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STRATEGIC VISION AND MARKET FORCES – ARE THEY IN CONFLICT?

Summary of a talk by Sir Maurice Hodgson to members of the Economic Research Council on 28th June 1989.

The Beginning at ICI

I think in addressing the subject that you've given me, I shall refer predominantly to my ICI experience, since after all that was the main part of my working life. I was ICI's first Corporate Planner. I was appointed to this job is 1965 at the behest of Dick Beeching, for whom I had worked previously in another capacity and it was at the time when Corporate Planning was just becoming recognised as an identifiable activity and given a name and it was about to become very fashionable. He asked me to set up a Corporate Planning Department which was done mainly by merging two existing departments which both had a Corporate Planning flavour but not really very explicitly, and then redirecting it. Most of my thoughts this evening go back to that experience and what emerged from it because when I took the job, I found that there was already in existence in ICI a Corporate Planning Committee. As was the recommended fashion of the time, it consisted of the highest authority, that is to say the Chairman of the Company was the Chairman of the Committee and the other four members were the then four Deputy-Chairmen – ICI had four deputy chairmen in those days. Now it has one. During John Harvey-Jones' time as Chairman, it didn't have any.

But it had four at that time, and the first interesting aspect of this planning committee was that it had never had any material put before it, and I think you can't expect five people to sit round a table and suddenly say 'Let's Corporately Plan'. It's not something that can come out of thin air like, 'Let's have a game of Poker'. It really has to be fed with some material to give it a basis for discussion. So, for starters I put a paper to it on Joint Ventures, because I had had the view for a long time that ICI was excessively indulging in Joint Ventures and that some disadvantages were flowing from this. I recall it because there was a memorable first meeting of this committee which contained an even more memorable exchange between the then Chairman, Sir Paul Chambers, and Dick Beeching, because Sir Paul said, 'Well, I never did like Joint Ventures' and Dick Beeching said in his usual thoughtful way, 'Well, Chairman, bearing in mind that we had two hundred of them when you became Chairman, and we have three hundred of them now, God knows what would have happened if you had liked them'. That has stuck in my mind ever since. Also, I recall the thought that went through my mind, and fortunately, my not well developed sense of self-preservation prevented me from making what I thought was the appropriate riposte, which would have been, 'Well, I don't know whether God knows, but I think I do – it probably wouldn't have made a damned bit of difference.' However, the planning department got under way and it is perhaps appropriate to set the scene a little bit as to why it was set up and what the state of the company was at the time.

Paul Chambers came into ICI directly to the main Board from the Inland Revenue. He was believed by some to have invested or developed PAYE, although there are other claimants to that honour. He found ICI to be virtually unborrowed. This is rather interesting really because it's not all that long ago – well all right, it is a long time ago, but it doesn't seem so to me. ICI had practically no borrowings and, for a company of its size, this, I suppose, was pretty remarkable. It may have been something to do with the long relationship ICI had with the Dupont company in the States. ICI reflected some Dupont and some RG Carbon thinking Dupont was also virtually ungeared in those days. Paul Chambers, very properly, saw the opportunity to celebrate the company's expansion by gearing it up. I think capital gearing when he arrived was about 5%. When he became Chairman, he geared the company up to the more normal sort of 30 or 35% and during that period he said quite explicitly, 'Anyone who has any good investment projects to bring forward should bring them forward and the money would be found'. I think the whole of the finance department and the finance director at the time almost regarded this as a matter of their professional competence, that money would be found for any investment projects that would be brought forward.

Of course, inviting a large company to bring forward investment projects and saying that you must not regard finance as a constraint provided they are good projects, is rather like giving a case of Scotch to an alcoholic, and the company did expand very rapidly, and geared itself up very rapidly. By the time the Corporate Planning Department was formed, the company had geared itself up to a fairly normal gearing and if one did any sort of projection, it was heading rapidly towards becoming over-borrowed. So when I got to thinking about what the Corporate Planning Department should do, it was really on capital investment that my thoughts were concentrated.

The Key Questions

At that time my concept of Strategic Vision, or Strategic Planning or whatever one cares to call it, was that it has three very specific questions to address. The first question is 'Where are we going if we don't change?' and I think you can ask that question of pretty well any kind of organisation, whether it's a private company, public company, a government department or whatever – even a Government. 'Where are we going if we don't change?' The second question is, 'Where would we rather be going?' This is really the objective question. The first one is the forecast question, the second is the objective question. Then of course the third question, the really key question is, 'How do we need to change to get from the one to the other?' That's really the planning question, and planning is change and strategic vision is change. And so this was my sort of framework. To the question 'Where are we going if we don't change?', the answer seemed to me to be that first of all we were going to become overborrowed, having throughout the company's history been under-borrowed. Secondly we were going to diversify in all directions at once and perhaps become overly diversified and dissipate the company's strength over too wide a field. Thirdly, we were going to be excessively UK orientated unless we did something about it, and whatever else one may or may not feel, it's really very difficult to be a world chemical company based predominantly on the UK however much you concentrate on exporting. So that was my tentative answer to question one.

Question number two – 'Where should we be going?' Well, certainly more international, particularly in investment, more selective in investment rather than spreading across the whole spectrum. Thirdly, and more specifically, we had to take account of the fact that this country was just going into the EEC and, therefore, we were becoming a European company rather than a British one in some senses. So then one came to question number three – 'How much do we need to change to get from the one to the other?' Well, I think given those previous answers, the change question becomes fairly self evident in its answers. More investment, particularly in Europe and the US, more selective investment which seemed to me to imply investment in the higher added-value end of the business, rather than in the basics, rather less in fertiliser and soda ash, and a bit more in pharmaceuticals and agricultural chemicals. So this was really the framework within which one began to operate. I might say it wasn't immediately easy to carry conviction that those were the right answers to those three questions. Indeed it wasn't particularly easy to carry conviction that those were the questions that one should be addressing.

Problems of Implementation

Then, of course, one moved to implementation and this was really a culture shock, because if you have lived for a decade or so in an environment in which any good project will be supported and the money will be found and more, to a much more selective basis, those that are not in the chosen areas of course feel threatened, concerned, indeed alarmed. And there is no fury like that of the division chairman who feels he is not going to get his fair whack of the available capital. Of course, there is an international dimension to it as well, because ICI was, and still is, not only the biggest chemical company in the UK, but also the biggest chemical company in Canada and Australia and South Africa and India. One had the national dimension in those countries, and one had partial ownership in some of those countries, for example, in Canada, something like 64% ICI ownership. They are all either 100% or majority owned, but there were minority shareholders in most of them, and of course if an overseas subsidiary which has a predominant position in the national economy of the country feels that it is going to be constrained in how much capital it can spend, it has not only the same sort of feelings of deprivation of the division chairman but it has all the nationalistic feelings of deprivation too. Australia in particular used to declare UDI about once a month, I remember around that time. So it was a culture shock to get this selectivity accepted and there was another difficulty because with joining the EEC, it was said to the divisions loud and clear, 'You are now European divisions not UK divisions, and when you bring forward your investment plans you will consider whether to invest in France, Germany or Italy as well as whether to invest in the UK'. And they said 'yes, splendid' and continued of course to do nothing but invest in the UK.

So the implementation involved the company setting up a separate European division, ICI Europa, and over-riding divisional authority to the extent that Europe could bring forward projects of its own with divisions obliged to provide the know-how, in order to build plants, as it turned out, principally in Germany and France. So implementation was quite difficult and quite a culture shock. However, it did proceed despite the difficulty, of course, that it takes a very long time for a large organisation to respond to a strategic change of this kind. Dick Beeching used to have the analogy of navigating the Queen Mary, in which if you change courses it takes several miles before anything actually happens. I think with a large company it's like that and it's really only in the last ten years (because this was a good while before that) that the more selective higher added-value, more international ICI has emerged. The change nevertheless is dramatic over that period, because ICI sales in the United States are now quite comparable with those in the UK and so are sales in continental Europe. The UK is now where it ought to be in a world company in terms of sales and investments. It takes a long time for these things to happen and unless one is consistent in having some sort of strategic vision they don't actually happen at all.

Company Strategy and Economic Cycles

One economic factor in which I was very interested during my ICI days, which I see was one of the basic reasons the ERC was set up, was economic cycling, and of course the chemical industry is fairly notoriously cyclical. I could see very clearly the benefits that would accrue from a contra-cyclic investment programme. Because the cycles seemed to be about four or five years at that time and since it takes about two-and-a-half years to build a plant, the demand for more capacity arose at the peak of the cycle, and the plant that you built to supply it came on stream just at the bottom of the cycle, when you didn't need it, and I thought, 'Wouldn't it be nice if we could change it to the other way round?' I have to say I abandoned that because it was not practical to go along to people and say, 'Well, we know you want a new plant and you think you want a new plant now. Come back when you don't think you need it, and we'll let you have it'. And I could never see any way through that particular dilemma, so I settled eventually for just trying to damp it down a bit, rather than to try and turn it on its head.

To Succeed, A National Strategy Must Liberate Market Forces

But in the economic field, I wonder about this apparent conflict between taking a strategic view, and letting market forces work without constraint – about the contrast between, say, Adam Smith and Maynard Keynes. At some point or other, planning got a bad name and I think there were a number of contributors to that, certainly the use of the terms. Centrally planned economies for instance have become a sort of long euphemism for communists. The Russians were always having five year plans which never worked. And there was Lord George Brown, who had his national plan, which wasn't a plan at all but a sort of national collective wish, which said 'if the Economy grows at 4 or 5% per annum compound, what will we do with all the loot?' Of course, that was fine except that it never grew at 4 or 5% per annum.

I think the whole concept lost its appeal and got overtones of socialism sort of mixed up in it. I think Keynes to some extent must take a little bit of the blame for that because he appeared to have found a rather straight-jacket type of strategic planning, which was going to enable the economy to be manipulated in a macro way. It again had, I think, overtones of socialism mixed up in it, because it was really concerned with stimulating the economy when it was down, rather than stimulating it when it was down *and* damping it when it was up.

We need to take a more realistic macro view whilst at the same time taking more account of micro economic factors – to go beyond Keynes whilst finding a new interest in Adam Smith. We know that the Chancellor has to work on the macro scale and push interest rates up and down and so on and so forth, but I think we should be more interested in how individuals react to circumstances. And individuals in fact try very properly to react in ways which are in their own best interests.

Currently, on the national scale, we seem to be developing some sort of a mixture tilted more towards the micro than to the macro side – with monetarism sort of inter-mingled and there is some concern that perhaps we have gone a little bit too far towards letting market forces rip.

These concerns are certainly understandable but I believe that there is no basic incompatibility between having a strategic vision and letting market forces work. Indeed, provided that that vision or strategy is stated broadly enough I think it can in fact liberate market forces rather than constrain them.

THE PARADOX OF DEMOGRAPHY AND SAVINGS – Your Financial Claims are only as good as your ability to exercise them

By Mr N.D.F. Carn

There is an argument which runs something like this: demographic shifts in the population will create a shrinking tax base, consequently social security promises will be difficult to honour and the burden of pension provision must therefore be increasingly borne by the private sector. As the debate becomes enmeshed in the intricacies of funded versus unfunded and private versus public, so fundamental dynamics, together with the implications for investment strategy, become ignored.

Demographics may or may not be an issue for the living standards in retirement of the current working age population because birth rates are a matter of fashion as much as anything, immigration (look at the German experience) may change the situation or continuing technology-led substitution of capital for labour may release available labour for services. To the extent that demographics will be an issue, however, the present structure of the debate manifestly fails to address the inherent paradox involved in attempting to save one's way out of a demographic problem.

The key is this: increasing savings does nothing to transform demographics. Higher capital investment might ease future labour shortages but that is a different discussion. In a future in which two of us will be retired whilst one person works it is quite clear that he cannot work for both of us. By increasing my savings relative to you I can achieve a tactical advantage by putting myself in a stronger position to bid for the available labour but there is nothing that we can do as a group to alleviate the situation. Transferring the problem from the public to the private sector achieves nothing but a transfer of the blame when it goes wrong.

Investments represent a claim over other people, and their value at the end of the day depends on the investor's ability to exercise that claim. If I am faced with a labour shortage in my own country I can address it in two ways; either I build a machine to work for me in my old age or I develop financial claims over someone or some country which will be able to work for me when I am retired; provide capital now to a country with a young or growing population in the hope and expectation that they will in exchange provide the labour when the time comes. What does no good is to develop claims over a group of people who are in the same boat.

The process by which high savings in an ageing population drives up domestic asset values and apparently increases provisions for future retirement in fact simply raises the certain prospect of a de,facto default by the younger generation. This is because the rate at which capital will be able to be exchanged for labour, all other things being equal, will be determined by the relative availability of each. Since the populous age group will be seeking to turn their savings into the purchase of labour at about the same time, it is fairly obvious that the purchasing power of those savings will decline. The implications for long term investment strategy hinge on whether this will be an inflationary default where labour becomes very expensive or a deflationary default where assets become very cheap.

The balance of probabilities weighs on the side of the deflationary default in which asset prices fall whilst labour inflates only modestly in nominal terms. A predominantly middle-aged or retired electorate will tend to elect governments which seek to maintain the purchasing power of money and if this is maintained in an environment of labour shortages, money will tend to rise in value relative to assets. That is to say, asset prices are likely to fall, in some cases precipitately.

This situation is beginning to be fairly well appreciated in specific instances. In the 1980s a rising working age population has ensured a very attractive exchange rate for residential housing against labour. Average house prices as a multiple of average income have risen from two and a half times at the beginning of the eighties to some five times today. It is reasonable to expect that as the working age population contracts, this exchange rate will move the other way. Recent studies such as that by CSFB and the Spicer Consulting Group, point to a growing recognition of the issues in this area; what is not appreciated in many quarters is the general nature of the problem.

A recognition of the situation, however, does have important policy implications. Raising the price of existing assets, whether property or shares, is a self defeating process. It merely provides the illusion of provision for retirement when in practice these claims will not be exercisable. It implies the necessity for labour saving capital expenditure to release available labour for services and it implies the necessity to accumulate financial claims over nations with quite different demographic profiles. Alternatively, should one strive for merely tactical advantage, one should make sure one holds different investments from the bulk of one's own age group.

INNER CITY DECAY – THE BLIGHT OF VACANT LAND

Summary of a talk by Professor Michael Chisholm
to members of the Economic Research Council on 24th January 1989

Immediately after her election victory in 1979, Mrs Thatcher signalled the urgent necessity to do something about inner city problems. Since then, there has been no major new initiative, notwithstanding the publication in 1988 of a glossy brochure – which did little more than re-package existing policies. Indeed, in the absence of major urban riots in recent years, and with the economy picking up and unemployment falling, inner city problems have receded from the limelight.

Some of the more important recent events with a bearing, or potential bearing, on inner city problems are: the designation in 1987 of additional Urban Development Corporations; the establishment of City Technical Colleges; and the commitment of the Department of the Environment to spend about £50 million refurbishing selected large blocks of council flats under the guidance of Professor Alice Coleman, who has long campaigned against their soulless design. Meantime, though, careful control of public expenditure, including local authority expenditure by means of "rate capping", has reduced the capacity of many authorities even to maintain the level of service provision and maintenance of buildings, including the disadvantaged areas. This hardly amounts to a policy for inner cities, unless such a policy begins and ends with the encouragement of jobs and employment.

Our perceptions of urban areas in general, and of inner cities in particular, have changed dramatically over the years. Until the mid-1970s, the basic problem with the big cities and conurbations was perceived to be that of controlling growth and limiting sprawl. Green belts and New Towns formed part of the containment strategy. At the same time, improvements to the urban fabric were urgent, especially the clearance of slums and reduction in overall residential densities. Until about the mid-1960s, problems within cities were perceived mainly in terms of physical planning.

However, social problems were seen to be accumulating, though these were initially identified mainly with the influx of New Commonwealth immigrants, which was a marked feature of the 1950s, until immigration controls were put in place in the early 1960s. Riots in 1958 in Nottingham and Notting Hill signalled ethnic tensions. For about a decade, from the mid-1960s until 1977, a succession of policy initiatives were undertaken, many administered by the Home Office, directed at social matters – nursery provision, community development, housing action areas, education priority areas etc.

By 1977, the realisation had dawned that the big cities were actually losing population and jobs, and that inner city inhabitants were experiencing high levels of unemployment. Physical planning plus social policies were clearly not enough. The emphasis has shifted towards the third ingredient – jobs. To this end, Enterprise Zones and Urban Development Corporations have been established, with the prime purpose of stimulating entrepreneurial activity and hence employment.

Within this evolving situation, some attention has been given to the waste associated with vacant land in urban areas – at once a symptom and a cause of urban problems.

Official data give an inadequate picture of the over-all problem. In England alone there are probably over 200,000 hectares of vacant land, equivalent to the county of Nottingham, most of it located in urban areas. In the central parts of the cities such as Liverpool and Glasgow, the proportion of land lying unused can rise to 10 per cent, even 20 per cent. Industrial recession, dock closure and land acquisition for slum clearance have all contributed to the stock of idle land. More important, though, is the fact that much of this vacant land has remained unused for long periods, even before the 1979–1983 recession; ten and twenty years are not uncommon.

Large areas of land, vacant for long periods, impose serious costs on the rest of a city, costs known as negative externalities. Thus, while such land remains idle, it is an uphill task to maintain the economic and social fabric. And yet, around most large cities there is considerable pressure to take in further tracts of green-field land. Therefore, vacant land exists in an urban context where there is a significant demand for land.

It could be argued – indeed, often is – that vacant land is too costly to clear and bring up to usable standard, or that the individual plots are too small to be worth using. Neither argument stands up against the evidence. In a recent publication with Philip Kivell (Inner City Waste Land, Hobart Paper 108, Institute of Economic Affairs, 1987) I have argued that there must be some more basic reason why the owners of vacant land, whether public or private, do not offer their land more readily for re-development. We argue that owners do not have a sufficient incentive, *which is reflected in their unrealistically high price* expectations. This arises from the combination of several things, of which two seem to be the most important. Under planning law, use rights, once established, cannot be extinguished except voluntarily or by compulsory purchase; both events are rare. An existing use right sets a floor to expectations about future uses for each parcel, and hence the price that can be realised. Secondly, vacant land is exempt from rates, so that there is no cost of land holding in the form of current cash outgoings. *Owners are therefore* justified in holding their land, speculating on future increases in land values.

For all the rhetoric about a market economy, the present government seems to be blind to the fact of a serious market failure in urban vacant land. Larger subsidies for restoration are not a suitable way to break this imperfection, since larger subsidies will inflate owners' price expectations. The logical thing is to recognise that large-scale land vacancy imposes costs on society. Vacant land should therefore be taxed, to create a significant holding cost. Instead of there being a sharp jump from zero tax to full rates, as at present, a tax on vacant land could graduate into the tax paid on developed land. There are practical problems to solve, but they are soluble. At present, however, there seems to be little or no perception that this element of market failure needs to be addressed, as part of a wider strategy to cope with inner city problems.

A SINGLE CURRENCY FOR THE EEC?

by Dr. D.C. Artingstall

Suddenly ideas are on the move again in Europe. The decision to make the EEC a single trading market in 1992 has found its logical extension in the Delors report, a report which opens up a debate on a social charter, a central bank and eventually a single currency. It is on the money aspect that I wish to comment.

Delors has it back to front. The priority should be a single monetary unit throughout the EEC, not the establishment of a central bank. Creating a central bank will not guarantee that a single currency would follow. Quite the contrary, for the main purpose of such a bank would be to maintain the stability of EEC exchange rates. To take over, in fact, the task of the existing EMS and, in so doing, further concentrate monetary power in non-accountable hands. The introduction of a single currency thereafter would deprive the central bank of the main reason for its existence. So to establish a central bank first would lead us into a blind alley. The EEC should proceed immediately to introduce a single monetary unit, which might very well be called a European currency unit or an ecu. Of course, the conversion of the existing monetary units – deutschmark, francs, lira, sterling etc must be based on the comparative value of a wide ranging basket of goods and services and most certainly not on a financial market determination of relative value.

What, therefore, are the advantages of making ecus the sole money transaction unit for the whole EEC? Simply that it will make life less complicated for both producers and customers.

A single currency, in abolishing different and fluctuating exchange rates, will put all producers and distributors on an equal footing – *initially so, at least. Long term planning,* pricing and investment decisions will be more straightforward because there will be no exchange rates to complicate or destabilise them. In addition, a single currency will demonstrate more clearly and precisely the more efficient firms, so that inefficiency will no longer be able to hide behind distorted financial market-determined exchange rates which are so often at variance with logically calculated exchange rates based on the comparative cost of a basket of commodities. But there is a price to pay. A single currency will eliminate the possibility of one economy devaluing its national currency as a means of restoring a lost competitive advantage. Whether we like it or not, the whole point of a capitalist market economy is that firms which can produce goods of the right quality at the lowest price will oust their higher cost competitors. So a single currency will do nothing to diminish the power of the large national and multi-national conglomerates which are able to profit by the economies of scale. As an economist I would argue that this process of producing in one location and then distributing throughout a large economic trading area is, in the long term, unecological because of the wasteful use of energy resources and the pollution caused by this price-profit driven practice. But that raises the fundamental question as to whether a capitalist economy can ever be ecologically sustainable. But in the context of this article on a single EEC currency the adoption of ecus will not make the issue either more or less difficult to resolve.

The same argument of overwhelming convenience applies to consumers, especially travellers. Having a common pricing language and not having to convert one currency into another when crossing national frontiers should meet with universal approval, far outweighing any regret for the loss of a national identity symbol. Indeed if Europe is to become a single economic unit and if all its people are to develop a common identify in being Europeans, then a single currency will probably prove to be the most potent means of cementing that ability.

However, a word of caution before our enthusiasm runs away with us. A unified trading unit, a central bank and a single currency will only serve to further entrench unaccountable corporate power, with its inherent capitalist compulsion to exploit resources and people, unless the European Parliament is reformed into an institution in which all future legislation is initiated, debated and passed by a majority into law and to which the executive and its civil service is responsible. Indeed, this is where we should be starting, with the proposed economic reforms coming not from the Council of Ministers and the European Commission, but flowing instead from such a democratic legislature. The fact that the current economic changes are being imposed by the existing governing structure, subjected as it is to overwhelming influence by the established corporate power of wealth producers and distributors, I find to be a cause of considerable apprehension.

THE EDWARD HOLLOWAY COLLECTION REVIEW

Where and Why public ownership has failed
by Yves Guyot
Published by MacMillan (New York) 1914

The most disappointing lesson that I have ever learned is that political arguments are generally won by power rather than by reason – though power and reason can sometimes be on the same side. In the debate over the UK's EEC membership every point in favour could be rebutted and many arguments against could be supported by sound reasoning. But we joined and I, like many others, walked away from direct voluntary participation in our version of democracy, sadly disillusioned.

This is not the moment to retrace the EEC debate, but I was reminded of my lesson by Yves Guyot's superbly researched and presented case in this remarkable 450 page book written in 1912.

At that time socialists throughout the world were clamouring for an extension of national and municipal ownership and claiming that there was a vast and irreversible trend in that direction. Conservatives and those in favour of private enterprise were on the defensive. Guyot had been a minister of the French government and had studied public sector operations in France, Britain, Prussia, Russia and many other countries. He was in the perfect position to compare existing public with private operations and with progress in such industries as telephones in the USA. The result reads like a speechwriter's report for Mrs Thatcher. Every argument so painfully learned from the experiences of the post 1945 period is there, the benefits of subcontracting at municipal level are given, and the case for private operation of railways, coal mines, gas supply, electricity supply and the rest, at national level, spelled out. The consequence is a wealth of quotations available today for anyone wishing to support denationalisation, in the vastly changed political atmosphere of the 1980s.

Guyot finds in public enterprise conditions conducive to corruption, lethargy, wasteful commercial decisions, negligence, nepotism, hypocrisy, scandalously inadequate accounting, spurious reasoning, dishonesty, thick-headed tyranny and, above all, a diversion of the limited energies of state institutions from 'essential functions' to the promotion of special interests.

Let me give just two quotations as samples of the wealth of material to hand. First, after giving 'chapter and verse' on the accounts and operations of state run railways, tramways, telegraphs etc, he says (p. 217) "Universal experience has proved that, whatever the state does, it does at a higher cost than private individuals or groups, and that, far from concentrating its attention upon the true objective point, it always drags in foreign considerations, which ruin the enterprises of which it has assumed direction. Accounts are confused in such a way as to make it next to impossible to discover either net cost or the true income. Although sheltered from competition, instead of being agents of progress, such undertakings foster nothing but lethargy; and, while accomplishing so little themselves, they block the way for the more productive enterprises of others".

Secondly, in reviewing state management he says (p. 434) "Parliamentary government will be strong in proportion as its activities are confined to the fundamental duties of the state. Statesmen who pursue the opposite policy are paving the way for anarchy. They are surrendering the institutions and the general policy of the country to the will of those who see only their own interest. They become the protegee of the employees whom they ought to control. They defer all questions to the convenience of the ringleaders of associations of their employees ... who consider themselves as the real proprietors of services which they are paid to perform."

Guyot argues that just a few public operations are matters of tradition, notably postal and water supply services, but that such things as the supply of gas, tramways, electricity, mines (in Prussia) and tobacco (in France) are *novelties* which provide no basis for any claim that public ownership is a matter of historical inevitability. He does concede (p. 375) that, "There is only one legitimate motive for substituting public ownership for private enterprise; that is, the absorption of the profits of private companies for the benefit either of consumers or taxpayers" but adds "on condition, of course that such profits are to be made."

There is no space here to repeat his hilarious account of the operation of the French telephone service (worthy of a script for Inspector Clouseau), his scathing account of the housing efforts of the London County Council or the immoral use of its Vodka monopoly by the Russian government. It must simply be recorded that Guyot favours state regulation on occasion of the operations of monopolies, the expropriation of excess profits and the imposition of legal restrictions on harmful operations, but he wholeheartedly condemns on the basis of empirical evidence public ownership generally whether national or municipal.

I wonder what we have really learned in exactly 100 years since Guyot was appointed France's Minister of Public Works in 1889?

LETTERS

A response to letters regarding 'The ECU as Shield and/or sword' from the author, Malise L Graham.

Sir,

While I appreciate the comments of Mr Havergal and Mr Haran, the weak state of the British economy and changes in the international monetary mechanism render their proposals impractical.

The evidence, from which all policy developments should flow, as to the state of our economy is clear: of the major free world producers Britain has the largest (relative) manufacturing trade and current account deficits; the highest rate of broad money growth; the highest rate of inflation; the highest interest rates; and consequently the most volatile currency; yet has the lowest wage rates.

These statistics are not a 'blip' but the continuation of a trend which must be halted. In 1945 Britain was the second largest economy in the Free World: now it ranks seventh, fourth in the EEC and 18th in manufacturing output growth. We cannot allow the economy to grow rapidly because although exports continue to grow, imports grow faster and the gap widens.

The reasons are well known and have been identified by the House of Lords Select Committee and by the NEDC but publicly discounted by the Government despite Britain being the only country among the above whose manufacturing output declined absolutely during the past decade.

The critical weakness has been identified as structural: British exports are largely in 'staple' industries where growth and value added are low and price competition intense. Britain does not invest enough in R&D and new product development and hence capital investment for innovation and expansion. Capital investment is too heavily weighted towards cost and labour saving. The U.S. pays the highest wage rates yet has the lowest unit costs. Since the turn of the century the U.S. has invested twice as much per employee in manufacturing equipment so that productivity has risen 4 times as much as in Britain; in 1987 British manufacturing investment was 85% of that in 1970 and between 1980–87 manufacturing output rose 8.7% against 20% in the US

To these should be added the traditional psychological reluctance to develop mass markets (except in 'staples') and a consequent lingering and pervasive weak marketing ability. Britain, for example, has abandoned the Space, Nuclear Power and Consumer Electronics industries; appears only halfheartedly in the Commercial Aircraft and Mass Automobile markets; and critics say it will lose its lead in Fibre Optics. The consequence is that the technological frontier continues to move away from Britain and focussing on the exchange rate or on monetary matters will not solve Britain's longer term problems.

But there are short and medium term gains in stabilising exchange rates which can make longer term structural changes at least more feasible. Britain can use her foreign exchange 'nest egg' and supplement this with high interest rates to maintain foreign balances. But Britain's foreign exchange reserves have already declined from $113bn in 1986 to $94bn in 1988 and high interest rates adversely affect investment. In these circumstances, membership of the ERMS would hugely supplement our ability to stabilise exchange rates.

The problem of exchange rate stabilisation needs also to be viewed within a wider financial context. After the U.S. 'closed the gold window' (a euphemism for defaulted) the 'Floating exchange' era opened. Under this regime Central Banks do not intervene in the trading markets. However they do intervene indirectly by influencing capital market flows through changes in interest rates. Unfortunately capital movements nevertheless rarely balance precisely the current balances. (The latest UK BoP figures for 1988 illustrate this: where the capital account inflow to balance the current deficit should have been £14.6 billion only £2.3 could be identified!) But it is clear that British Foreign investment continues to exceed foreign investment here. British foreign investment now totals £771 billion, equivalent to approximately 40 years of investment in manufacturing plant and equipment at the average annual rate since 1985. This factor plus foreigners' doubts about the future of Sterling require high interest rates to maintain balances in London.

However the use of interest rates alone has proven unsatisfactory also and a 'managed float' regime has been introduced whereby central banks intervene 'to iron out' temporary fluctuations'. However due to the vast increase in 'liquid capital' (floating funds not invested in productive assets but which follow the highest interest rate) this system is also far from adequate. The problem here is that these funds vastly exceed the reserves available to the Central Banks. Initially the situation was reversed with central bank reserves of $600 billion and liquid hoardings of $60 billion. Today central bank reserves approximate $600 billion while the eurodollar market alone is $5 trillion.

Thus it will be seen that not only is the British trading economy interdependent with the rest of the world but so also is the financial industry.

The Old Lady of Threadneedle Street surely recognises that there must be power sharing. There is no longer any relationship between the amounts of foreign currencies traded over the foreign exchanges ($140 billion daily in London alone) and the amounts required for international trade. This latter accounts for only about 20% of forex trading.

In its May 89 bulletin the Bank of England has also stated "In recent years widening profit margins have undoubtedly accounted for a significant part of increases in prices

– perhaps as much as a third". To these have to be added the wounding price increases inflicted upon industry by the Government in energy, business rates, finance charges, abolition of the investment tax credit, all accompanied by rises in raw material costs. 80% of world trade is denominated in dollars.

To suggest that our balance of payments problems can be solved by 'jettisoning and destroying demand' suggests that both demand and supply are definable limited stocks and ignores the structural weaknesses described. Companies must and do create new products and markets. Total economies grow through increased supply creating increased demand.

That is where we need to wield the Sword – in the reconstruction of the supply side along the lines of the most successful economies – Japan, the Federal Republic of Germany, South Korea, France and South Africa. We need an industrial investment policy accompanied by approved education training and labour relations. The object is to produce new products and processes ahead of the competition. Macro economic policies have little, if any, relevance to this task.

Telling the country the grim facts is not unpatriotic now any more than it was in 1940. On the contrary it is the way to ensure success as it did then. To think otherwise is to look at society as it was or as the critic thinks it was – a mass of people who are told what to do by people who know better.

Why repeat a recipe for disaster? Why not see society as it wants to be – a society of equal citizenship able to develop "the white heat of the consensus" (to employ Mr Churchill's phrase) which, he said, gave us victory. "It was your victory", he said, "I was not the Lion, I only gave the roar". That's Labour Relations!

The Government has made an ambiguous start by financing the entry of the Japanese into this country. The Minister for European Affairs earlier this year referred to "our partnership with the Japanese", but the construction of a society of equal citizenship in which all are partners for success must be extended to include the other members of the European Community. National Sovereignty is a contradiction in terms when economic relationships are interdependent. 'Power sharing' must become the new buzzword.

Until the sword is forged, by releasing and canalising national energies and suppressed talents, we need the ECU as shield. Thereafter it should no longer be necessary.

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MUSING ABOUT LANGUAGES

By James Bourlet

Military strategists see power in terms of armed strength and Karl Marx saw economics as the basis of political developments. Perhaps they are all beside the real point – what about language?

The extent of any commitment to an investment depends on the amount invested and the length of time involved, compounded by the flexibility possible. A large sum, held for a long time where any change into an alternative is impossible represents the largest possible commitment. Just such is one's native tongue. A stupendous effort is made in early childhood, it is kept for life and fluency in another language is a difficult addition – but never an alternative. Every nation would like the advantage of forcing others into the disadvantageous position of adopting its own language.

In this light we can see a century and a half of European wars as a struggle between two languages – German and French, for dominance on the Continent. At Waterloo, Wellington and Blucher actually had to converse in French! But now the Germans and the French profess – and indeed it seems true – to be the greatest of friends. And this friendship is the cornerstone of the emerging new Brussels-based empire. Why?

Well, of course, both languages have simply been 'outflanked' by English. The Germans, the Scandinavians and the Dutch in particular have accepted it as the most important language for business and international communication. The whispered truth about the EEC commission is that most officials end up speaking to each other in English. The native English speaking world is a larger proportion of the world than any other. Add the Indian subcontinent, the millions of Chinese and Japanese learning English, and one sees that the picture is overwhelming. Even young Koreans and Japanese generally talk to each other in English – and the faculty of German at Japan's Tokyo university has recently closed – for lack of students.

The world has now come as close as it is ever likely to get to having a 'world language' – English. So, for the English language, how about a little 'harmonisation for harmonisation's sake'? Meanwhile, for the native English speaker there will always be a social status to be gained by learning a romance language – especially French. And English salesmen will continue to be regaled for their inability to speak other tongues.

Anyway, one is reminded of Professor Harry Johnson's comment when asked about the future of the British economy, "Britain" he concluded "will always survive due to the public school system and its effortless command of the American language". We can afford to accept his jibe – our greatest investment is remarkably secure.

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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.

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