BRITAIN & OVERSEAS

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

Autumn 1990 Vol. 20, No. 3

Published quarterly by
The Economic Research Council
Benchmark House, 86 Newman Street, London W1P 3LD

Price: U.K. £10 Australia $20 Canada $20 New Zealand $30 U.S.A. $20 Japan ¥3,000

MEMBERSHIP

Membership of the Economic Research Council is open to all who are in sympathy with its declared objects. The minimum annual subscription for individual members is £18 for full members, £10 for Associate members, and Student members £8.

Corporate membership is open to all companies and other bodies, minimum annual subscription £50 (Educational institutions £35) in respect of which they may send up to six nominees to any of the Council's discussion meetings and lectures.

THE FUTURE FOR BRITAIN'S FREE ENTERPRISE ECONOMY

Summary of talk by Alan Beith M.P., Treasury spokesman for the Liberal Democrats and member of the Treasury and Civil Service Select Committee, to members of the Economic Research Council on Tuesday 3rd April 1990.

If Mrs Thatcher goes down in history as the Prime Minister who put free enterprise back in its rightful place as the essential driving force of a modern economy, she will also go on record as the Prime Minister who jeopardised the enterprise economy by failing to control inflation, failing to promote competition, failing to uphold social justice, failing to invest in essential infrastructure and failing to seize the opportunities of European monetary union.

Competition policy

The free enterprise economy requires law and order just as much as the free society, and the Government should therefore be a far more rigorous opponent of monopoly and protector of the rights of the consumer; instead it has been content to privatise public monopolies to create private monopolies. And in her "little England" attitude to Europe, the Prime Minister has fought to hang on to those very powers to devalue the currency and destroy the value of money which are at the root of inflation.

The vital importance of a legal system for a market economy is being demonstrated by the experience of the newly-democratising countries in Eastern Europe: without contract law, for example, trade is inevitably restricted: few people will risk exchanging in a market where there is uncertainty of receiving delivery or payment. While contract law is perhaps the minimum legal framework for a developing economy, for a highly developed economy the legal framework needs to be necessarily more developed.

That legal framework needs to be fairly yet vigorously enforced. This Government has simply not been a vigorous enough opponent of monopoly. They have not protected the rights of the consumer. Their privatisation policy has been based on the transfer of monopolies from public to private ownership. From Telecom to Gas to Electricity, monopoly has been preserved by the structure chosen for privatisation. Cabinet Ministers responsible for the promotion of competition and the protection of the consumer have erected inactivity into an article of faith. Nicholas Ridley and his predecessor, far from promoting law and order in the market place, have looked like sleeping policemen. The Thatcher view fails to distinguish between a genuine free enterprise economy and a jungle.

In a stimulating lecture on this area, Professor Kay quoted the words of Adam Smith which suggest that he favoured competition, not unfettered laissez-faire:

> "People of the same trade seldom meet together, even for merriment and diversion but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

He went on to quote a Monopolies and Mergers Commission report on British Gas' pricing policy in 1988. One section reads like an up-dated version of Adam Smith:

"we have found that British Gas's policy in the contract market involves systematic and extensive discrimination ... we have concluded that this policy is attributable to the existence of the monopoly situation, constitutes a step taken for the purpose of exploiting the monopoly situation and operates or may be expected to operate against the public interest."

A free enterprise economy, if it is to be successful, requires that competition is promoted. Monopoly positions are not simply bad because they punish the consumer: they are bad because they eventually ruin the firm itself. Monopolists have it easy. They do not worry so much about improving their product. They do not bother about finding whether consumer tastes have changed. They spend time preventing potential competitors from eating into their profits. The Government sometimes argue that the "fact" of Britain's economic renaissance is shown by the increasing profitability of British industry. They may be right. Yet high profitability need not be a sign of a buoyant economy; it may be proof that market mechanisms are being thwarted, and that potential entrants into these profitable sectors are being obstructed.

Competition policy encompasses many other aspects of our economic life. It requires regulation of areas of the economy where competition cannot operate so easily, such as telecommunications, water and electricity; it requires consumer information, not only in the form of, but also in other forms; for example, the hidden cost of spare parts and maintenance may be impediments to genuine price competition. On petrol pricing, the Government actually abolished the requirements that garages display unit prices in both imperial and metric measurements, despite the opposition of the relevant Commons Select Committee.

Short Termism

A link can also be drawn between the debate on the competitive framework for a free enterprise economy and the topical discussion of short termism. While industrialists complain that they are unable to invest for the long term because of the need to watch their share price, a City protagonist might argue that financial institutions perform a key role in promoting competition. Management grown flabby by years of monopolistic dominance can nowadays be removed by management who may be in a totally different industry, but feel they could revamp the target company's fortunes. Indeed, one might think that the takeover and merger boom of the eighties suggests that competition is adequate: when managers fail to manage properly, shareholders ensure that such management loses the right to manage their assets. Takeovers keep management on their toes.

Yet the evidence is that takeovers do not result in better performance. Management may be replaced, but that does not mean that any underlying problems will be tackled. Takeovers are an expensive way of shaking up a company, particularly if the end result may well not satisfy. More significantly, the threat of takeover may not so much discipline management as distract their attention from considering the fundamental shopfloor operations of the company, as well as the long term strategy of the company.

So there is a dilemma. On the one hand, firms who have built up monopoly positions

or whose management has for some other reason failed to perform adequately may have to be regulated, broken up or altered in some way. On the other hand, the present mechanisms of disciplining management in the United Kingdom do not appear to be very effective or efficient.

Yet the present Government is playing no part in this key debate even though it deals with fundamental issues for the British industry and the economy. The quality press is full of articles debating whether or not the problem exists, and if it does, what should be done. Yet the Government ministers' only contribution is silence. The free enterprise economy deserves a better response.

Liberal Democrats have put forward various ideas in our economic documents, and are keen to participate in this debate. We have suggested that the mechanism of the hostile takeover bid be more limited by various measures which might include: a delay before newly-acquired shares can be voted on; a lowering of the trigger point for a full takeover bid from 30% to 15%; a requirement that a bidder gives the fullest possible information about their plans for the target company at the time of the bid; the introduction of a steep rate of capital gains tax from short-term share dealing.

As the second half of any package, other methods of controlling management must be designed. We have put forward for discussion the idea that either the presence of non-executive directors on boards of larger companies be made mandatory, or larger companies be given the choice of establishing second tier or supervisory boards. Directors of such boards would be given the statutory duty to consider strategic questions such as the research and development investments of the firm. Other possible measures might include mandatory disclosure of directors' ages, qualifications and remuneration packages in the annual report, or encouraging the institutional investors to play a more active role in the corporate rather than simply the financial strategy of firms in which they have a stake.

Europe

A key issue for the future of free enterprise is the further economic integration of Europe. While the Government's support for the Single Market has enabled it to proclaim its pro-Europe credentials, Mrs Thatcher still attempts to forestall other moves, such as the discussion over monetary union.

There is some substance in the claim that Britain has the best record on enacting the directives that implement the Single Market. Since the Commission became aware of the failure of several countries to enact agreed directives at the end of last year however, there has been a rapid improvement. The number of directives passed into law in all 12 countries tripled between December last year and March 1990. That will mean that the spotlight will soon return to the Council of Ministers. While they have surprised everyone to date by agreeing on 60% of the directives, the remaining ones cover the politically-difficult areas, including 32 directives that require unanimity. These involve areas such as VAT, company taxes and customs duties where Britain is more often than not the spoiler.

Perhaps the greatest problem for Mrs Thatcher's European policy, and its relation to

Britain's economic development has been her rhetoric. There is not and has never been some continental plot to change the British way of life or abolish the Monarchy. It makes no sense to keep Britain on the sidelines of the economic debate because of such unfounded fears.

Anti-inflation policies

In her opposition to UK participation in the exchange rate mechanism and monetary union the powers Mrs Thatcher is trying to hang on to are the powers to devalue the currency, and destroy the value of money. This is an extraordinary stance for a Prime Minister who claims to be determined to defeat inflation and create stable prices. The Prime Minister's reputation for being tough on inflation has in any case been diminished by recent experience. Already it is clear that the budget was misjudged. We are still paying the price of the lethal combination of tax cuts, rapid credit expansion and the scramble to secure multiple mortgages in the Summer of 1988. The Government may have depressed consumer demand in the housing and related markets, but the consumer is still fairly active. Meanwhile, industry is sweating it out after two years of high interest rates. Liberal Democrats argued before the budget that fiscal policy would have to be tightened still further, but the new Chancellor failed to do that.

But the Government's failure of anti-inflation resolve goes much further. We await Britain's entry into the exchange rate mechanism of the European Monetary System, not for a time when it would help us in the fight against inflation, but at a time when it will fit in with the Government's election strategy. We are told that Mrs Thatcher has dropped her veto over EMS membership, not because her Cabinet or party have persuaded her of the merits of the case, but because Labour has warmed towards membership, and she wants to steal the opposition's clothes.

Nigel Lawson told the House of Commons in his resignation speech that he had proposed to Mrs Thatcher that the Bank of England be made independent of Government, over a year before he resigned, because he firmly believed that would help in the fight against inflation: it would bring back credibility to monetary policy. Mrs Thatcher did not like the idea of reducing her power to reduce interest rates in the run up to an election. This is an odd position for someone who so firmly believes that inflation poses a serious threat to a free enterprise economy.

The Political Stage

It is impossible to believe that however many nationalisation commitments it has shelved, the Labour Party has suddenly become a party of free enterprise. Very many of its MPs and leading supporters have spent their political lives arguing from sincere conviction that state management and state planning is morally and practically better, and this conviction shows through all the packaging of the "new approach".

Liberal Democrats have a clear and distinctive political role in arguing from conviction for a genuine free enterprise economy in which the liberty of the consumer is as surely protected by a framework of law and order as political freedom has to be.

GLOBAL IMPLICATIONS OF ASPECTS OF THE JAPANESE BUSINESS ENVIRONMENT

Extracts from a talk by James Bourlet, Hon. Secretary of the Economic Research Council and Visiting Fellow at Keio University, Tokyo, to members of the Council on the 6th December 1989.

If Japan is an enigma, it is an enigma of our own making. When we look at Japan's hierarchical social system we blind ourselves to its simple logic by labelling it 'feudal'; when we look at Japan's thriving inner cities we blind ourselves to its virtues by assuming that Japan would prefer our suburbo-county life-style if only the land use opportunity existed; when we look at Japan's educational system we blind ourselves to the confidence and skill which it (mostly) imparts by branding it 'conformist'; and when we look at Japan's economic success, her contribution to new product development and her explosion in overseas investment, I think that we often fail to realise the benefits for ourselves in these developments – because we are alarmed by the challenges they pose.

I want to start by painting a brief picture of Japan and its economy. We need a vision of the subject. The country consists of four large, and numerous tiny mountainous islands amounting to roughly double the land area of the U.K. The population is also roughly double that of the U.K. The largely 'middle class' mostly city dwelling Japanese tend, however, to crowd into the coastal strip just south of the main mountain chain – an area which enjoys a climate rather similar to that between Monte-Carlo and Barcelona. Whilst Japan possesses few raw materials for industry, we should note that she nonetheless has many natural advantages. In terms of climate, topography, rainfall, rich soil, pollution dispelling sea breezes, kind-to-the-skin humidity, easy-to-dig city building sites and tameable sea inlets, nature, notwithstanding hurricanes and earthquakes, has been generous to Japan.

And in her mountain and sea edged garden-land, Japan has created a virulent expansive capitalism. Our capitalism is characterised by a drive towards wealth accumulation. Japan's is yet more so – and institutionalised. Our capitalism is characterised by a lamentable imperfection of market mechanisms. Japan is riddled with restrictive practices, guilds, monopolies and barriers. Our capitalism is as competitive as cricket on a Saturday compared to the seriousness with which Japanese companies thrust for market share increases. This capitalism is run by one forty-fifth of the world's population and yet produces over 10% of the world's GNP. Japanese GNP is expected to exceed US$4 trillion by 1992, equal to what the USA achieved in 1986. Japanese overseas assets stood at US$727.3 billion in 1986 and are expected to total US$1,884 billion by the end of 1992. Most of these assets are portfolio investments but direct Japanese investment overseas is expected to grow from US$58 billion in 1986 to US$237 billion by 1992.

In terms of population, land area and raw materials Japan is tiny compared to Europe, the USA, China or Russia, and yet is regarded, on its own, as a serious challenge to any – or all – of them. And the Japanese love that and gaily ignore numbers in their aspirations to surpass their enemy, mentor and friend, the USA. There is indeed a remarkable ambitiousness about modern mercantilist Japan. Of course all nations and all immature individuals dream of world domination and I'm not particularly bothered to discover that the Japanese have this in common with (say) the French. But just occasionally, when I sense the modest manners of Japanese business leaders giving way to a slight smug scorn, I wonder if I am seeing that other side of Japan which the world witnessed 50 years ago.

The Japanese Challenge

Let me briefly assess the Japanese challenge. Its underlying strength is based on the effective use of an able workforce (life-long employment, promotion by seniority and master-servant mutual obligations which harness loyalty, responsibility and initiative from a talented and well schooled work-force); an instinctive drive towards interdependent specialisation which nurtures always the use of the latest, if complicated methods; the successful exploitation of urban potential (mixed activities in most neighbourhoods, an enthusiasm for ever increasing density ensuring the viability of endless urban building renewal; a belief in city life as sophisticated, rural life as banal, and suburbia as a failure); and national characteristics such as orderliness, doggedness, lack of petty crime (I would guess that up to 10% of Britain's GNP goes on theft, excess policing, insurance and security, almost all of which Japan need not bother with) consensus decision making and meticulous attention to cleanliness and detail. All these factors make for the most successful giant manufacturing operations in the world.

But there are enormous weaknesses. For one thing, short runs and one-off schemes can be hideously expensive. For another, these highly successful manufacturing operations have to work within an export framework constrained by the sum of imports and the transfer of savings abroad. Beyond that the exchange rate rises and squeezes out relatively weak industries – silk, cotton textiles, shipbuilding, cutlery and many others have suffered this fate. Moreover as Japanese firms expand via investment abroad, they hit two enormous constraints – which threaten their long term viability. One is the language problem within management ranks – there aren't that many Japanese with enough English to participate in all that consensus building, and the other is the difficulty Japanese firms have in employing top able foreigners – foreigners who are likely to find it difficult to gain the top ranks, difficult to accept Japanese work ethics and difficult to fit into a system which normally regards length of service over daily merit. High flying foreigners are needed in mid-career and will never quite fit the established group which has been in place since graduation. On the domestic side the Japanese market is as hard for the Japanese upstart to penetrate as it is for the importer – costs are enormous, established distribution outlets are hostile, and the consumers often won't enthuse about a new idea until it has become 'the in thing' – at which stage your choice is to sell a million or none at all. Small wonder that so many Japanese enterprises are linked to bigger companies – it shares the risks. I will mention lastly, the inevitable weakness arising from Japan's group oriented strengths – the fact that if the 'insider' receives excessive loyalty, trust and consideration, the 'outsider' is often accorded scant regard – he is there to be taken advantage of. Temporary workers complain of shoddy remuneration, foreign suppliers are 'mucked about' and end up selling little and, in the past, patent and copyright protection has been weak in Japan.

Cultural Explanations

Commonplace wisdom has it that the Japanese have succeeded in business because of 'cultural' factors – by which is meant the character of the people and their ability to co-operate. Making generalisations on this subject is a veritable minefield! The Japanese (here is my initial generalisation) play a kind of game with foreigners which runs "We are different. Can you spot the difference?" You suggest something and they say "No. Try again". And so on. Now given the fact that there must be exceptions to every rule and that even Japan is a fairly varied place, this can be a frustrating game to play. Anyway, here goes.

I find the Japanese a meticulous, courteous, well disciplined and responsible people. But against this I find them relatively joyless and humourless. They are a serious, dogged and finicky lot, terrier-like in their insistence on correct detail and the application of petty rules. They are a people who particularly enjoy amazing you, just as American's enjoy impressing you and Englishmen enjoy amusing you. In general Japanese are thoughtful, observant and practical people who attempt to repress, trivialise or regiment the emotional and intuitive aspects of the mind.

I find the Japanese to be a superstitious lot and a people who always turn to diagrams, structures, rules, established customs, statistics, questionnaires, endless facts and lists rather than judgement and priority when faced with emotional choices and managerial problems. They try and 'think' their way out whilst we want to rely on something mysteriously called 'leadership'. And there seems to be an overwhelming reluctance to let feelings 'escape' – they must be anchored into the scheme of things where often we regard them as "too bad" or simply irrelevant. For example, everyone who works for a company knows that they have (or want to have) a 'feeling' that the company is 'theirs' rather than the exclusive property of the shareholder. They have given their working lives to the organisation and feel a sense of possession. Shareholders, they feel, should be given just enough to keep them quiet. We offend these feelings by allowing hostile takeovers and accepting redundancies; and few are promoted for long service. But in Japan this feeling is built upon somehow. As people work longer so they gain promotion and as they feel a greater sense of possession they are called on to accept more responsibility. It works – people respond. Within firms we tend to establish elaborate charts of everyone's position and job even though we know that each of these slots has to be filled by fallible mortals. In fact organisations succeed where everyone simply puts everything they have into it – one person's strength doing overtime for another's weakness, and each suspending judgement of the other in the faith that no possible effort is being spared. Small firms run this way in Britain – large ones run this way in Japan. Everyone has a 'feeling' that he owes his colleagues a 'debt' for their help and his feelings of debt are nurtured rather than allowed to evaporate in cynicism as they so often are in Britain.

Nurture not nature

What makes this possible? I think that we should look at Japanese upbringing. My understanding of Western upbringing is that during the first two years or so the 'ego' is fostered by a process of encouragement, flattery and adoration which gives a person an inner strength for life. The wilful little brat is then 'tamed' in his early school years and then typically chooses to emulate father – and other same-sex figures. My understanding of the Japanese upbringing is that during the first two years or so the child is cared for physically but treated very neutrally from an emotional point of view. The 'ego' is NOT encouraged and mother's response to baby initiatives is one of mild curiosity but not engagement. Babies in Japan are the same as anywhere else and if you treat them as we treat them you get the same result. If you give them an emotional stage, they will perform. I have spent a great deal of time observing baby minding in Japanese parks and I am very sure that I know this point. The first chance the Japanese baby gets to obtain praise and warm approval is really from age 3 onwards – a stage when he identifies with mother. He is in the position where, to gain any sense of identity, of 'I am', of 'ego', he has to correspond to rather than oppose his mother, his teachers and even his siblings. The Japanese character is thus built on a very tender and vulnerable ego and the later loss of group membership or the antagonism of any person meaningful to the individual will bring subconscious memories of those agonising lonely identity lacking baby experiences. But this initial stage makes a great deal possible. First of all it makes early schooling very easily disciplined. If you read Joy Hendry's book 'Becoming Japanese' you can get the full picture. I think that if a load of Japanese teachers took over a London playgroup or primary school they would become utterly exhausted with our strong willed little so and so's! After this, in Japan, I suspect that the Oedipal crisis most often results in the young boy seeing his Mother rather than his Father as the dominant character in the household and he initially emulates HER in his search for strength. Discipline, group orientation and a fear of separation seem predictable results.

Much to Offer us

What are the global implications? Disciplined people usually, all other things being equal, have an advantage over non-disciplined individuals. Japan's discipline, groupism, conformism makes her a formidable economic power. She will constantly match every management challenge and prove that success is possible. With Japan around we cannot get away with excuses. Other disciplined groups have taught us many things in the past – the Romans with their legions or (to take an example from Nicholas Kaldor's 'The Economic Consequences of Mrs Thatcher') the Flemish weavers in the 13th century. Japanese management attitudes and methods have much to offer us.

Finally I should mention that the Japanese are certainly nationalistic – the first question to foreigners is "Do you like Japan?", and if you criticise something they look downcast with responsibility. They feel a duty to provide jobs for fellow Japanese and take the attitude only too often that the rest of the world's land area is more or less conveniently scattered around for Japan's benefit. Any import – of goods or ideas, will normally be accepted only after being 'Japanified' – that is, made more sophisticated and probably a little smaller.

Economic Explanations – High Land Values

The national income – the annual cake – the total product of Japan, is very differently distributed from that of Britain and I don't think that this question of distribution of

income is often accorded the importance it deserves. But it is of fundamental importance to the Japanese business environment and it does have global implications. I want to *focus on two aspects.*

The first is a fairly straightforward consequence of space limitations — central city success — and the Japanese share the point with Hong Kong, Taiwan and Korea. This is the question of very high land values, and astonishing rents. I was told that the increase in property values in the Kanto area alone during one recent year exceeded the entire value of the U.S.A.! As a result, in every conceivable way, *income is sucked out of one's pocket into the hands of property owners.* Put the other way around, it is the fact that so much of the national income goes into land rental which tempts buyers to pay so much for property. The result is that as cities grow prosperous so the income of that section of the community which tends to save a lot grows disproportionately and property ownership confers control over borrowing and thus resources for investment. This provided an abundant flow of capital for investment during the early years of the post war boom but since about 1970 has produced an enormous surplus of funds over private sector investment opportunities. Part of the surplus has gone into government borrowing — a hostage to the future — but the larger part has gone into overseas investment thus necessitating Japan's current account surplus. We can say that Japan's trade surplus has rather less to do with productivity and innovation than with yen depressing long term capital account outflows.

What is perhaps interesting for the Georgist land value taxation theorists among us is that these high land values have NOT killed enterprise or prosperity and seem in the Japanese case to have abetted rather than hindered economic success. The future may be different I suppose.

Different priorities

In Britain our cities are inefficient, densities are too low, jobs are separated from residential areas, and the more affluent live in suburbia. Local Authorities mismanage their estate portfolio and social and educational irrelevances – the class one comes from and the study of (for example) Latin are prized. In Japan your status depends on your job and your job is not just important, without it life doesn't mean much at all! And cities are *efficient – the producers of Japan's wealth, not a drain on public resources.* Then again, in Britain dividends and interest payments are relatively high – much to the benefit of older consumers, the 'grey panthers' spending in the High Street. In Japan, to a greater extent funds remain with companies, the expenditure is on investment rather than consumption.

In short Japan's incentives and economic priorities seem right for success whilst ours somehow are not.

Some implications

But how does this economy affect us? Japanese finance is spreading around the globe and in the words of Aaron Viner, author of "The Emerging Power of Japanese Money", this money is mainly controlled by Japanese institutions and corporations rather than by individuals and it is likely to penetrate every conceivable investment area. He says, "From mansions in Monterey, California, to shopping malls in Indiana, to the most prominent Manhattan towers, the names on the deeds will be Japanese". But in addition to Japanese finance there is the ever greater spread of Japanese goods – and in recent times, most especially the spread of 'process goods' – that is, goods used in the production of other goods. I mean everything from robots and computers to facsimile machines and electronic typewriters. The importance of Japan as the cost cutting leader in the production of process goods is an issue not normally noticed but it is thanks to Japan's thrusting progress in these areas that prices for so many goods have been driven down miraculously. And this fall in prices for goods used in the process of producing manufacturers and services enables the economies (such as Britain) to stumble forward in spite of themselves with minimal unemployment. A similar boost was given by Saudi Arabia in the 1950s and 1960s in driving down the cost of power but the Japanese contribution (which will involve endless miniaturisation and CAD CAM concepts), is going to be more lasting – and we haven't seen the best yet.

REGULATING PUBLIC UTILITIES: LESSONS FROM THE US?

By Cosmo Graham (Lecturer in Law, Department of Law, University of Sheffield)

The privatisation of nationalised industries has been one of the most significant policies of the Conservative governments. From modest beginnings in the early 1980s, this policy has now expanded to encompass the major utilities; telecommunications, gas, electricity and water. However, privatising such enterprises raises different problems from the privatisation of enterprises operating in competitive markets, such as Jaguar and British Aerospace, because the utilities all contain some element of natural monopoly and so are not subject to the competitive forces of the product market. Instead of restructuring the industries to increase competition the Government has opted to create public bodies which will regulate the newly privatised utilities. These bodies have been created in an *ad hoc*, piecemeal fashion, a point recognised by the Energy Select Committee of the House of Commons which said that "although we are becoming a nation of regulatory bodies" we had not yet developed a philosophy of regulation.

Accountability

One of the reasons for this piecemeal development is that regulatory agencies are, in the British context, a constitutional innovation. This raises serious questions about the accountability of such bodies, which cannot be answered by recourse to traditional notions of ministerial responsibility and the role of the courts. It is interesting to look at the experience of the United States, which has had a long history of regulatory agencies,

to see what lessons might be learnt. Although the American legal system derives originally from the English common law, it has evolved in a different manner, particularly where the question of constitutional issues are concerned.

Although there are important differences between the legal regimes for the regulation of utilities in Britain, there is a common structure. A body is set up under statute which is headed up by a Director General, who is appointed by the Secretary of State. The utility is granted an operating licence (or equivalent document) by the Secretary of State which sets out the terms and conditions under which it will operate. This will include a formula restricting price increases, as well as other requirements, such as a ban on cross-subsidisation, the provision of information to the Director General etc. After the licence is granted the regulator is responsible for ensuring that the utility obeys its terms and conditions and generally monitoring the workings of the industry. The regulator has, however, very limited powers to modify the licence. This can only be done with the agreement of the utility or after a reference to the Monopolies and Mergers Commission. Given the time that such a reference would take it is not surprising that this procedure has only been used once, in the case of telephone Chatlines.

It is also worth noting here that, even after privatisation, the government retains important new regulatory powers. For example, in electricity, the Secretary of State not only issues licences but can also specify that electricity suppliers take a certain amount of non-fossil fuel. Indeed, the (Conservative) Chair of the Energy Select Committee has claimed that the Secretary of State would be involved in 67 distinct and separate areas of the Electricity Act, requiring the formulation and application of 'what can only be described as a national energy policy for the electricity industry'. Clearly under such circumstances all regulators must necessarily be involved in some dialogue with the government.

In the United States there are important differences between industries, and matters are complicated by the division of powers between federal and state levels, but again a general pattern can be detected. Usually regulatory agencies are headed by a group of Commissioners who are appointed, for staggered terms, by the Executive. Unlike the United Kingdom, this is usually done with the advice and consent of the legislature, so there is some public element to the selection process. The power to licence or grant franchises will be solely in the hands of the regulatory agency which is free, subject to following the appropriate procedures, to modify them in ways it seem fit.

Neither the executive branch nor the legislature have any direct powers over the industry or the activities of the agency and specific provisions protecting agency independence may be written into the law. For example, the California constitution allows the legislature to grant further powers to the Public Utilities Commission, but not to take them away. Obviously the legislature and the executive still have great influence but much of this may take place through a public process, such as the Senate hearings on the proposals of the Federal Energy Regulatory Commission to introduce greater operation of market forces in the electricity industry. One of the great controversies in the United States of recent years has been over the extent to which the Executive has attempted to influence clandestinely the policies of the agencies and there have been attempts to ensure that such communications reach the public record.

Proceedures for Decision-Making

One of the most striking differences between the two countries is in the area of procedures for decision-making. In the United Kingdom the question of what procedures the agencies will follow and how open they will be is left almost entirely to the regulator's discretion. (The same is true of governmental powers.) The practice of the Office of Telecommunications (OFTEL) is outstanding as the Director General has made a commitment to be as open as possible in his decision-making and has implemented this in various ways, such as publishing his advice to the Secretary of State, issuing consultation papers and treating responses as being on the public record unless respondents specifically ask otherwise. This is admirable practice, but it depends on the inclinations of a particular Director General. By contrast, the Office of Gas Supply has not been as forthcoming, although this should not be equated with a lack of pro-competitive vigour.

In the United States procedural matters have always had a high profile. In part this is because of the 'due process' clause of the Constitution which forbids the taking of life, liberty or property without the due process of law. In the field of utilities regulation this was interpreted as meaning that, before setting rates for utilities, agencies had to told a trial-type hearing at which the relevant issues could be discussed. More generally, the question of procedures for agencies became wrapped up in questions about their legitimacy. In order to ensure some consistency in decision-making a federal (there are now state equivalents) Administrative Procedure Act (APA) was passed in 1946 which laid down a general set of procedures for federal agencies to follow. The APA broadly divides decision-making into adjudication and rule-making. The provisions for rule-making specify that notice must be given of proposed rules, that public comment must be accepted and that reasons for decisions must be given. Most interesting is the way that these rule-making provisions have been developed by the federal courts and Congress. Essentially what they have tried to do is create a half-way house between trial-type procedures and informal rule-making, so-called 'hybrid rule-making'. The idea is to place the agencies' reasoning process in the public domain, to try and ensure that it responds to comments, that its decisions are based on the evidence before it and that they are properly reasoned. The only real equivalent we can find in Britain is in relation to land-use planning. Nor should we forget that the American agencies operate under the Freedom of Information Act and supporting legislation, the British position being almost entirely the opposite.

Consumer rights of redress

The other interesting area is that of consumer rights of redress and input into the decision-making process. In the United Kingdom the consumer is given a minimal place in the institutional machinery. Generally the only thing done is to provide some special procedures for grievance resolution, for example through OFTEL and the Telecommunications Advisory Committees. Only in gas is there a body which exists specifically to represent the consumer interest, the Gas Consumers' Council, which has the potential to make an input into broader, policy matters. In fact, the Council has successfully involved itself in campaigns over British Gas' pricing policy to industrial customers and

on disconnections. Within the United States, perhaps because regulation is seen much more as an adversarial process, demanding a balancing of interests, there has been much more interest in institutionalising a consumer voice. This has been done in numerous ways. In some states there is an Office of Peoples' Counsel with a specific mandate to represent the interests of domestic consumers in utility regulation. Sometimes this function is undertaken by the Attorney-General's office, as in Massachusetts. An alternative is provided by California where the agency has created a Division of Ratepayer Advocates, whose sole job is to represent the consumer viewpoint, domestic and commercial, in proceedings, as well as a small Public Adviser's Office with the job of helping people participate in agency proceedings. There are also numerous examples where complaints are taken much more seriously and fed into the policy process.

We might end by observing that in functional terms the systems on both sides of the Atlantic are coming closer together because, in the United States, there is great interest in adopting some variant of the British price-cap system. Although consumer representatives have expressed great scepticism about this, the Federal Communications Commission's rule-making procedures involved comment from over 80 private parties, as well as government entities and resulted in more than 6,000 pages of testimony. By contrast, the negotiations between the Department of Trade and Industry and British Telecom on the details of the first price-cap were treated as a private matter and the Post Office Users' National Council, representing the consumer interest, was not allowed to participate. If the Americans can learn from us in terms of regulatory formulas, we can surely find lessons from America for the accountability of public bodies.

Note

The research on which this short piece was based was partially funded by the Economic Research Council, to whom a grateful acknowledgement. The support of the American Embassy, the University of Sheffield Research Fund and the Society of Public Teachers of Law is also gratefully acknowledged.

THE EDWARD HOLLOWAY COLLECTION REVIEW

***Economic Tribulation* by Vincent C. Vickers.**
The Bodley Head 1941

The book opens with the following 'NOTE' by Mr Vickers' daughter:

> "Vincent Cartwright Vickers was born on the 16th January 1879, and educated at Eton and Magdalen College, Oxford. He was a Deputy Lieutenant of the City of London, a director of Vickers, Limited, for twenty-two years, and a director of the London Assurance from which he resigned in January 1939. In 1910 he was made a governor of the Bank of England, and resigned this appointment in 1919. Later, he became President of the Economic Club and Institute.
>
> He died on the 3rd November 1939 after a long illness during which, against time and with failing strength, he was working and writing on economics. A few days before his death he wrote: 'My keen desire to help up to the end has been the sole incentive which still enabled me to carry on perhaps a few weeks longer.'
>
> It has therefore been my privilege to arrange my father's papers into the book which he laboured to finish, and which represents only a part of his ceaseless work towards national and international economic stability and his single-minded convictions of its attainment." Wilma Cawdor

Anyone who is seriously concerned about the continuing problems of poverty, unemployment, debt and human suffering, in spite of increased knowledge and productivity, must also be concerned about the inability of experts to solve these problems, or hold serious discussions on the subject.

We boast about our freedom of speech in Parliament, and in the press, but this is a myth, because very powerful interests are well served by the present system. Vincent Vickers had the courage to explain the truth about these matters in clear language, and reveal to future generations the way of escape from ever increasing debt, both national and international.

We are privileged to possess the most wonderful means of communication in the world's history, but see declining standards of life for millions of good people, primarily because the *message*, according to Vincent Vickers – and many others of that kind – conflicts with vested interests and is therefore unsuitable material for the press, radio and T.V. 'Democracy is in danger for the very reason that democratic government itself is subservient to sectional interests which control finance, and which have it in their power to inflict a financial crisis upon the nation should they anticipate legislation inimical to their own particular interests.' (E.T. page 58). It is to the credit of the Economic Research Council that it has continued to support these views.

In addition to *Economic Tribulation* Vickers published in 1936 an excellent 30 page booklet entitled *Finance in the Melting Pot Reform or Revolution?*, in support of the Petition to His Majesty the King for the establishment of an Official Enquiry into the causes of poverty and other evils of our society.

A.M.W.

THE ERM ILLUSION

By Douglas Jay and 16 other members of the Labour Common Market Safeguards Committee. Published by the LCMSC and available, price £1.20 (inc. P&P) from the LCMSC, 72 Albert Street, London NW1 7NR.

This is a mercifully short and admirably comprehensive statement in simple prose of the case against UK entry into the European Monetary System as currently envisaged. It also notes the Labour Party's 4 'conditions for entry' - adherence to which would, of course, fundamentally alter the present arrangements.

The main point of the argument is contained in the following passages:

> "A new fallacy, however, has grown up in recent months, which needs to be exposed. This is the illusion that balance-of-payments problems can be spirited away if everyone adopts a single currency. But they cannot. A single currency does not abolish a real payments deficit. It transforms it into a different guise, in this case the transformation of the deficit country into a depressed area. If for instance under a multi-currency system, the UK is in deficit with Germany, balance will be achieved by the sterling rate falling against the mark. If there is a single currency, more and more UK enterprises will find their money costs too high to compete, and will shed labour or close down. This has been the fate of N. Ireland over the last fifty years. If N. Ireland had had a separate currency to depreciate against sterling, it would probably have had no higher unemployment than Scotland or Wales over that period. Naturally, a strong-currency country like Germany likes to manoeuvre its weaker competitors into this awkward corner, by political propaganda if necessary.
>
> "The wise course, therefore, for the UK today is to retain its control over exchange rate policy, to use intervention by the Bank of England to smooth out speculative movements as it has done usually with much success since the end of 1931, to encourage co-operation between world central banks, and to aim for the maximum long-term flexibility as well as the maximum practical short-term stability. The exchange rate would then be a genuine means to growth, higher living standards and high employment and not an end in itself.
>
> "And there is an even more fundamental issue ever more plainly involved in this controversy: whether the British Electorate and Parliament are to retain the power to determine their own internal economic policy and so their people's living standards. The reality of this issue is proved by the preposterous suggestion now being actually made that final power over economic policy in the W. European democracies should be handed over to a group of central bankers. So we are asked to return at the end of the 20th century to the days when Mr Montagu Norman claimed the right to decide Britain's economic, and often foreign policy without 'interference from the politicians'.
>
> **So it is not merely standards of living that are at stake in this issue, but also not far beneath the surface, the right of the people in modern Western democracies to govern themselves."**

In addition the pamphlet describes the historical context, Germany's position within the E.R.M., the system's deflationary bias and the proposed voting arrangements.

Conservative Party students may be content to listen to Alan Walters and Nicholas Ridley, but for the rest of us, the pamphlet is a most timely and valuable contribution to the debate.

J.B.

LETTERS

A response to *Popular Inheritance* by Mr Gavin D.R. Oldham, from Mr Anthony Cooney

Dear Sir

As a 'Distributist' I was greatly interested in Mr. Gavin D.R. Oldham's article 'Popular Inheritance'. It would certainly appear to provide a mechanism for the wider distribution of property. Piquancy was added to his argument by a statement attributed to the leader of the Japanese Communist Party during a T.V. programme on Japan. One of those taking part, commenting upon the compulsory break-up of the large estates and the sale of farms to the tenants, said that the Communist leader had told him that it would make his party's programme of land nationalisation 'very difficult.'

However the proposal to re-distribute inheritance tax/capital transfer tax by means of bonds leaves untouched the problem of the real concentrations of capital in the hands of the Multi-nationals and native joint stock companies. As these 'legal persons' never die, they do not generate any inheritance tax. Equally they are in the happy position of adding any capital transfer tax onto the price of the transfer. Whenever we are considering any scheme to achieve 'justice' by means of taxation we must not lose sight of two facts:

a) ALL taxation is paid by ultimate consumers

b) ALL taxation is inflationary.

But why must we always think in terms of taxation? Is it *ultra vires* of the sovereign crown to issue 'Coming of Age Bonds' without first garnering the 'money' they represent through taxes? The issue of such bonds would be a creation of money - debt free money in this case - but two things must be borne in mind. The new money would represent investment in capital production, not consumer production, and it would not pass through the costing system of industry and therefore would not be inflationary.

Distributists have been slow to grasp the fact that it is the present debt-system of monetary creation which centralises and concentrates ownership. There can be no large-scale and successful distribution of ownership without a reform of the monetary system.

Anthony Cooney
Rose Cottage, 17 Hadassah Grove
Lark Lane, Liverpool, L17 8XH

Further responses to the review of *Monetary Analysis* from the author Mr T.B. Haran and from Mr Eric de Mare.

Dear Mr Bourlet

Perhaps I may be allowed to make some comments on the issues raised by Mr Christopher Havergal and Mr Geoffrey Gardiner in their letters in the Summer 1990 edition.

I welcome Mr Havergal's support for my contention that the only way to cure inflation is to cut remuneration. However, it involves all, and not just industrial, remuneration. Moreover, my proposals include progressively larger cuts for higher incomes. Readers should, therefore, refer to my letter in the Winter 1989 edition.

Clearly Mr Havergal's main purpose is to make his points in regard to leadership. However, he concludes that cunning monetary engineering is not a viable alternative to good leadership.

These two issues are ways of improving the economy. They are not in opposition and cannot, therefore, be alternatives. In any event, my proposals are not cunning monetary engineering, but practical suggestions as to how the damage done by continuous rounds of wage and salary increases can be repaired. The alternative is to blunder on as usual.

Good leadership can only flourish in the right environment and cannot, for example, save businesses unable to contend with high interest rates, even when they are otherwise sound. My proposals would, inter alia, reduce interest rates dramatically.

I appreciate Mr Gardiner's kind remarks in regard to my book, but would like to make it clear that his bank did not create the money which financed the purchase of his house during the period from 1956 to 1989.

A loan has to be kept in existence until the borrower is ready to repay it. Suppose that Mr Gardiner had borrowed the money from a friend. It would be clear that **for every day** of the loan the lender was giving up the purchasing power gained by the borrower.

In the real situation, the principle was the same, but it was the purchasing power not being used immediately by many and changing depositors, which financed Mr Gardiner's loan. The bank received a continuous supply of new deposits, which more than replenished those spent. It used whatever percentage of them was necessary **on a daily basis** to cover its advances. One might say the Mr Gardiner had many more friends than he was aware of!

Money is a credit **in services** of one party and a debt **in services** of another. Consequently, it is intangible and banks can only deal in titles to it. They cannot, therefore, create money by lending.

The banks are debtor parties, having **spent** in purchasing assets money raised from the public. They create more money when they spend on creditor services and destroy money when they receive income from creditor parties. Thus, the position is exactly the same as with any other debtor party. No party can create money by lending.

A bank will issue a draft for a house purchase transaction. 'Drafts Issued' account is credited with the sum involved and an account in the name of the borrower is debited. The money supply appears to have been increased, but this is not the case, as the borrower could return the draft. Money is only created when he **spends** the proceeds on purchasing the house and the bank does not lend the funds until the draft is presented for payment.

In the same way, cheques creating (or destroying) money are issued before banks are called upon to pay them. Thus, money is created **outside** the banking system; its creation precedes the lending.

Mr Gardiner maintains that one bank on its own increased the money supply by £41 *billion between 1st January 1988 and 31st December 1989. This figure is, of course,* staggering, but it should be clear now that the bank did not create that amount of money supply. An average pay increase of say, five per cent, causes a large increase in the real money supply, since most of the additional payments are made by debtor parties to creditor ones. This fact and the depreciation in the value of the currency reflect in both bank deposits and advances. It should be remembered, too, that trying to measure the real money supply by adding cash and bank deposits gives grossly exaggerated and meaningless figures for the many reasons mentioned in my book. In any event, it is the depositors who help, however unwittingly, to advance consumption, even up to twenty-five years, while the banks simply provide the expertise.

We will not be able to cure our economic difficulties until we recognise that banks **cannot** create money by lending and that the sole cause of inflation is the practice of recouping pay increases from higher prices.

T B Haran
'Grianan', 23 Orchard Road
Bromley, Kent BR1 2PR

Sir,

In his letter you printed in your last issue Mr. T.B. Haran declared that Velocity of Circulation is a myth. There he is right, but he is wrong in stating that banks 'cannot create money by lending'. So he raises two questions of the utmost importance to us all for which we urgently need clear answers: Where, and how, does money come into existence? That banks do create money by lending, writes Mr. Haran, is the 'popular belief'. In fact, the popular belief is that banks merely lend their deposits, making their profits by charging their borrowers a higher rate of interest than they pay their depositors. But that is not true either. The truth is that banks create credits up to thirteen times the cash value of the money that has been deposited with them. Thus by manipulating an all-powerful abstraction at almost no cost to themselves they own and control the world - its real wealth, its governments, its industries and its peoples.

The fraud began some centuries ago when the goldsmiths of Lombardy found they could issue more receipts for gold than the actual gold they guarded in their vaults, such receipts being used as a form of paper money. It was a confidence trick then and so it remains - a trick so monstrous that very few people have dared to question it, even though the effects of the system have been, and will continue to be, disastrous. Indeed

the fate of humanity may well depend on whether or not the egregious costing error that results from the monopoly of credit is going to be tolerated in the near future.

My book of revelations, 'A Matter of Life or Debt', provides some sixteen authoritative quotations to support the fact that the commercial banks of the world create money out of nothing. Here are four of them:

'The Bank hath benefit of interest on all monies it creates out of nothing'. - William Paterson, founder of the so-called Bank of England.

'Every bank loan creates a deposit' - Reginald McKenna, Chairman of the Midland Bank and Chancellor of the Exchequer, in 1924.

'Banks create credit. It is a mistake to suppose that Bank Credit is created to any important extent by the payment of money into the Banks.' *Encyclopaedia Britannica.*

Lord Stamp, a Director of the Bank of England in a speech he made shortly before his death in 1940, admitted that 'banking was conceived in iniquity and born in sin. Bankers own the earth; take it away from them but leave them with the power to create credit, and, with a flick of the pen, they will create enough money to buy it all back again.'

This matter is of the utmost moment and it is time more people of integrity, responsibility and courage said so in public. We will continue to ignore the truth about money at our peril, for, until we do our money sums correctly so that what is physically possible can be made financially possible by equating purchasing power and prices, nothing in human affairs can possibly thrive. After all, money isn't wealth.

Eric de Maré
The Old Chapel,
Tunley, Nr. Sapperton,
Cirencester, Glos. GL7 6LW

ISLAMIC ECONOMICS – A CALL FOR PAPERS

The ERC has received an invitation from the International Islamic University, Malaysia to submit a paper or papers for their international conference to be held during August 1991.

A fundamental difference between 'Islamic Economics' and the Western contemporary scene is their determination to avoid the use of interest payments and substitute forms of profit sharing. There are therefore important implications for monetary policy involved, of great interest to the ERC.

Suggested titles for papers include 'Islamic position on deficit financing through money creation' and 'Policies for minimising domestic debt burden on an economy from an Islamic perspective'.

Further details for any members who would be interested in submitting a paper on behalf of the ERC are available from the Hon. Secretary.

NEW MEMBERS

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

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

OBJECTS

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

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

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

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

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

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

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

BENEFITS

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

SUBSCRIPTION RATES

Individual members	£18 per year
Corporate members	£50 per year (for which they may send up to six nominees to meetings, and receive six copies of publications).
Associate members	£10 per year (Associate members do not receive Occasional Papers or the journal 'Britain and Overseas').
Student members	£8 per year
Educational Institutions	£35 per year (For which they may send up to six nominees to meetings and receive six copies of publications).

APPLICATION

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

APPLICATION FORM

To the Honorary Secretary
Economic Research Council
Benchmark House, 86 Newman Street
LONDON W1P 3LD.

Date ....

APPLICATION FOR MEMBERSHIP

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

This application is for *(delete those non-applicable)*	Individual membership (£18 per year)
	Corporate membership (£50 per year)
	Associate membership (£10 per year)
	Student membership (£8 per year)
	Educational Institutions (£35 per year)

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

NAME OF ORGANISATION ....
(if corporate)

ADDRESS ....

....

....

PROFESSION OR BUSINESS ....

REMITTANCE HEREWITH ....

SIGNATURE OF APPLICANT ....

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

AND SIGNATURE OF PROPOSER ....