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AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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COMPLACENCY – AND THE BALANCE OF PAYMENTS

Summary of a talk by the Rt. Hon John Smith M.P., the Shadow Chancellor, to members of the Economic Research Council on 17th May 1989

This evening I do not propose to debate the pros and cons of a hard or soft landing for the British economy. Since we are told by the Government that the UK is now performing miraculously I still wonder why it is that we have to come into land. Soft landings seem awfully hard for borrowers – especially home owners and British industry – when interest rates soar. And soft landings even seem rather hard for the Chancellor of the Exchequer whose next take-off and flight plan has to be supervised by Sir Alan Walters.

The punditry about hard or soft landings, it seems to me, obscures more fundamental issues of British economic policy. The issue is not whether Mr Lawson can escape 'Houdini-style' from his straitjacket of high interest rates, inflation and the trade deficit, but why the Chancellor became bound hand and foot in the first place, and what will be the cost to the British economy as he tries to wriggle free.

The Government, of course, has tried to minimise the whole debate. In particular they have brushed aside the claim that the balance of payments deficit is a major problem for the UK economy.

Tory ministers, somewhat alarmed by the growing recognition that Mrs Thatcher's economic achievements are more mirage than miracle, have developed a new technique in massaging the truth. They turn all problems on their head and declare them to be a success.

So it is argued that the balance of payments deficit is really a sign of success, a short-term phenomenon that can be readily financed, and which in the long run will adjust itself. The softest of soft landings in miraculous Thatcherland.

This evening I propose to show that the government's remarkable optimism and complacency cannot be justified by the facts.

In a speech earlier this month to the American Chamber of Commerce, the Chief Secretary to the Treasury, John Major, claimed that the balance of payments deficit is essentially a short-term problem, a temporary blip (to borrow a phrase) caused by "excessive growth in domestic demand" last year.

Certainly I agree with Mr Major that last year the Government's demand management was grossly irresponsible. The 1988 budget combined foolish and unfair tax cuts with a four year old credit boom and dramatically aggravated Britain's emerging balance of payments problems. But the deficit clearly pre-dates the recent Lawson boom. Sadly it is not a temporary blip.

Since 1982 Britain's non-oil current account has been in deficit and has grown worse in every year except 1985. This long-run trend of deterioration – mainly the result of the poor trade performance of British manufacturing industry – has until recently been concealed by North Sea oil. But as the impact of oil revenues has declined so the long-term structural nature of Britain's balance of payments deficit has been revealed.

So the Government's presentation of the balance of payments deficit as a short-term cyclical event is plainly wrong. They ignore the essentially long-term and structural nature of our present balance of payments predicament.

Also painfully clear today is the devastating impact of the early Thatcher years. The monetarist inspired deflation from 1979 to 1982, combining high interest rates with a massively over-valued Pound, wiped out over twenty per cent of Britain's manufacturing industry.

Not surprisingly this loss of capacity has been a key contributor to the weakness of the UK's export performance and our inability to resist import penetration. The recent Lawson boom, generating demand far in excess of industry's capacity to supply, is eloquent testimony of the extent of the Tory destruction of Britain's manufacturing base.

But Treasury ministers, above all, like to argue that the balance of payments deficit is really a sign of success – surely the most puzzling claim of all. By implication the surpluses of Japan and Germany are evidence of economic failure and their growing role as the world's foremost creditor nations is a lamentable national humiliation. Nevertheless Mr Lawson regards his £14.5 billion deficit for 1988 as a success.

It is a success we are told because the surge in manufactured imports is primarily accounted for by goods for 'production and investment'. By this definition, according to the Chief Secretary of the Treasury, three quarters of the growth in the value of manufactured imports between 1987 and 1988 was caused by "British firms investing both to modernise and increase output .. the precursor of long-term improvement in productive capacity and efficiency".

Now there are many economists who dispute the claim that the deficit is the result of an investment boom, and there are difficulties about determining which imports can be attributed to investment. But the problem with Mr Major's analysis is that goods for production and investment (using his own preferred definition) have consistently amounted to three-quarters of all manufactured imports in the both the 1980s and 1970s. There is no evidence, therefore, of an unusual or unprecedented surge in investment-related imports.

The key fact which Mr Major, in common with all his Treasury colleagues, wilfully ignores, is that manufacturing investment in 1988 was still below the level achieved by the last Labour Government. And it is manufacturing investment that in the long-run will ease Britain's burgeoning trade deficit and balance of payments problems.

Investment in services, in high street shopping malls, and in leisure parks, welcome as they are, will do little to improve Britain's balance of payments. At best they might ease the appalling deficit in the balance of our tourist trade.

And it is not an especially comforting thought that, whilst manufacturing investment has declined over the last decade, investment in distribution and in retailing has substantially increased. We have lost the role of the workshop of the world and become a nation of shop-keepers selling goods from the rest of the world. Given that experience of the retail trade was the basis of Mrs Thatcher's formative years perhaps this outcome is not entirely unexpected.

What the Government seems unable to understand is that investment in manufacturing is overwhelmingly investment in the tradeable sector of our economy. And that is where investment needs to be if Britain is to escape from its balance of payments constraints. Investment in the tradeable economy is the key measure of success and where Mrs Thatcher's administration has so lamentably failed.

The Government ignore these arguments about the vital importance of manufacturing, just as they ignored the House of Lords Select Committee on Overseas Trade in 1985. At that time their Lordships produced a major study of the importance of reversing Britain's deficit in manufacturing trade. The report warned that without steps to enlarge the manufacturing base, to combat import penetration, and to stimulate exports, Britain would "face an adverse balance of payments of such proportions that severely deflationary measures will be needed".

But Mr Lawson and his ministerial colleagues scornfully dismissed the Select Committee Report and swept aside the concern expressed about the impact of declining North Sea oil revenues. The Committee had "overstated the likely speed of that decline" said the Government. The manufacturing deficit did not matter, they argued, and service industries would fill the gap.

In fact, far from filling the gap, the balance on commercial services has actually deteriorated since 1979. The Committee's report, if anything, understated the speed of our slump into deficit and today we are witnessing the Chancellor's deflationary measures.

But whatever the merits of the bizarre claim that Britain's balance of payments deficit is a success – it still has to be paid for. And Tory ministers offer further reassurances that, in a world of movable international capital, a deficit equivalent to almost 4 per cent of GDP is easily financed.

The Government, again leaning rather too heavily on their argument about 'successful' deficits, like to present their need to borrow from abroad as the spontaneous desire of foreigners to invest in Britain. But I'm afraid the facts fail to fit again.

Last year direct and portfolio investment in the UK amounted to a net outflow of about £14½ billion. So far from foreign investors queueing up to buy into the Thatcher miracle, long term investment has been flowing out of the nation – and the hole in our balance of payments has been plugged by foreign speculators looking for easy profits.

Hot money, short-term banking flows attracted by high interest rates are the fragile and expensive parachute on which Nigel Lawson's landing – soft or hard – depends. So certainly the deficit can be financed but only at the price of interest rates that are the highest available among the leading industrialised countries.

It's not hard to see who is really paying Mr Lawson's risk premium. It is British companies borrowing to invest and British people borrowing to buy their homes. And, of course it is British exporters forced to compete in world markets with a Pound priced uncompetitively as a result of high interest rates.

These costs of Mr Lawson's complacency, and his reliance on high interest rates to finance the deficit, will ultimately undermine the remaining Tory argument – that in due course the deficit will adjust itself. And this takes me back to my first disagreement with the Tory analysis – that the balance of payments is merely a short-term problem which will be cured by a temporary deflation of domestic demand.

Certainly Lawson's monetary squeeze will eventually depress domestic demand, making life difficult for the consumer with the result that some of the appetite for imports is curbed. But it is very hard to see how a regime of high interest rates and a high Pound will help restore the underlying long-term cause of Britain's balance of payments problem – the under-investment and weakened capacity of manufacturing industry.

The Government is hoping that as domestic demand is depressed British industry will switch its output from home to overseas markets. Thus overall UK output will be sustained and a surge in exports will halt the deterioration in the trade deficit. The budget forecast suggested that growth in export volume would exceed that of imports. Yet even on these optimistic assumptions the balance of payments is forecast to stay in deficit this year by £14½ billion.

This failure to anticipate any substantial reduction in the deficit reveals all too clearly the Government's inability to tackle the underlying cause of the balance of payments problem. And the policy measures which the Chancellor is using to correct his own mismanagement of demand, high interest rates and a high Pound, will harm manufacturing industry – the very sector that lies at the heart of Britain's balance of payments problems.

Having provoked an unsustainable consumer boom far beyond the capacity of industry to supply – in the process unleashing a spiral of self-inflicted inflationary pressures – the Chancellor has been forced to use interest rates and a high exchange rate as counter-inflationary weapons.

These are the consequences of his earlier mistakes and are the short-term devices of a Chancellor trying to restore his credibility – they are not the policies that will restore Britain's balance of payments in the crucial decade ahead.

A PROPOSAL FOR 'DEVELOPMENT LEASEHOLD'

By Mr. V. T. Linacre.

While house-buyers are at the mercy of a capricious mortgage-market, inflated by partial subsidy, dependent on scarcity to create capital gains at the expense of other house-buyers – the game of **Beggar my Neighbour** *– we have not one but three micro-sectors in rented housing: one for the few in historically protected tenancies who enjoy sub-standard rents in properties that are rapidly deteriorating; one for the many who rent furnished (a few out of choice but mostly for the lack of it) and one for the very few who can afford to rent unfurnished. 'Development Leasehold' could provide a timely new alternative.*

The Owner Occupied Sector

1988 passed without a murmur of complaint from the building societies, while they repossessed 23,000 homes throughout the UK. Nor did they protest as house-prices soared by 33%, causing anguish among frustrated buyers and national economic havoc. Yet they greeted 1989 with dire warnings of increased homelessness and damage to confidence in home-ownership consequent upon the raising of interest rates, even though deflation in house-prices had already been signalled by the Chancellor's policy of stealthily dismantling mortgage-interest tax-relief, which for far too long has artificially subsidized house-purchasers at the expense of the rest of the community and ultimately – as the current cycle once again demonstrates – at the expense of themselves.

There are two things wrong with the near-monopoly of the building societies in fixing mortgages ... *they are not building societies and they are not mortgages*! The financial conglomerates of today are poles apart from the co-operatives formed last century for the purpose of actually building houses for their members; whilst the personal loans advanced against the security of the title-deeds to the homes of the borrowers have nothing to do with proper mortgages which would be charges attached to the title-deeds directly transferable on resale. (Likewise the 20% of the market commanded by the banks, from whom, incidentally, dispossession figures are not available.) There is no reason – especially following the deregulation of the whole securities market – why houses should not be quickly bought and sold, subject to and with the benefit of one or more outstanding mortgages, as is common for commercial as well as residential property in other countries.

The public, politicians and media alike, have for sixty years been taken in by this colossal confidence trick – this presumption that the best means of providing for home-ownership is through so-called building society mortgages – which itself is the product of an even more stupendous confidence trick: the presumption that home-ownership provides the best means of housing the population. So millions of purchasers each year solemnly enter into mortgage contracts for twenty years or longer, although their average duration is less than six years. 'Owner-occupiers' are practically life-tenants of building societies, and since most do not finally pay off a mortgage until close to retirement, they remain strictly 'first-time buyers' throughout!

We must rid ourselves of these chronic illusions concerning the nature of mortgages and the role of building societies before we can study the nation's ever-deteriorating housing problem. In the liberal economic climate and consumerist society generated by this government, we still have an *owner occupied housing system operating restrictively* and performing lamentably.

The Rental Sector

The sheer scale and proliferation of the rental accommodation problem is scarcely recognized. It arises from:

(i) the falling national inventory – the accumulating annual deficits between new building and the accelerating obsolescence of our pre-1914 stocks and post-1939 blight (a recent RICS survey found that more than 200,000 houses are falling into serious disrepair each year, whilst only 15% of grants are spent on improvements to houses in the worst condition);

(ii) the lack of versatile housing in derelict central areas;

(iii) the lack of provision for one- and two-person households (which now account for more than half of all the households in Britain.);

(iv) the death or depletion of rural communities;

(v) the immobility of labour – caused by the rigidity of both the mortgage system and municipal tenancies;

(vi) the growth of 'hidden homelessness' (caravans becoming permanent homes, multiple sub-lettings in immigrant communities, etc).

The private rented sector, which until 1914 housed 90% of the entire population, has now dwindled to a paltry 8% as a result of the Rent Acts and consequent emergence of municipal housing in the public sector and speculative development for sale by private builders. That residue of Victorian landlordism can never be revived as a major force because it is largely confined to individual owners of old properties and it is too susceptible to abuse and political prejudice.

This is a peculiarly British problem: our housing crisis is self-inflicted. Since 1979 the administration has complacently supported the status quo, with only minor legislation recently to salvage the wreckages of both the old private rented sector and local authority housing, while treating the central issueof new development for letting as merely a short-term haven for wealthy tax-payers. Housing remains an intellectual no-man's land – a political 'no-go' area. With the imminent exhaustion of our remaining Victorian stocks of rented housing, the soaring costs of 'bed-and-breakfasting' for homeless families, the vicious circle surrounding the mortgage-market, the desperate plight of those with good

employment offered in the metropolis but nowhere to live, the frustration of transient workers and of young couples everywhere, the need is to devise a solution which will:

(a) restructure the housing industry by creating a viable alternative to mortgage-based house-purchase to ensure a plentiful supply of readily accessible housing throughout Britain and so eliminate the cycle of boom and slump – by introducing a new competitive sector with a long-term investment orientation in contrast to the costly short-term fluctuation of the mortgage market – and;

(b) house the other half of the nation who comprise principally: the many categories for whom the estate developers do not cater; the many others who are buying houses but by virtue of their domestic or vocational circumstances would be better off renting; and the many others besides who would prefer a civilized life in the city centre but are condemned to suburbia or distant commuting.

The Inner City Crisis

Town centres have decayed to the extent that commercial developers are now scrambling to build out-of-town to get back among the people, but clearly, with a rational housing structure – *but for the twin tyrannies of the Rent Acts and mortgage-buying* – the 'inner-city crisis' would never have erupted. This is not just a question of keeping the hearts of our towns and cities alive at night but, even more important, keeping our towns and cities ticking over by providing homes near their work for all those in the wide range of essential services, who tend to be low paid and to work unsociable hours. These include the hotel and catering trades, tourism and entertainment, retailing, staffing public buildings, public transport, police, hospitals and other emergency services, cleaning, draining and utilities, etc. These with families account for several millions, all of whom would benefit greatly by the provision of new, rented housing with long-term security, within their town centres.

The Proposal and Prospects for 'Development Leasehold'

In Glasgow and Edinburgh and elsewhere within living memory, the majority of people – including the middle-classes as well as the poor – lived in solid tenement blocks, renting their apartments from local property companies and trusts that employed professional factors to administer repairs and maintenance as well as collect the rents. Many tenants lived for a generation in the same apartment on continually renewed agreements: a simple contract observed by both parties. A plentiful supply of alternative accommodation available in the vicinity provided the only kind of real security. It was the Rent Acts, and the lack of maintenance consequently throughout the first world war and subsequent depression, that were mainly responsible for the degeneration of so many such districts into slums.

Development-leasehold can be seen as the modern equivalent of that Scottish model. The main difference is the leasehold tenure, which has become universal throughout the UK as a result of commercial development by collaboration among investing institutions (life assurance companies and pension funds), local authorities and development companies.

This legal hierarchy matches the proprietary interests of the parties to their respective functions. Whereas in the old days there was simply corporate ownership and domestic occupancy, there are now three levels representing: (i) ownership of the land by freehold; (ii) ownership of the buildings by ground-lease; and (iii) occupational sub-leases of the various premises for terms of from five to twenty-five years or longer. This flexible, vertical structure facilitates the total development process; each party retaining an interest capable of precise valuation from year to year.

The other practical application of 'development leasehold' housing in relation to the inner cities is the facility for commercial-residential mixed-use schemes. They would add vastly to the vitality of our urban centres and to the stock of housing for local workers, but remain impossible without the introduction of leasehold housing. The merits of this commercial basis are that, firstly, permanent funding is attracted from institutions. This is economical finance from prime sources: 'wholesale' as opposed to the 'retail' finance required for mortgages. Secondly, large-sale development is encouraged, incorporating a multiplicity of uses; the commercial elements subsidising the residential. Likewise, collaboration with local authorities is fostered, especially in the sphere of urban renewal. Finally, the benefits of experts professional management ensure good relations and efficient maintenance.

Development-leasehold could account for more than a quarter of the nation's housing within the next thirty years – roughly equivalent to the growth-rate of the superstores' capture of total food-sales.

Level of Rents under 'Development Leasehold'

The residential rents might be either subject to periodic review, like commercial rents, or annually indexed to maintain the same value in real terms; depending on the length of lease and nature of the whole development. A really big break-through is vital here, to eradicate scarcity once and for all, so that *'economic rents' means 'low rents'*.

A plentiful supply, which the huge potential market fully justifies, is the key to unlock the real demand at true economic rents. (Incidentally, a fundamental difference between commercial and residential rental values is that the former depend primarily on the level of the local economy and on precise location; whereas residential rental values will be much more uniform within town or region throughout the country.)

Where leases are subject to periodic reviews (normally at five-year intervals) rather than annual indexation, no disputes should arise and accordingly the provisions for arbitration and appeal should very seldom be invoked, because of the abundant evidence of direct comparables readily available.

The phobia of a re-imposition of rent-control by a future socialist government, often cited as a restraint on institutional investment in housing, must be exorcized once and for all. We can well recall a freeze on business rents; yet that does not haunt the commercial development market, any more than memories of food-rationing have inhibited the expansion of superstores! Besides, which is the safer market: long-term development based on leases at freely agreed rents which are fixed for five years at a stretch, or mortgages on terms which can be altered by one party only whenever it wishes?

Conclusions

The shunning of the residential sector by the property and development industry has had appalling repercussions. Town planning has become two-dimensional, its thinking devitalised by the segregation of uses. Our architects consequently have lost any sense of civic design, of three dimensional space – street-picture and townscape. They design buildings, not places. Multiple retailers have spread everywhere at the expense of family shop-keepers, whilst upper floors above the most expensive shopping floor-space in our principal thoroughfares stand empty and derelict.

Hence this paper: to confront all those who should be immediately concerned – the institutional investors, construction and property development industries, the real estate and building professions, as well as the multitude of housing bodies and interested academics and journalists – with the realities of the present situation and the practicalities of the solution. 'Development leasehold' constitutes the one immediately practicable measure which (a) exactly meets the current deficiencies and (b) would lead to a long-term restructuring of housing in this country.

It is an illustration of the potential demand that the pioneering Business Expansion Schemes have already attracted substantial investment, even though they are based on assured tenancies that provide for a measure of rent control on reviews and renewals by rent assessment committees.

Any relief from the Exchequer during the inaugural period should take the form of depreciation allowances on building costs rather than personal tax privileges, in order to promote investment in industry rather than inflation and the Chancellor would undoubtedly welcome country-wide evidence of rents as a key economic indicator, rather than the vagaries of mortgage repayments, which he would fondly remove from the cost-of-living index altogether!

We have all the multi-disciplinary expertise and financial resources necessary for the early introduction of development-leasehold on a massive scale.

The choice facing the nation is clear: *know-how or no housing*!

JAPAN WORRIES ABOUT INFLATION

From the Mainichi Shimbun

The Bank of Japan has decided to raise its official discount rate for the first time in nine years, not necessarily to nip certain tangible signs of accelerating inflation in the bud, but rather to deal with the broader range of evils that the nation's relaxed financial policy has given rise to.

"Ordinary people don't care about a slight price increase of 0.1 or 0.2 percent, even though concerned specialists may see such a price trend as a sign of inflation. But there are a number of harmful side-effects that come with longtime low interest rates, and Japan is suffering from a glut of money," said a senior official of Japan's central bank.

In September 1985, the heads of the Group of Seven countries agreed to boost domestic demand in Japan and West Germany and to maintain the dollar at a low value, in a bid to rectify the world's trade imbalance.

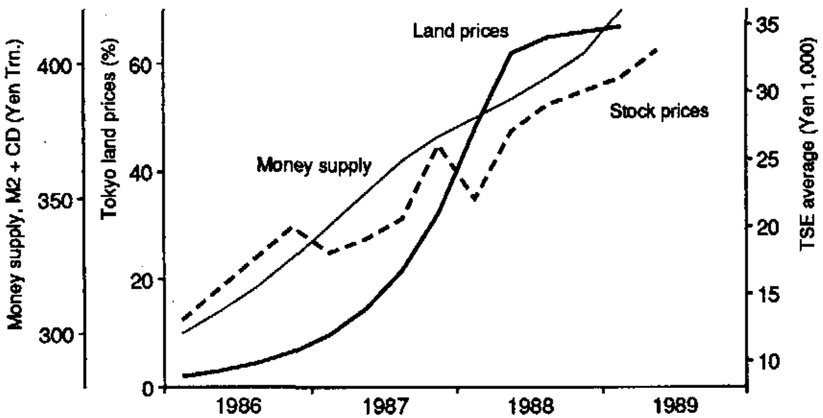
The Japanese authorities have since lowered the official discount rate five times. The country's key annual interest rate plunged to a record low of 2.5 percent after the last cut was implemented in February 1987.

When interest rates are not a burden, people tend to request loans.

Then people in Japan began pouring borrowed money into speculative investments such as land, stocks, gold and even memberships in prestigious golf clubs.

Moreover, Japan's monetary aggregates recorded a twofold growth over the previous year, and profits flowed into the hands of those who already had enough.

Money Glut Indexes



Sky rocketing land prices are a typical example of how those who have money to spare invested for higher profits.

Up until 1986, the annual increase of land prices in the Tokyo metropolitan area remained within a modest single-digit range; however, land showed a sudden upturn with a 23.8 percent jump in 1987, followed by an exorbitant 65.3 percent leap in 1988.

High-flying stock prices are another case in point.

In the 27 months of the 2.5 percent discount rate, the Tokyo Stock Exchange average has climbed to the ¥34,000 mark from around the ¥20,000 level.

Recruit Co. founder Hiromasa Ezoe's offer of pre-listed shares cannot be considered an effective way of winning favours from influential figures, unless the stock prices are on the constant rise under the central bank's easy money policy.

Ironically, increasing the money supply has not led to a rise in retail prices, simply because it was unevenly distributed. Corporations did not have to raise the prices of their goods and services, partly because they earned much from investments of their surplus financial resources, according to a bank researcher.

Further, the prices of imported goods kept on declining thanks to the constant appreciation of the Japanese yen against the dollar. Walking on a tightrope is how a senior Bank of Japan official described the conditions that contributed to prevent inflation in the days of extremely low interest rates.

The 0.75 percent official discount rate hike is the central bank's first bid to make a safe landing, though the Japanese economy can still be seen as balancing on a tightrope, but a slightly thicker one.

THE EDWARD HOLLOWAY COLLECTION REVIEW

The Intelligent man's guide through world chaos by G.D.H. Cole

Published by Victor Gollancz, London in 1932 and reaching the seventh impression – the reviewer's copy, by December 1933.

Without doubt this is a monumental work – 680 pages packed with cogent but readily understandable argument, stacks of tables and references and based on an historical sweep of knowledge which is simply awesome in its comprehensiveness. The book displays a clear and thorough understanding of the workings of the entire economic system both nationally and in international terms – and it is enjoyable reading. To review such a book, by one of the great authors of this century is indeed somewhat daunting. But now one has the benefit of hindsight.

The basic drift of the book is that it sets out to explain 'for the intelligent layman' the reasons for the economic woes of the 1929–32 period, examines some (but not all) of the various remedies proposed, naively praises developments in Russia and ends by advocating Socialism – mainly in the form of state planning, as a solution for Britain.

A quick look at the chapter headings can illustrate this: The World Crisis – The Economic Consequences of the War – Two Centuries of Economic Growth – The Economic System in Theory and Practice – Prices and the Price Level – Money, Credit and Capital – Unemployment and Industrial Fluctuations – Foreign Trade and Fiscal Policy – Public Finance and Taxation – Economic Organisation – The Challenge of Russia – Alternatives to Capitalism – and – The World Outlook.

Looked at as a work of economic history one is first struck by possible parallels between 1930 and today. Cole brilliantly analyses the course of events leading up to the American stock market crash in 1929. There is a parallel with the Japan of today. Cole speaks of the remarkable prosperity, optimism and high profits in the America of 1928 and says "Up to 1928 the Americans were lending abroad on a very large scale by the export of capital to South America and to Europe – above all to Germany where the movement for rationalisation was financed largely with American money". "When this ceased, the money flowed back to the USA, American exports necessarily fell and, since American wages were too low, purchasing power collapsed". (p. 78) Could this now happen with Japan whose money has so largely financed the recent rationalisation of the American economy? Again, on page 163, he notes that a country with a savings surplus can only *postpone* a crisis by "constantly sending its surplus products abroad without receiving any equivalent in imports".

A second parallel is between his comments on Britain's 1920s monetary policies (and the return to the gold standard) and monetarism today. He heavily criticises the policies of artificially high interest rates and high exchange rates. Of the late 1920s he says that governments expanded the money supply to create purchasing power – but could not prevent the money from being used for asset speculation instead. He fully understands credit creation and when asking himself (p. 233) if banks create credit he answers, "of course yes" – but goes on to find the point rather irrelevant. In fact he goes further and speaks of those who seek a solution to the economic crisis through monetary reform as "currency cranks" – "whose doctrines have at all times of economic distress an extraordinary fascination over men's minds, so that whenever anything goes wrong with the industrial system it is safe to predict that a fresh batch of infallible plans for restoring prosperity by the manipulation of money will make its appearance" (p 216). Cole did not specify whether he had in mind here Keynes, Douglas, Hayek, or anyone else. Indeed it is noteworthy that none of these names appear, in this context, in the book's index. Cole is nonetheless worried over the American federal Reserve System's ability to control money supply and refers to the 1928 USA consumer lending expansion as a merely temporary and unsustainable solution. Is today's consumer lending binge to be similarly recorded? At any rate Cole's conclusions on monetarism can bring comfort to (the 1989 version of) Nigel Lawson when he says that "The right degree of price stability can be brought about only by applying common sense rather than rule of thumb to the control of monetary policy" (p 212).

A third uncomfortable parallel concerns taxation. As one who would prefer a more

egalitarian society, Cole favours direct taxation over indirect taxation, – income taxation rather than taxes on purchases. In the 1930s indirect taxes referred to the taxation of imports and to purchase taxes whilst today it would mean "voluntary export restraints" (by supplying countries) and Value Added Taxation. Cole blasts such taxation as damaging the poor and he could well be quoted in criticism of the EEC today when he says "Most countries in the world are used to tariffs (we can say 'import restrictions'); and the raising of tariff duties which can be represented as a necessary measure for the protection of industry, therefore causes far less emphatic protest than an attempt to increase the yield of direct taxation. This is both because the rich are in most countries more articulate and more influential than the poor, and also because it is far easier to realise that one is paying a direct than an indirect tax. States in need of revenue are therefore under a strong temptation to resort to a protective policy" (p. 393). He further comments sourly that "Only the world crisis of 1929 made feasible the realisation of the Conservative dream of a general tariff policy" (p. 405).

A fourth and fascinating, if smaller parallel concerns reform of the local government rating system. Cole acknowledges the antiquated and unfair characteristics of the existing rates system, discusses and dismisses the idea of local income taxes, does not mention a poll tax and then advocates site or land value taxation (p. 472). He notes that such a system is already in operation in Germany.

A fifth interesting parallel concerns his comments on the effects of Britain's industrial revolution and that of today's micro-electronics revolution. He notes that "The skill of the operative was being transferred to the skill of the machine by improvements in design" (p. 58). Today the skills of many administrative workers are being thus displaced.

A sixth parallel emerges from his section on 'Economic Imperialism' and reminds one of the current third world debt crisis. He noted that less developed countries "have loans thrust upon them even against their will" (p. 124).

Another parallel (and this is the last one this reviewer will mention since this list is getting perilously close to the old joke which runs "How did the student sitting on the university lawn know that two gentlemen who had just passed him were university dons, even though he had overheard only two words? Answer – one said to the other 'and ninthly'") concerns the current debate over free trade. Many today proclaim that free trade is 'dead' and near openly advocate economic block nationalism. Andreas Van Agt, the EEC's Commissioner in Tokyo, at a recent meeting, put the point most subtly. He said "Everywhere Free trade is now on the ascendency and so it is only right that checks should be considered to mitigate the effects of that process". Cole sees Free trade as a hugely convenient philosophy for 19th century Britain (and links Adam Smith with Frederick Bastiat in France) but discusses at length the ideas of Freidrich List which had supported the protection of 'infant industries' until free trade could be conducted under conditions of 'equality'. He concludes that "The difference between List and Adam Smith is that Adam Smith thinks primarily of the world's wealth as a whole, and List of the wealth of a particular nation" (p. 424).

The Intelligent Man's Guide contains two excellent passages of descriptive but now only historical interest. These are the chapters on foreign trade in which he briefly describes the development and history of economic developments in many countries – essential background reading for any stockbroker's analyst specialising in an overseas market, and the chapter on industrial fluctuations and the 'trade cycle'. Cole looks at the various theories advanced in explanation of such fluctuations. After considering psychological and then monetary theories he expounds and supports the theory put forward by J.A. Hobson – that during booms profits increase thus stimulating investment and the constructional trades, but, since wages lag behind, there is relative 'oversaving' and the consequent inadequate demand turns boom into slump. The slump can last indefinitely, he suggests, unless either a 'fortunate event' occurs (such as the opening up of undeveloped areas or the exploitation of a new epoch making discovery) or the state 'plans' a way out. Flexible, indicative, state planning with the state making the necessary savings and investments leaving consumers with their allocated purchasing power only is advocated. And such economics is underlaid by the belief that there should be a replacement of class antagonism by the Idea of Service. Man's motives, he believes, are ultimately social.

It would perhaps be kindest to ignore Cole's lengthy admiration for the economic development of the Soviet Union. I fear than even Mr Gorbachef would be someone embarrassed to read this section today and if George Knuppfer, author of 'The Struggle for World Power' were to hear Cole read this section on an open stage one fears that there would be a 'bare knuckle fight'.

His rosy predictions for Russia are not the only mistakes we can now identify however. Another is his conviction that as each nation becomes more developed and thus supplies more of its own needs, the proportion of international trade between such nations will fall. Today, the greatest part of world trade consists of the exchange of rather similar products between OECD member countries. The fun of idle car swapping now seems to outshine the gains economists can logically defend from trade between differently endowed countries. Indeed such gainful trade is now often prevented (pace the CAP), on the grounds that it is somehow unfair. Cole's prediction was wrong, but perhaps sadly wrong.

I am however, picking on details and it would be unfair to summarise this magnificently educational book without turning attention to his main concern and theme. He addresses the central question of his time by saying "It may seem to the technician as if the manual worker were becoming more and more superfluous as an agent of production; but if he is not allowed to produce how shall he be given the means to consume? And unless he is given the means to consume, how shall the vast productivity of the modern economic system be successfully employed?" (p. 149) and he perhaps summarises his personal answer by saying "... there is an overwhelming case for an attempt at world economic organisation – of reconciliation of national rather than the protection of vested interests ... and it must, above all, be flexible and capable of rapid adaptation". (p. 63).

This socialist vision is indeed superficially admirable, but for this reviewer, the overall conclusion seems to be that Cole, like Marx before him, should be valued and studied for the depth of his analysis but should command far less attention for the strength of his solutions.

J.B.

REVIEW

Share Millions by Kevin Goldstein-Jackson
Published by Elliot Right Way Book, Price £1.75

Targeted to be read by ... well, by *anybody* with an eye towards investing in stocks and shares with an introductory injunction "Happy investing!", this book seems, on closer perusal to be more in line for two rather well defined groups – fund managers and students who wish to become fund managers.

The strength – and the weakness – of "*Share Millions – How to Make Money on the Stock Market*" is that it is packed with detailed instructions on what information to seek, how to interpret balance sheets and incidental comment, what all the jargon means and how to use statistics. This is wonderfully useful advice and it is of great value to have it all condensed into an easy-to-read slim volume. Every word is directly 'to the point' – and the point is to invest profitably rather than to be impressed by the academic abilities of the author as is the case with so many studious texts.

But whilst the book is certainly readable it could well be found somewhat turgid to anyone lacking the personal interest (and prior knowledge) of existing fund managers or the diligence of the patient and ambitious student. It can easily become 'too much to take in' and leave the reader wondering whether he can ever obtain all the information suggested as useful, before making an investment.

But this review so far is perhaps a little unfair because parts of the book are most certainly fascinating. Chapter 11 in particular, headed 'What do they really mean?' sets out – and succeeds brilliantly in reinterpreting the glib platitudinous statements of analysts and company chairmen. I like the interpretation of (shares being) "neglected for too long" as "we've encouraged people to buy these shares before, but few people took any notice" and (chairmen saying) "due to circumstances beyond our control" as "we were asleep at the time".

This should be rated as a cogent and useful, readable and in part amusing book.

J.B.

LETTERS

A further response to The ECU as Shield: History and Outlook by Malise L. Graham from Mr T.B. Haran

Sir,

The Debate on the ECU and the EMS

Malise Graham contends that floating exchange rates, or competitive devaluation, have failed to achieve balance of payments equilibria or the control of inflation. That is true, but it is because exchange rates of any description cannot achieve these aims. An exchange rate is only a mirror reflection of what has happened in the market place. That reflection is mathematically precise.

For example, if all other things are equal in the meantime, an adverse balance in our terms of trade would result in falling exchange rates for sterling. Why did this not immediately happen? It appears that many of our foreign creditors, particularly the Japanese, have been accepting payment for our imports in sterling and have been using the funds to strengthen their presence in the City of London, to build factories in this country and to invest in British companies.

Thus, the exchange rates have correctly reflected that situation and any attempted manipulation of them can have little or no bearing on the happenings in the market place. In the same way, exchange rates cannot be used to control inflation. It is wrong, therefore, to attribute Italy's recovery to the joining of the EMS.

For our part, we can only cure our problems by becoming more competitive in the market place. The Bank of England is, therefore, correct in laying the present inflationary threat at the door of excessive wage increases.

If, as the CBI respondents maintain, increased wage awards were related to productivity gains, why have prices been put up? The employers should have been able to pay their increases, including management remuneration, from their own resources.

In any event, many of the increases in productivity are due to scientific and technological advances. These benefits should be passed on to the consumer and not dissipated in increased wages, which price us out of our markets.

Labour costs cannot average only one third of costs, as Malise Graham maintains. Raw materials are provided without charge by providence. Consequently, all costs of whatever description are forms of remuneration for labour, productive or unproductive.

Thus, only increases in the remuneration level can cause inflation. More money is then needed to carry out the same, far less a greater level of trading activity.

Current monetary theory is based on the false notion that the money supply is a stock, which can have a velocity of circulation in excess of one and passes endlessly from hand to hand. However, there is a better and factual explanation which proves that it is subject to a process of continual creation and destruction and can only be used once.

All the 'M' measures give grossly exaggerated figures. The true money supply is much smaller and rises and falls in step with the level of trading activity; in addition, it reflects the rate of inflation. There is no monetary phenomenon - only a dismal failure to uncover the facts.

Malise Graham would have had a case if all the countries in the EMS were doing better than the Japanese, who control their own currency. Our need, therefore, is not to join the herd, but to learn how to compete with the strongest. We can only do this if we have control of our own affairs.

At present, it is not a debate on the ECU and joining the EMS that are required, but a re-examination of monetary theory with the object of eliminating the false principles which are causing us to go wrong.

We have to find a sword and not a shield.

T.B. Haran
'Grianan'
23 Orchard Road
Bromley
Kent.

A further response to the review of 'Douglas Fallacies' from Mr A.M. Wade.

Sir,

Major C.H. Douglas, to his lasting credit, exposed to the British public how the present banking system operates in regard to their practice of credit creation, which amounts to money creation, and therefore involves the nation in ever growing National Debt.

As an Engineer he saw how this adversely affected the employment situation and played into the hands of the international armament industry. His proposals were in the interests of peace and abolition of poverty. In other words, they were in harmony with Christian principles.

For no personal advantage Douglas wrote several books on his view of the national financial system and his proposals for reform, which he called "Social Credit".

These aroused great public attention and much loyal support from the followers of the Movement for Social Credit here and abroad.

The Church showed interest in this revelation and the subject was widely discussed in the press until 1925 when, for some unknown reason, a taboo was placed on this subject which remains to this day in the press and in Parliament. The fundamental point at issue is the rightness or otherwise of the power to create money by the private banks (including the Bank of England although it was nominally nationalised in 1946) and now widened to include building societies. Nevertheless, we boast of our freedom of expression, to the whole world!

A. Maurice Wade
67 Kyoto Court
Nyewood Lane
Bognor Regis
West Sussex

REGULATING PRIVATISED ENTERPRISES: LESSONS FROM THE USA

Consistent with its policy and practice of supporting suitable research projects, the Council is providing £500 towards the cost of a study of the US experience in regulating utility companies to see what lessons may be learned for regulating privatised enterprises in the U.K.

The research project will be carried out by a lecturer at the University of Sheffield Centre for Criminological and Socio-legal Studies, and will focus on the public law issues of designing open and accountable procedures and institutions for decision making. In particular the study will examine how consumer institutions may take part in decision-making.

The proposal emphasises the importance of effective procedures for the regulation of privatised enterprises. This involves a number of issues which have been much discussed in the USA but for which the USA experience has not been studied systematically by either the Government or by legal academics.

The Council will invite the researcher to make a presentation of the results when the study is completed.

GOVERNMENT STATISTICS

By Mr Bill Allen

This subtle challenge contributed by a member who describes himself as "a writer, who spent twenty years as a stockbroker before he found a proper job" first appeared in Financial Weekly.

Thirty seconds and counting; the Industrial Production figure is due. Will it confirm a slowdown? Will it show renewed strength and squash hopes of an easing in interest rate policy? Fifteen seconds and counting; prices go subject on dealing screens.

Not so long ago, in a factory far away ...

Mr Harris held out two grimy sheets of paper. "You'll find us a bit different from school, young Tom. Now, count up crates in t' big warehouse. Ask lass in th'office to work out cost and you write it down. Be careful now. It's for t' Government."

Full of first day enthusiasm, Tom crossed the yard, squeezed through the sliding doors, and peered into the gloomy warehouse. It was filled with boxes piled high and low: they stretched as far as he could see, disappearing into the shadows where the dismal light from the grubby windows could not penetrate.

He looked at the papers he had been given. Amidst the grime he could make out some of the words on them: "*The estimates of fixed capital formation and stocks and work in progress rest heavily on the statistics provided by the censuses of production ... The inquiries are also used for certain estimates of consumers' expenditure and for estimating wages and salaries in individual industries ...*"

A large smudge from Mr Harris' thumb marked the part Tom had to complete: "Work in Progress" with an asterisk and a footnote that said "*Shipbuilding – Do not include the value of work in progress on ships in course of construction (see Note 5)*". Of "Note 5" there was no trace.

"Want some tea, lad?" He turned and saw a smiling woman pushing an enamelled tea-urn. She offered him some tea in a large mug.

"I've to count crates," he said.

"Old Ernie used to do that," she said, "He always used to pour out a pint of milk for the cat, walk down t' end of the row and back again. He swore he could tell how many crates of pickles in t' place by how much milk was left when he got back."

Tom looked slowly around, and then turned back to her.

"Cat died when old Ernie left," she said.

Tom went to the office. At a desk, a young girl was staring at a PC screen. She looked up as he entered. "You're the one that's doing the Census of Production returns," she said. He nodded.

"That Mr Harris, he doesn't understand. We've got the computer now; I just use a statistical model to estimate the stocks from the figures in past years. We've gone all up-to-date, you see."

Tom didn't understand either, but her eyes were so clear and bright that he would have believed anything she said.

Her slender fingers moved quickly over the keys of the computer; she paused, took the paper from Tom's hand, and wrote some figures on it. "I'll just round it to two decimal places for you."

She called after him as he left, "Thank goodness they had old Ernie to collect all the past numbers I've built the database from, or I don't know what we should do now."

Five seconds ... Then a cry goes up as the Industrial Production index flashes on the screen. An economist screams out: "Careful! Looks like a freak figure. There's an explanation coming up. Something about an unusual movement in inventories ..."

A forest of hands grabs at phones and positions are quickly unwound in hectic trading. Anxious eyes scan screens to glean the reaction of sterling to the latest swing in industrial output.

"Well done young Tom," said Mr Harris, "I know it's hard for you to understand, but there's people up in London as needs these figures to make important decisions that affect our lives.

"So I want you to make sure that you do just as good a job next time." Tom nodded.

NEW MEMBERS

The Council, as always, needs new members so that it can continue to serve the purposes for which it was formed; meet its obligations to existing members; and extend the benefits of members to others.

Members may propose persons for membership at any time. The only requirement is that applicants should be sympathetic with the objects of the Council.

OBJECTS

i) To promote education in the science of economics with particular reference to monetary practice.

ii) To devote sympathetic and detailed study to presentations on monetary and economic subjects submitted by members and others, reporting thereon in the light of knowledge and experience.

iii) To explore with other bodies the fields of monetary and economic thought in order progressively to secure a maximum of common ground for purposes of public enlightenment.

iv) To take all necessary steps to increase the interest of the general public in the objects of the Council, by making known the results of study and research.

v) To publish reports and other documents embodying the results of study and research.

vi) To encourage the establishment by other countries of bodies having aims similar to those of the Council, and to collaborate with such bodies to the public advantage.

vii) To do such other things as may be incidental or conducive to the attainment of the aforesaid objects.

BENEFITS

Members are entitled to attend, with guests, normally 6 to 8 talks and discussions a year in London, *at no additional cost, with the option of dining beforehand* (for which a charge is made). Members receive the journal 'Britain and Overseas' and Occasional Papers. Members may submit papers for consideration with a view to issue as Occasional Papers. The Council runs study-lectures and publishes pamphlets, for both of which a small charge is made. From time to time the Council carries out research projects.

SUBSCRIPTION RATES

Individual members	£12 per year
Corporate members	£35 per year (for which they may send up to six nominees to meetings, and receive six copies of publications).
Associate members	£7 per year (Associate members do not receive Occasional Papers or the journal 'Britain and Overseas').

APPLICATION

Prospective members should send application forms, supported by the proposing member or members to the Honorary Secretary. Applications are considered at each meeting of the Executive Committee.

CHANGE OF ADDRESS

The Economic Reseach Council has a new address:

55 St James's Street
London SW1A 1LA

The telephone number is unchanged

APPLICATION FORM

To the Honorary Secretary
Economic Research Council
55 St James's Street
LONDON SW1A 1LA.

Date ....

APPLICATION FOR MEMBERSHIP

I am/We are in sympathy with the objects of the Economic Research Council and hereby apply for membership.

This application is for	Individual membership (£12 per year)
(delete those non-applicable)	Corporate membership (£35 per year)
	Associate membership (£7 per year)

NAME ....

(If Corporate membership, give name of individual to whom correspondence should be addressed)

NAME OF ORGANISATION ....

(*if corporate*)

ADDRESS ....

....

....

PROFESSION OR BUSINESS ....

REMITTANCE HEREWITH ....

SIGNATURE OF APPLICANT ....

NAME OF PROPOSER (*in block letters*) ....

AND SIGNATURE OF PROPOSER ....