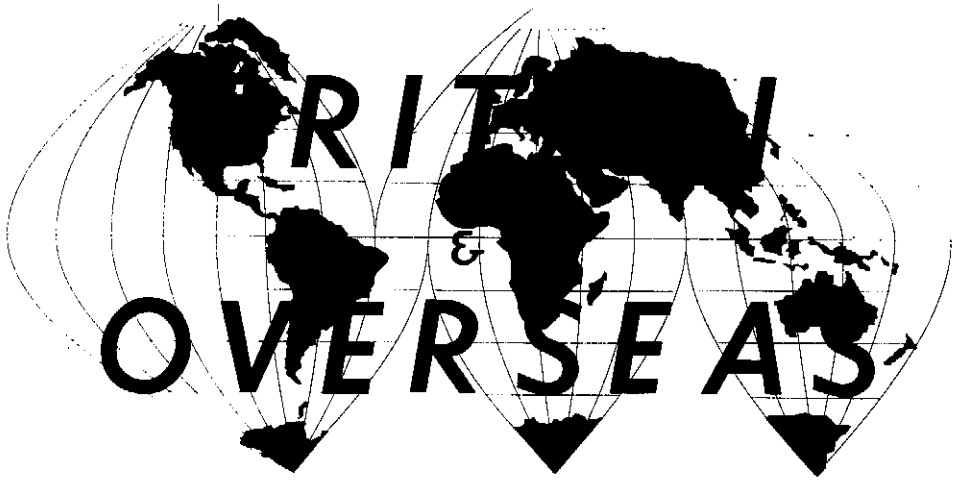

A DIGEST OF NEWS AND VIEWS ON BRITAIN'S ECONOMY AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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EDUCATION FOR INDUSTRIAL DECLINE

Summary of a talk by Professor Correlli Barnett to members of the Economic Research Council on 8th March 1990.[1]

The Real Mediocrity of our Circumstances

My topic tonight is 'Education for Industrial Decline.' But before I launch into it, I would like to take stock of Britain as an industrial society today, nearly 45 years after the end of the Second World War, and after ten years of the Thatcher revolution. Firstly, I admire the Thatcher revolution for its euthanasia of the old industrial dinosaurs and its transformation of the trade unions. It is also possible to admire the 'Yuppyvilles' that are springing up in the 'Enterprise Zones' in derelict urban areas, to say nothing of Mrs Thatcher's hand-bagging of our EC partners and her passionate assertion of Britain's world role and importance.

And yet, Britain today rather reminds me of late eighteenth century Venice, on the verge of her final oblivion, in that all the institutions and ceremonies and architectural symbols of a great and vigorous past are still all in place – giving the illusion that nothing has changed, when the reality is one of shrinking importance and power: the monarchy and its ceremonial; the foreign office and civil service mandarins in their Victorian palaces and their 'Ks' and 'Gs'; the armed forces and their parades and pageants; Oxbridge and its academic and social rituals; the public schools with their own prized quirks of tradition, and housed in Victorian or real Gothic built out of the wealth of departed commercial success. This continuity serves to blunt the impact of decline on our imaginations. We may debate our decline, but we do not feel it as we should, and as we would, if all those comforting leftovers from past greatness were suddenly stripped away from us, to reveal us as we really are.

And what we really are is a country with a likely future of total eclipse as a state of any world importance; with a future of only second-rank importance in Europe; third rank in relation to a united Germany. In other words like eighteenth-century Venice, a once great power on the way to oblivion.

Let me remind you of the objective facts. Our total manufacturing output is about one-third of West Germany's. Our total GDP is only three and a half times larger than Switzerland's, but on the other hand a mere third of Japan's and a ninth of America's. And with the blip of the North-Sea oil bonanza now over, our balance of payments is back in the old chronic mess – £20 billions last year in the red, as compared with West Germany's surplus of £50 billions. What is especially worrying is that we're also running whacking deficits in exactly the modern technologies where we ought to be making a killing – £2.5 billions in the red last year in information technology; £6.5 billion in motor vehicles and parts.

The underlying factors – i.e., the long term factors – are just as depressing. As a proportion of GDP British civil R&D spending is the lowest in the OECD and getting lower. West Germany spends three times as much on R&D as we do; France twice as much. Our industrial investment per employee is barely 60 percent of Japan's. Instead

1) For a further discussion see *The Audit of War* Macmillan 1986, Ch. Eleven.

of the highly educated and trained workforce we need, from boardroom to the shopfloor, we have the worst educated and trained, as compared with our main competitors. An 'underclass' of 5–6 million functional illiterates – coolies for an age of advanced technology. Only a third of British children stay on in school beyond 16, as against four-fifths of French and German, and nine-tenths of Japanese. Only some 24 per cent of British top managers have degrees as against 85 per cent in the USA and Japan. Most British managers have received NO on-the-job training at all. Most British school-leavers still receive NO vocational training, as against virtually ALL receiving it in France, Germany and Japan.

We are told that the British aerospace industry – one of our success stories, £2.5 billion in the black last year – is being constrained by shortages of scientists and skilled technicians.

I can't emphasise too much how precarious I believe our long term national situation to be: how deeply disturbing our prospects in a world market up against such mammoth and dynamic technological competitors as the Japanese, the Europeans (especially the Germans), the Americans and the 'Pacific Rim'.

The one major achievement of the last decade has lain in at least largely liquidating old technologies – not creating new. Despite this slaughtering of first-industrial revolution dinosaurs and the general sharpening up of productivity, Britain still displays today the same basic patterns of weakness that you can trace back through the gruesome 1970s and 1960s, through the two world wars, through the late Victorian era (as documented by vast Royal Commission reports) to the very moment when we lost our original monopoly as the first and only industrial country – say about 1840. You'll be glad to hear that I don't propose to regurgitate a potted history of all this tonight – it's all in two excellent books whose titles modestly forbid me to mention; they are *The Collapse of British Power* and *The Audit of War*.

The Lack of Skills

There is, however, one particular factor in this story of Britain remaining 'one-beat-behind-the band' for 150 years which is absolutely fundamental. That factor is our national want of developed skills relevant to industrial success. Again and again in all the private and official investigations of our lagging performance, this factor has been identified as crucial. Again and again our education and training for personal and collective capability – for the creation of wealth – has been unfavourably compared with that of our rivals.

A major aspect of our inferiority has been in sheer lack of quantity of provision as well as quality; sheer smallness of output of young people qualified at different levels and in different skills.

For all the educational reforms over the last century, we have never caught up or surpassed our competitors in this; a basic example of the British 'one-beat-behind-the-band' syndrome. Let me telegraph all the detailed evidence and figures by giving some quotes which straddle the century – starting with the top, with management. This is what the House of Commons Select Committee on Scientific Instruction of 1867–8 had to say about senior managers at board level:

> Any knowledge of scientific principles which they may have acquired is generally the result of solitary reading, and of observations of the facts with which their pursuits have made them familiar.

In other words, they were self-taught 'practical men'.

The same committee had this to say about what we should call middle or line management:

> Unfortunately this division may be disposed of in a very few words. Its members have either risen from the rank of foreman and workman, or they are an offshoot from the class of smaller tradesmen, clerks etc.

By contrast the Royal Commission on Technical Instruction of 1884 had this to say about European management:

> Your commissioners cannot repeat too often that they have been impressed with the general intelligence and technical knowledge of the masters and managers of industrial establishments on the Continent.

Now let me make a jump of almost half a century forwards to the Balfour Royal Commission on our deficiencies as an industrial society. It is here quoting from an enlightened managing director (of which article there were far too few). This what he says:

> ... the old-fashioned type of more or less self-made man, who had grown up as a practical man inside a factory, and reached a position as works manager, is now definitely out of date. His continuance in this position is, in my opinion, largely responsible for the parlous condition of many of our industries, particularly engineering and textiles ...

Or take an advanced technology like aircraft manufacture as recently as the Second World War, even under the spur of total war. According to a Ministry of Aircraft Production report in November 1944:

> Probably the most outstanding single cause of failing to reach a maximum production efficiency in wartime is scarcity of skilled management.

And to come nearly right up to date, I'd like to quote from the 1987 joint report by the MSC, NEDC and BIM on 'The Making of Managers', which compared British management education with that of our main rivals:

> Only 21 percent of all managers appear to have degrees or professional qualifications of any sort (including HND), although the record is better for top managers ...

How much better? Not much: only 24 percent of British top managers have degrees as against 85 per cent in the USA and Japan. Add to that the fact that 75 per cent of smaller British companies and even 20 per cent of larger ones (i.e., over 1,000 in the workforce) give no training at all to their managers, and you can see how we still remain firmly 'one-beat-behind-the-band' in terms of the educated intelligence and professionalism of

management.

When we turn to the workforce, the historical picture – the legacy we have to tackle – is grimmer still. Take that 1868 House of Commons Committee report: this is what it says about the education and training of British foremen:

> Their education, and that of the workmen, during the school age, has been received in the elementary schools; and owing to the defective character of the instruction in some of these schools, and to the early age at which children go to work, it is rarely sufficient to enable them to take advantage of scientific instruction at a later period.

And again, we have the contrast in the 1884 Royal Commission on Technical Education, speaking about Germany:

> The one point in which Germany is overwhelmingly superior to England is in schools and in the education of all classes of the people. The dense ignorance so common among workmen in England is unknown ...

Let me jump over the two world wars, when our industrial production was each time throttled back by want of skilled labour, to the Plowden Report of 1967:

> Comparison with other countries – all of them more recently industrialized than Britain, but all now at a similar stage of economic development – suggests that we have not done enough to provide the educational background necessary to support an economy which needs fewer and fewer unskilled workers and increasing numbers of skilled and adaptable people.

And to come virtually bang up to date, here is Geoffrey Holland, then head of the MME, in 1985 introducing yet another study of our deficiencies in education as an industrial society. Compared with our rivals, he said, 'We're not only not in the same league, we're not in the same game.'

One piece of proof of this, from the National Institute of Economic and Social Research Council report in 1987 on the British and German metal and woodworking industries: 90 per cent of German employees had vocational qualifications after three years of training; only 10 per cent of British had the equivalent City and Guilds Certificate.

No wonder then that Britain is suffering from a crippling shortage of skilled workers, especially in high-tech industries.

So again we find ourselves confronting the legacy of a century and more of neglect; we see again the 'one-beat-behind-the-band' syndrome; we see a dismaying continuity in our shortcomings and our failure to date to remedy them.

But the inherited problem goes deeper than professional and vocational training as such. Quite simply, we have failed adequately to educate the British nation, and without proper education you cannot have effective subsequent training. This is what the Schools Enquiry Royal Commission of 1868 had to say on this topic:

> ... our evidence appears to show that our industrial classes have not even the basis of sound general education on which alone technical education can rest ... In fact our deficiency is not merely a deficiency of technical education, but ... in general intelligence, and unless we remedy this want we shall gradually but surely find that our undeniable superiority in wealth and perhaps in energy will not save us from decline.

Pretty prophetic, you may think! And to make a clean leap over 120 years, Kenneth Baker as Secretary of State for Education was stating in 1987 that 9 out of 10 German children leaving school at age 16 get a Hauptschule certificate, while fewer than four out of 10 British 16-year-olds leave with the British equivalent, CSE Grade 4. Britain is particularly bad in educating the average and below average children. The gap in performance between the lowest and highest attainers in a class of 13 year-olds in Britain is seven years, as against only four in Japan and Germany. Moreover, in Britain only half of children stay on after 16 – and that includes YTS – against over 90 per cent in Japan and the US, and soon 70 per cent in France.

Can you wonder, then, that over a century after the Schools Enquiry Royal Commission issued its warning, we have around 6 million people who are not adequately skilled in reading, writing and maths?

The 'Underclass'

The consequences of this educational failure have been the worse because of other aspects of British social history since the first industrial revolution – and I mean the nature of the urban working class created by life and work in the early nineteenth century slum factory towns. Even today the facts and figures show that we are still suffering from the effects –passed down from one generation to the next – poor diet, bad habits like smoking, poor health, poor management of personal and family affairs. Slice the health and diet statistics regionally, and the map shows the inner cities and the old industrial areas. *Slice them in terms of social layers, and they show – like the unemployment figures* – the manual and semi-skilled working class. The very same 'frontline' of ignorance where our education and training system has thus far been losing the battle – or not mounting a big enough offensive.

It's customary to discuss the problems of the urban regions and what Ralf Dahrendorff calls the 'underclass' from a 'social conscience' point of view, but to me it's less a matter for moral indignation than a terrifying index of widespread lack of personal capability in terms of today's and tomorrow's world. We are told that some 5 or 6 million people are living below the Government's poverty line – in other words, cannot sustain out of their own capability the standard of living we associate with an advanced country. What hope for them when it is predicted that most of the 1.4 million new jobs by 1995 will be in professional and related occupations?

Education for Aristocrats and Coolies

To return to the British education system's share of responsibility for the existence of this class of what I can only call 'coolies', the fault has not only lain in the tardiness and

poorness of provision of state primary and secondary education, but also in the ethos that has inspired the curriculum. In a word, the skewing of education for all towards the ultimate requirements of university entrance for a few – a highly academic approach and way of teaching; a weight on 'pure science' rather than technology; a vaunting of literary culture -whether classical, English or even European; an emphasis on performance on paper; the analytical and critical faculties rather than the practical or problem-solving ones; in the design and making of things, an 'Arts and Crafts' approach rather than 'Bauhaus' industrial design. You can trace this dominance of the academic back through Cyril Norwood and his influential committee on the postwar curriculum for secondary schools in 1943; to Sir Robert Morant and his narks at the Board of Education after the 1902 Education Act, determined to steer state education away from concern with career preparation, and finally back to the Victorian prophets of high-minded academicism such as Cardinal Newman and Dr Arnold. Through the medium of the public school and Oxbridge it created a ruling class and an intelligentsia ignorant of, contemptuous of, industry, technology, and the achievement of success in world markets. It created the pecking-order of prestige in British life by which the term 'engineer' means the chap who fixes the washing machine or telephone, or, at best, an uncultured specialist with a row of pens in his breast pocket. This governing class disdain for anything so vulgar as the nation's capability to earn its living has been a major reason for our failure to match our rivals in the provision of vocational and technical education - at every level, from school-leavers to universities.

It's only really since around 1970, with the final end of Empire and the world role, the entry into Europe and the stunning industrial collapses of that decade, that this whole Victorian educational ethos has come under challenge; that things have at last begun to change. It's hard to think of a more radical innovation in the whole history of British education than the setting up of TVEI. The Technical and Vocational Education Initiative. YTS and now JTS represent at long last a real effort to emulate the kind of post-school vocational education which European countries have enjoyed for sixty years and more. And now the DES, the last rampart of Morantism, has introduced the GCSE, with such amazing subjects as 'Craft, Design and Technology'.

Yet what we have so far done since the 1970s has to be measured against the scale of the backlog of ignorance and incapability I was describing earlier.

A Conscious National Purpose?

For Britain today vis-à-vis our market rivals is really in a similar position to them vis-à-vis us back in the early nineteenth century. Then Britain stood before them as a supremely successful industrial national and world technological leader – the leader they must seek somehow to overtake. Hence the Europeans' field investigations at that time of the British industrial scene in order to learn our strengths – and find out our weaknesses, so that they might do better. Hence – unlike us, who were first in the field with the industrial revolution by accident and without conscious national purpose – the Europeans mounted deliberate and sustained efforts to turn themselves into great industrial states. I think here particularly of Germany. And in these efforts national education and training, coupled with R&D, were perceived as a key instrument of future

success. In the 1820s and 1830s came the Technische Hochschule; in the 1870s and 1880s the industrial breakthrough thanks to superbly trained industrial troops, NCOs and officers.

What a contrast with the Britain of that era! There we were, the greatest industrial and commercial nation in the world, centre of a vast empire, and defended by the world's most powerful navy. We seemed to have it made for all time; and it had been achieved by the 'practical man' and his native nous. This is why the highminded like Newman could take it for granted that their concept of civilised values would always be supported by a host of rude mechanicals. This is why they could be so incredibly frivolous in their belief in the gentlemanly purposes of true education. And this is surely why we, smug in our success, became deeply resistant to technological change, while our rivals had given themselves the mental equipment and habits of mind to keep on embracing change; keep on searching for new and better technologies.

But now today we are the laggards, thinking how we might eventually catch up the leaders; looking to them to see what lessons we may learn. And like the Europeans or Japanese a century and more ago, we have at last realised that education and training – national capability – is absolutely fundamental to success.

The Task

For us as a nation, then, it is a totally novel situation. The present government has certainly recognised this. They accept that our national future depends on our developed intelligence; on our resourcefulness and adaptability. They have introduced a succession of innovations – I've already mentioned some of them: TVEI, YTS and JTS, the new GCSE. There are others – the City Technology Colleges; the freedom of schools to opt out of local government control; the new University Funding Council, with a strong representation of businessmen. But is all this enough to overturn the educational ethos of a century – the under-investment of a century? I am told that though TVEI is becoming more widespread, it is also becoming diluted and feebler in impact because resources are being diluted. We see that the Government has failed to adopt the recommendation to replace 'A' Levels, with their narrow specialisation, with a broader band of subjects like the International Baccalaureat. There is therefore a mismatch between GCSE and 'A' level and university entrance requirements. Our provision for children to stay on at school beyond 16 remains far behind our competitors. The French, for example, are aiming to get 90 per cent of the children up to Baccalaureat level or its vocational equivalents. Our combined education and further training effort will still fall far short of the comprehensive provision of the German system. Are we therefore spending enough – or proposing to spend enough? Remember, we are coming from behind. We need therefore to spend more per capita on education and training than our rivals – much more. This is a national investment in the future – NOT just a charge on the public purse.

As a strategic historian by original trade, I worry about the organisation and deployment of our education and training effort. The history of it over the last 100 years has been one of hopeless ad hockery, with agencies and initiatives added on and on without any clear organic or functional relationships; education under one ministry, training under another: universities under one system of funding; polytechnics under

another, and subject to local authorities. Responsibility for education split between the DES and the LEAs.

That's the way it all happened, Topsy-like. But I wonder whether we are still not displaying our national genius for disintegration. I mean, how far do all the present government's initiatives add up to a coherent national strategy in terms of aim, wiring diagrams and coordinated deployment of resources? They look to me like a series of one-offs - TVEI, GCSE (how do these two relate?), opting out of LEA control, City Technology Colleges, and so on.

In any case, I wonder if our heart is even now really in creating an education and training system devoted to the end-product of personal and team capability in an industrial society and in a world market. The Victorian high-minded academic school of education cannot be written off – as we see from the letter columns of the posher newspapers. There are eloquent voices pleading that 'culture' and 'values' belong exclusively to an academic and 'liberal arts' education – education for its own sake – and seeking to prove that 'education for capability' is just narrow, unadaptable vocational training, and 'Philistine' to boot. In the past this became a self-fulfilling prophesy, with dire consequences for Britain. It must not happen again.

The Future

So I would like to finish by proposing for this country a clear aim for national 'formation': to surpass the best that is currently being done in Europe, both in quantity and quality of provision.

And that we should design 'education for capability' at all levels so that it is in fact more civilising, more mind-broadening, than the narrow and intellectually remote traditional academic curriculum.

INCREASED LAND VALUES AND INFLATION

By John Hatherley

1989 marked the end of the upward spiral of land prices – a spiral caused partly by events in the 'real' economy, such as motorway construction and rising productive investment, and partly by an increase in the availability of funds for property purchase made possible by the entry of the banks into the hitherto rather exclusive mortgage provision business of the building societies.

Land as a 'Factor of Production'

The 'classical' economists (notably Adam Smith and David Ricardo) considered three 'factors of production' – labour, capital and *land* and would have little difficulty in arguing that major rises in the price of land *must* lead to general inflation *unless* there were commensurate falls in the price of the other two factors. In practice such falls would be a reduction in the values of industrial investments – and a rise in unemployment.

Today's academic economists mostly treat 'land' as just another form of 'capital' and

thus tend to ignore the relationship of price changes between the two. It is therefore worth reminding ourselves of three facts which suggest that 'land' must be regarded separately. First, land is subject to its own peculiar laws. For example, whilst a tax on goods or wages will normally increase prices and reduce supply, a tax of land values forces owners to bring it into use (in order to pay the tax) thus increasing supply and quite possibly reducing prices. Secondly, every improvement in a community – be it in increased skills and invention or in increased productive investment both private and public, is quickly reflected in a rise in land values. Such 'betterment' in values is quite independent of the owners' personal efforts. A dramatic example of this was the recent rise in London's docklands land values. The announcement of a new railway access project heralded sales of land at £1m per acre – land which only a short time previously had been available for only £50,000 per acre. Thirdly, *some* land must be used for any activity and its cost cannot therefore be circumvented. That is why it is described as a *primary* factor of production.

Land Values and Inflation

A modest increase in credit, if channelled into property, increases the collateral available for further credit. A quite small increase in the supply of funds can thus lead to major increases in the demand for funds. During the mid-1980s householders eagerly responded to mortgage companies' invitations to borrow against the higher values of their homes. Whereas in 1985 the U.K. housing stock (in 1988 pounds) was valued at £800bn., in 1988 it was over £1,100bn., the land value naturally accounting for most of the increase since the majority of buildings depreciate over time.[1] Private indebtness rose from £90bn. in 1980 to £282bn. by the end of 1987. During 1988 personal borrowing rose a further £40bn. and the 'YUPpy boom' in London enabled many to afford and thus encourage yet higher house prices.

The high costs of housing deterred labour from moving from slack areas to areas of labour shortage, upward pressure was exerted on wages, and production costs rose. A connection between land values and the general price level seemed impossible to ignore any longer. One leading economist commented "If the government had worried as much about rising house prices as it worries about retail price increases, the consumer boom would not have got out of hand"[2]. And, along with the consumer boom, went a fall in savings from 12.2% of disposable incomes in 1979 to 4.4% in 1988. Asset-price inflation made people effortlessly wealthier. Being wealthier, they saved less and borrowed and spent more. Retail prices began to rise – and so did the trade deficit.

Now if land values could, by a switch of credit supply policy, be somehow reduced again to pre-boom levels, at least a part of the inflationary pressures caused by land cost increases and consumer demand from excessive borrowing might be evaded. Somehow, however, land prices, once established tend not to fall – or fall by very little. Just as Keynes found in the 1920s that during deflation wages are 'sticky downwards', so we are finding today that during periods of anti-inflationary penal interest rates, house prices too, are 'sticky downwards'. Just as Keynes found that to maintain a fully engaged economy in the 1930s demand and inflation had to be allowed to rise to accommodate established wage levels, so today we seem forced to allow rises in demand and inflation to accommodate established house prices.

Land Values and Public Policy

Two main issues for public policy making arise from this discussion. First, that part of land value increases which is caused by excessive bursts of available credit should be countered by appropriate credit control policies. Steady increases in land values are evidence of a community's economic success but steep rises followed by periods of price stagnation are disruptive. To this extent, the brou-ha-ha between Professor Walters and Chancellor Lawson was appropriate. When he realised that retail price inflation was inevitable Nigel Lawson very sensibly decided to leave.

Secondly however there is the steady rise in land values caused by general prosperity. That part of land value rises caused by 'artificial' restrictions on land usage of course points to a loss of efficiency, but the rest is a symptom of increased wealth and, to that extent, can be welcomed. But it also brings us to a moral imperative and an economic opportunity. An early and distinguished writer noted over 100 years ago that "Housing inflation has depressed our economy, frenzied our psyches, divided our society"[3]. In fact, increases in land values and rents are the natural income of that power which allocates the use of the land a people has won or defended – a sovereign right or, in today's terms, the most 'just' tax imaginable. Writers as diverse as Tom Paine, John Stuart Mill, Henry George and Dr Sun Yat-Sen have all recognised this point but when, from time to time it has been expressed by political leaders, established interests have generally been able to prevent action. It is, to use the economist's jargon, a 'distribution of income' problem.

But why an 'economic opportunity'? Because a change in land value taxation could make a significant impact on inflation. More land brought into use could bring down housing costs; land taxation could bring relief from other taxes such as VAT thus directly reducing prices, and reductions in land values resulting from such a tax would render land as a collateral for borrowing less attractive thus taking the steam out of the consumer credit boom.

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POPULAR INHERITANCE

By Mr Gavin D.R. Oldham

Ensuring the perpetuity of broadly spread individual ownership

As we approach the 21st Century, the benefits and flaws of competing socio-economic systems are becoming clearer than ever.

People the world over can sympathise with the high ideals of socialism: community-based egalitarianism, no unemployment, a society based on fairness of treatment. But in

truth the only way such a society could survive long-term is through massive state coercion or total individual selflessness (which is made very difficult by communist denial of religion). In reality the total absence of differentials removes all spurs to enterprise, denies liberty and those in power fall prey to the temptations of abuse via corruption. The result is almost uniform poverty and restriction; the consequences are evident for us all to see.

We may consider that, as a result, the world is turning to capitalism at present - and indeed it might be. However, the main force for change is democracy, so that individuals may state their preference for the way forward. It may be that they will choose a capitalist path ahead, impressed by the evidence of affluence and vigour in the western economies. However, our societies have also been subject to their share of socialism, albeit less marked, and taken as a whole the world economic order is swinging like a pendulum from left to right.

Should we be content to see a full swing take place, from extreme to extreme, or should we try again to find the balance which has proved so elusive for so many years?

I believe we should attempt the latter, for the extremes of capitalism are little better than the extremes of socialism and will generate in due course just as much social discord. Even though their worst effects may be tempered by the presence of a "welfare state", this does little to engender enthusiasm or enterprise among those at "the bottom of the pile". It is not sufficient to claim that these individuals should grasp opportunities and that they simply represent the idle of our society; the fact is that they have neither the initial capital resources nor, in many cases, the education to be able to shake themselves free of their situation.

Extreme capitalism not only denies equality – this may be considered a virtue – but also equality of opportunity; thus it can never become a stable long-lasting socio-economic system. In due course, the manifest unfairness of both wealth concentration and lack of opportunity will stir the masses to rise up and challenge the economic aristocracy, and the good will be thrown out with the bad.

The objectives of "popular inheritance".

We need a way forward for genuinely popular capitalism which seeks to allow full rein to its best characteristics whilst ensuring a substantial degree of equality of opportunity as the generations roll by. The basis of "popular inheritance" is extremely simple indeed, and if it were a constitutional feature it could operate under governments of all shades of political hue, provided that they were committed to individual ownership.

It seeks to achieve four specific objectives:

(i) as described above, to ensure a continuing broadly-spread distribution of wealth throughout the population, thereby acting as an adjusting balance to the natural tendency of "pure capitalism" to increase the gulf between rich and poor: but preserving the positive attributes of individual ownership which are so essential in encouraging enterprise.

(ii) to provide young people with an initial capital base for a (financial) "start" in adult life, whether or not they are likely to receive any form of family assistance/ inheritance.

(iii) to encourage a wider and deeper extent of individual asset ownership, with particular focus on direct share ownership.

(iv) to avoid the conversion of privately-owned capital into Government expenditure through the imposition of inheritance and capital transfer taxes.

The "popular inheritance" proposal

The core of the proposal is to transform inheritance tax/capital transfer tax into a capital re-distribution rather than a collection of Government revenue. The mechanism already exists for collecting this levy, and the proposal would leave its degree of severity as a matter for individual Governments to decide.

Instead of paying the levy directly into Government coffers each fiscal year, Government bonds would be issued to the equivalent value and would be distributed equally and freely to all U.K. resident, U.K. national individuals reaching the age of 18 during that fiscal year. Based on recent figures of annual tax revenue and population census, it is estimated that, at present, each individual's bond would be worth about £1,000.

The bond itself would be a seven-year maturity index-linked gilt-edged stock, and would form the first investment in a portfolio which could have the following characteristics:

- switching would be fully permitted at any time, including involving sale of the bond, and allowable re-investments would include equities, other gilt-edged stocks or unit trusts. Options, futures and other types of leverage would not be permitted.
- the portfolio would operate along PEP lines; therefore all dividends and capital gain would be tax-free. Additional cash could be injected up to the PEP limits, but withdrawals during the seven year period would not be permitted to exceed the value or proportional element of those additional injections: in other words, the initial capital re-distribution would be "locked in" for seven years to enable the individual to become used to the experience of owning capital.
- notwithstanding the limitation on withdrawal, dividends may be paid directly to the individual, thus enabling familiarisation with receipt of investment income.
- the "controlled withdrawal" status of the portfolio would end after seven years, coincident with the maturity of the initial Government bond.
- the security of the portfolio may be used at all times as collateral towards home ownership or starting a small business.

Assessing the impact

Assessing the effects of the proposal in terms of the objectives set out above, the most significant is in enabling wealth distribution without endangering wealth creation through individual enterprise. During a person's lifetime, the ability to not only generate but also benefit from increased wealth will not in any way be abated, and even when inheritance or a capital gift is made the effect will be no harsher than at present if current rates are unchanged. Popular inheritance would effectively act as a ratchet on the concentration of wealth, taking effect within the life cycle so far as both suppliers and recipients of capital were concerned.

It is inevitable that differences in the annual distribution would occur as the years go by; indeed the concept of distribution only to "those coming of age" would initially pass over all those already over 18. However, it will be seen that the proposal is a genuine effort to give the young a chance to develop self-sufficiency, and that it will form a long-term basis for a less-polarised, thus more harmonious, society. A distribution fixed annually by the Government of the day is not recommended; this could bring the mechanism itself into disrepute by leaving it too open to political manipulation.

The proposal also adopts a constructive approach to wealth distribution; in disallowing early withdrawal it positively encourages a learning process so that young people have a good opportunity to come to appreciate the value of having access to a "capital reserve". During this period, guidance would become available to assist with handling investments, and the emergence of PEP intermediaries has already demonstrated that a wide range of organisations are prepared to provide a portfolio monitoring/intermediary role, even for small portfolios such as these. The use of the portfolio as collateral for a house deposit would also make life easier for first-time buyers.

The proposal also ensures that capital in the private sector remains in private hands after re-distribution, an important factor in avoiding the current practice of "nationalising capital" via capital taxes (only to turn that capital into government expenditure).

A socio-economic system for the future

The challenge of introducing a form of wealth distribution which does not adversely affect the proper operation of capitalism has remained elusive ever since the concept of socialism first laid down its egalitarian challenge to the free enterprise system. It is arguably true to say that, once that challenge is solved, the case for communist-style socialism will be reduced to extremist calls for equality irrespective of individual effort: an unsustainable proposition. The "popular inheritance" proposal provides a steady state, long term solution to that challenge without adversely affecting any element of population (and thus electorate) since it only redistributes the funds of the dead: which would otherwise be converted to general Government expenditure.

Although this paper is written in the context of the United Kingdom, there is no reason why its applicability could not be more universal. There is an urgent need to find middle ground as the old order of socialism collapses around us; perhaps this proposal for a more egalitarian form of capitalism, in which the young are presented with a greater opportunity to develop their potential, has a role to play, not just in the western economies, but also in those countries emerging from decades of communism.

SPANISH LESSONS ON THE E.M.S. *

Joining the European currency system will not be a doddle, as the little drama currently unfolding across the Channel serves to remind us. There we are being treated to the bizarre spectacle of a stampede by investors into the Italian lira and Spanish peseta, which for all their flamboyant qualities, hardly rank as Europe's finest currencies.

The wisest thing to do with a fistful of lire or pesetas has always been to spend them as fast as possible, preferably on Deutschemarks. But the European Monetary System has changed all that.

Now foreigners can get premium rates of interest while believing they do not run the usual risk of an exchange loss. This one-way bet has sent both the lira and the peseta up by almost 3 p.c. in a month and necessitated heavy intervention to prevent them breaking through their ERM ceilings.

The switch of attention to Italy and Spain follows a brief period when the French franc was all the rage. Then came the decision by the Bank of France in April to cut its intervention rate by 1/2 p.c. to 9 1/2 p.c., in the belief that the French economy was strong enough for French rates to buck the trend in Germany and elsewhere in Europe. Now the French may have to rethink that decision, embarrassing though it would be.

This is just the kind of mess which Sir Alan Walters, the Prime Minister's former economic adviser, believes is in store for Britain if it joins the ERM. Like Spain, Britain needs to keep interest rates high to cool inflation; but like Spain it could find this causes instability on the exchanges. Spain's experience since joining the ERM almost exactly a year ago is instructive. Inflation is high and rising, wages are escalating, industry is suffering the consequences of an overheating economy and an overvalued currency and the current account is in record deficit.

Meanwhile, consumers are spending furiously and the government is resorting to all sorts of ridiculous ruses to try to bring the economy to its senses.

It has imposed credit controls which are being circumvented and has appealed to the unions for restraint, with exactly the same result as that achieved by Britain when it tried the same thing in the 1970s.

Far from making life easier, joining the ERM may make life harder for this Government or any other. The only hope is that the pound will appreciate enough in the run up to membership to make it less of an attractive option when we finally go in.

Otherwise, upward pressure on the currency could force the cuts in interest rates which might win the Government the next election but will almost certainly end up re-igniting inflation.

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BRITAIN'S EDUCATION SYSTEM – A SUGGESTION FOR DEBATE

By Professor David Bell

"Force and restraint may, no doubt, be in some degree requisite in order to oblige children or very young boys to attend to those parts of education which it is thought necessary for them to acquire during the early period of life; but after twelve or thirteen years of age, provided the master does his duty, force or restraint can scarce ever be necessary to carry on any part of education." *Adam Smith*

It is difficult for one who lives in a prosperous rural area and has been professionally involved with those who were successful in the existing school system (university students) to understand the problem areas; but it is undeniable that there are problems in the inner cities (and elsewhere) and that several million children attend city schools (when they are not playing truant). The following proposal will no doubt be regarded by 'educationists' as an outrageous retrograde step. It is that pupils should be allowed (not compelled) to leave school at 14 *provided* they can satisfy three conditions:

(i) They have reached a certain minimum level of attainment which can be verified by the proposed tests of attainment (presumably in terms of the National Curriculum).

(ii) They have secured entry to some kind of formal apprenticeship which leads to a skilled occupation.

(iii) They continue part-time study until they have gained GCSE in at least English and mathematics.

Those who want to follow a more 'Grammar School' (German 'Gymnasium') line can stay at school to take GCSE in several subjects with the possibility of going on to sixth form, higher education etc. The advantages of this proposal are:

(a) To provide the younger years with a visible motive for achievement (to be able to leave school sooner!)

(b) To eliminate some potentially disruptive students who resent staying at school till 16.

(c) To reduce the squeeze on apprenticeship between leaving school at 16 and nominally becoming adult at 18.

LETTERS

Responses to the review of *Monetary Analysis* from the author, Mr T.B. Haran, and from Mr Geoffrey Gardiner and Mr Christopher Havergal.

Sir

Thank you for reviewing my book, *'The Monetary Analysis'* in the Spring 1990 edition of your magazine.

As you know, my purposes are to demonstrate that current monetary theory is unsound and to replace fallacies with facts. Indeed, my contention is that virtually the whole subject matter needs to be rewritten. It is important, therefore, that fresh arguments should not go unchallenged.

You mention in the review that the amount of savings people are prepared to keep as balances in banks is the true meaning of the concept of 'velocity of circulation' – which slows if people are prepared to hold more idle balances and is normally measured by dividing GNP (gross national product) by M3 (cash and bank deposits).

Present teaching is based on the *assumption* that money is a stock, say M3, which can be reused and has a varying velocity of circulation.

I, on the other hand, have set out to prove that money is subject to a process of continuous creation and destruction and that it can only be used once. There are no circumstances, therefore, in which its velocity of circulation can be other than 'one'.

Economists have failed to distinguish between cash and its underlying value. Thus, a banknote is a title to something else and both cannot properly be described as 'money'. Faced with the need to make a choice, I have classified titles such as cash, cheques etc., as 'monetary instruments' and the underlying values as 'money'.

The economy operates on the principle that people give their services in one way or another to the community and receive in return rights to buy the services of others, whether productive or unproductive in both cases. Thus, money is both a debt and a credit *in services*. To enlarge on that, it is a debt in services due by one party and a credit in services of the party to whom it is owed. As such it is intangible.

Monetary instruments are needed to evidence its existence and to transfer its ownership. Such instruments, particularly cash, can be reused or, in other words, circulated, but each reuse relates to a different debt. Thus, monetary instruments can have a velocity of circulation but money can only be used once. That is the experience of us all and the economy is the total sum of our experiences in this connection.

In the same way, deposits are not reusable balances. They represent money which is flowing through the hands of the banks. The earliest sums deposited are spent first and the balances are made up of the latest deposits. Thus they are ever-changing – active rather than idle. Personally, I do not think it is right to describe the amount of savings people are prepared to keep as balances in banks as the true meaning of the concept of velocity of circulation. Trading activity is simply rising or falling.

If GNP is interpreted as including both productive and unproductive services, it becomes the total value of all our economic activities. It is quite inappropriate to divide it by anything.

Incidentally, your readers may be interested to note that since money is intangible, banks can only deal in titles to it. Contrary to popular belief, they cannot therefore create money by lending.

For my part, I feel that only one question remains to be asked. What will it take to make the economic establishment realise that they have gone disastrously wrong and that there is an urgent need to re-examine monetary theory? The stakes in this issue are, after all, the livelihoods and the standards of living of people.

T. B. Haran
"Grianan", 23 Orchard Road
Bromley, Kent BR1 2PR

Sir,

I share James Bourlet's view, expressed in his review of "Monetary Analysis" by Thomas B. Haran, that Mr. Haran has made a very valuable contribution to the subject of monetary analysis, but that contribution is almost solely his careful analysis of the debtor-creditor relationship. With his thorough knowledge of bookkeeping and banking he has recognised what so many economists are untrained to recognise and that is that all money is also debt. They have all been taught that one of the purposes of money is to be a store of value but it is also a measure of intermediated indebtedness and it is a logical necessity that the totals of those two functions of money always amount to the same figure. Mr. Haran makes that clear.

I liked his terminology. To say that for every "debtor party" there is must be a "creditor party" is nice. His analysis might quieten the vociferous claque which wants the public to save more but never acknowledges that that implies increased borrowing as well. Those who advocate increased savings never state who is to be the borrower of those savings. Probably they are just being careless with words and merely want the public to leave its credit balances unspent. But Mr. Haran's analysis makes it clear that the fact that there is no activity on the credit side of a bank's balance sheet does not mean that there might not be a high velocity of circulation on the debit side. His analysis of the bookkeeping deserves to be compulsory reading on every course in economics.

It is most unfortunate that Mr. Haran spoils his analysis by asserting that banks do not create money. The example he gives of a typical depositor and borrower is the situation where one producer has supplied goods to a farmer who has work in progress but nothing yet ready to sell. One cannot accept that all bank deposits are financing work in progress. What he has ignored is that the banking system, among other purposes, conquers the fourth dimension, that is time. The making of a loan enables a borrower to consume immediately production which he might not be able to reciprocate with his own production until very much later. Thus a bank enabled me to buy a house in 1956 but got no repayment until 1989. When money is advanced for the purpose of buying an existing, not a newly minted, capital asset it is particularly likely that that the money is being created.

Lending by banks is able to increase the money supply, to increase indebtedness, and to promote economic activity. If the economic resources of the country are insufficient to satisfy the demand created then the bank has provided either the fodder of inflation, or precipitated a trade deficit. I would agree with Mr. Haran that an increase in the money supply does not of itself *cause* inflation as the direct causes are wages and price increases. But an increase in the money supply enables those other increases to take place without a consequent increase in unemployment. One bank on its own increased the money supply by £41bn. between 1st January 1988 and 31st December 1989 and it would need only elementary research to ascertain where that money went. Little of it I am sure financed work in progress. The low start endowment mortgages that that bank advertises on television help advance consumption by twenty five years!

Banks do create money, but not always judiciously as the last two years have demonstrated.

Geoffrey Gardiner
3 Molly Potts Close, Knutsford
Cheshire, WA16 8QT

Sir,
I want if I may to offer wholehearted support to Mr. T.B. Haran's suggestion (in his interesting letter to 1989 Winter edition of Britain and Overseas) that the only sure cure for inflation is a general commensurate cut-back in industrial remunerations. In so saying I am assuming that Mr. Haran meant that such cuts should take the form of equal percentage reductions at every level of salaries and wages in the management administrative and production bands in each industry's employment spectrum. Pie in the sky? I do not think so.

I differ from Mr. Haran, however, where he advocates the institution of a new value-controlled 'Wages Pound', for I do not believe that the all-too-familiar apparently almost irrepressible British disease of recurring inflation can be cured by any means other than by a very considerable improvement in the general quality of our industrial leadership.

In this connection it is hardly credible that so many captains of our industries appear unaware that they do great economic damage to their Country and their businesses when, under inflationary circumstances, they accept often year-on-year large inflation-exceeding salary and perks increments for themselves, while expecting their production teams to be content with much lower and sometimes even sub-inflation pay adjustments.

Surely there can be no well-informed doubt that, when costs have to be cut to control inflation, industrial leaders should be the first to blaze an example by cutting appropriate percentages from their own remunerations before inviting their production teams to do likewise proportionately, in the interests of ensuring severally; the continuity of their markets, their levels of employment, and the viability of their companies. If led generously and fairly all intelligent industrial teams would be ready and willing to serve what is clearly their own and their Country's common good. I know because I have done

it in the past successfully. Cunning monetary engineering is not a viable alternative to good leadership.

Christopher Havergal
Tower House, Woolton Hill
Newbury, Berkshire RG15 9XX

A further response to *The ECU as Shield* from Mr. C. J. Budd

Sir,
The recent correspondence between Messrs Graham and Haran leads me to wonder whether a European currency is the real issue at all. To stem the tide of the EMS/ECU is surely modern day Canutism. Can it be to any real avail to invoke quasi-imperialist notions of Britain, the Commonwealth and the "outside world" when there no longer is an outside world? Understand it or not, like it or not, a European currency exists. One needs only to basket all relevant currencies in order to "see" it. The real debate lies elsewhere.

Can a European currency be a viable economic aim, when the real problem that faces us is the need to find our relationship to the realities of a single global economy? We cannot do this if we remain imprisoned by outdated and political (rather than economic) concepts of sovereignty, national currencies and so on. All this is the musty baggage of times gone by.

Similarly, to tinker with interest rates is not real. True monetary adjustments can only result from effective management of "real" economic activity. When a room gets too hot you open a window or turn the heating down. The falling mercury is the thermometer then reflects the new situation. But nothing is changed by merely pushing the mercury down the thermometer with one's finger.

National currencies the world over are but doomed anachronisms. The sooner they go the better. For only then will the abstract (albeit very real) manipulations of currency which shape much of modern economic events and policies become impossible. A veil will be lifted from our economic eyes and the resulting clarity will reveal above all the inevitability of a world currency. It is to this circumstance that any and every national currency has to find its connection.

As far as Britain is concerned, this alone will show what her future economic role is to be. This role can hardly be that of a reserve currency or factory of the world - functions that now belong to history. To see the future of Britain we need to scan the approaching horizons, not hanker after the receding ones.

C. J. Budd
5 Hoathly Hill, West Hoathly
W. Sussex

THE EDWARD HOLLOWAY COLLECTION REVIEW

The Wealth of Nations by Adam Smith

Published in 1776 by George Routledge and Sons and reprinted in many editions in England, Ireland, America and Scotland prior to the reviewer's copy dated 1874.

"An inquiry into the Nature and Causes of the Wealth of Nations" concludes with the statement "If any of the provinces of the British empire cannot be made to contribute towards the support of the whole empire, it is surely time that Great Britain should free herself from the expense of defending those provinces in time of war, and of supporting any part of their civil or military establishments in time of peace, and endeavour to accommodate her future views and designs to the real mediocrity of her circumstances". Such thoughts make this book as appropriate and refreshing an exercise to read today as it was more than two hundred years ago.

A wag once commented that the trouble with Shakespeare's "Hamlet" is that that prince seems only to be able to speak quotations. One has the same feeling about "The Wealth of Nations" and almost every line seems worth reading to a companion to enjoy a wry laugh, a thoughtful pause or as a cue for conversation. And for most people, Adam Smith has reached them *only* through the most popular and folksy such quotations - about the self interests of butchers and bakers, about an invisible hand or about the division of labour. Such indeed may be the lot of all those who are popularly remembered but as in so many such cases, this trivial legacy of Adam Smith does him a great injustice.

To he who would have the courage to take down "The Wealth of Nations" from the library shelf, the first pleasant shock is to find that practically everything he has ever heard about the book is contained in the first 20 pages – and there are 740 more to go! The range of this book is surely wider than anyone could contemplate writing today. It is at once a history of the Greek and Roman empires, an analysis of the factors making for military prowess, an account of regional and urban development, an introduction (and conclusion) to money and banking, a discussion of colonialisation, an analysis of the economic, moral and political purpose and progress of education, a discussion of justice and good government, an introduction to the works of Plato and Aristotle and an advanced candid overview of world circumstances which no intending diplomat should ignore. And the key to all this is quite straightforward – Adam Smith speaks from the perspective of the 'public' interest, the 'national' interest – that which whilst opposing the interests of sections and individuals, benefits the whole. Do away with 7 year apprenticeships, he says, when 3 years training is enough. Then there will be more artisans in a given skill – *and* they will all be worse off than those currently so employed. But the public will benefit from lower prices. Do away with the privileges of cosseted lazy university professors. They will all lose – but the students will benefit.

In short this is overwhelmingly a book about public policy making in general. It is advice to politicians and statesmen, the publications of a dozen policy research institutes all rolled into one. And as such it is also a political manifesto and an appeal to all who can take a detached view. It is a background guide for a ministry of trade, a ministry of

education, a ministry of defence – and even a reformed ministry of agriculture. Its educational value is in informing our public spirit – in making us more enlightened citizens.

But this is the awful paradox of this magnificent effort. The book shows Adam Smith's comprehensive understanding of self interest as a motivation for human endeavour and opinion and yet only those who can abjure their own immediate interests can have any interest in reading this book. The dilemma is still with us; those who take up the public cause are trampled by the stampede of private interests. Even liberal parliamentarianism has been sacrificed to the corporatism of Brussels – a move described by T.E. Utley as putting class before country. Who finds it worthwhile to study public policy interests? If one is not to be a politician or teacher, one is inevitably better engaged studying a skill, a function, business studies or a science. And yet *everyone* should study public policy if democracy is to work. Such should represent our stake in our nation – yet the very notion of national identity is subject to scorn. And the many who, quite unsuspecting, have invested years in the study of public concerns – the inheritors of the passionate interest developed by the leisured classes of Adam Smith's day, can now only write and publish, broadcast and debate, support struggling institutions of Left and Right, print their leaflets and attend their meetings. But who is there to listen? Those who would be adversely affected listen – to keep track of their opponent's strength. Perhaps. Everything Adam Smith says is just sound common sense based on an extensive grasp of background information. And everything is designed to throw light into dark corners where conspirators against the public interest seek to hide.

We need Adam Smith today as never before. Let this short review end with just one example. Correlli Barnett recently described Britain's educational system as "education for clerics". Adam Smith puts flesh on the point. Page 607 tells us "But though the public schools and universities were originally intended only for the education of a particular profession – that of churchmen, and though they were not always very diligent in instructing their pupils even in the sciences which were supposed necessary for that profession, yet they gradually drew to themselves the education of almost all other people, particularly of almost all gentlemen and men of fortune. No better method, it seems, could be fallen upon of spending, with any advantage, the long interval between infancy and that period of life at which men begin to apply in good earnest to the real business of the world, the business which is to employ them during the remainder of their days. The greater part of what is taught in schools and universities, however, does not seem to be the most proper preparation for that business." Smith's solution is characteristic of the man – he refers to a law of Solon (page 609) by which "the children were acquitted from maintaining those parents in their old age who had neglected to instruct them in some profitable trade or business". Such may be our reward in an ageing society.

J.B.

SOCIALIST ECONOMIC BULLETIN

The E.R.C. has been notified of a new two monthly economic *bulletin* analysing Britain's economic situation and containing a wealth of valuable and up to date statistical and chart material. Started in March 1990, the intention is to provide a serious and informed background for contemporary issues. The annual subscription is £12.50 and further details can be obtained from 'Socialist Economic Bulletin' c/o Ken Livingstone M.P., House of Commons, S.W.1.

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