; and the lending of an equivalent sum on mortgage, to be spent, is in principle inflationary but in so far as it balances the deposits the whole operation is neutral, leaving the amount of purchasing power in the market unchanged.

The statement that no depositor is ever denied the facility to withdraw any or all of his/her money requires qualification. A building society does not hold enough money in each branch office to repay each one of the deposits made at that office, but only enough to cover any likely amount of withdrawals in one day. But suppose there were to be a 'run on the bank'? Building societies give themselves some legal cover by having a rule book which provides that deposits in a share account will 'normally' be repaid on demand but repayment may exceptionally be delayed – to give the society time to realise assets. Of course the invoking of such a rule would create panic demands for withdrawals and the society would probably have to cease business: in recent years the solution has been for a failing society to be taken over by another society. this gives the security which enables building societies in general to attract the deposits which they have traditionally used to finance mortgages, though they now have also a secondary interest in a two-way trade in finance other than deposits and mortgages, namely borrowing from the wholsale money market and investing in gilt-edged securities. But deposits still provide the greater part of the finance of building societies and are likely to do so for as long as they provide a useful service to depositors. Probably their most useful service is the facility to accumulate savings so small that individually they could not be profitably invested elsewhere in the private sector.

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