BRITAIN & OVERSEAS

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

Winter 1990 — Vol. 20, No. 4

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

THE FUTURE FOR ARAB BANKING AFTER THE INVASION OF KUWAIT

*A contribution by Mr Stephen Timewell, Assistant editor of 'The Banker' following his talk to members of the Economic Research Council on the 18th September 1990.**

Saddam Hussein's invasion of Kuwait has not only changed the shape of Arab politics for years to come, it has also crushed the life out of what has become known as Arab Banking. In the 1970s the enormous petrodollar growth spawned a massive development of financial institutions. By the 1980s the Gulf states were producing oil and banks at a great rate and the dream of becoming both an oil and a financial superpower appeared to be nearing reality.

The world's appetite for syndicated borrowing gave infant Arab banks an instant entree into international markets, and, funded by huge oil surpluses, the concept of Arab banking was born. The rest of the 1980s, however, told a different story as Arab banks began to realise they needed more than just surpluses to create a successful banking industry. It was a tough period. The oil surpluses dried up and much of the free-for-all lending of the boom times, to both international and domestic borrowers, turned sour.

Like many international banks, Arab institutions have worked themselves through a wave of loan loss provisioning in recent years, but with the end of the Iran-Iraq war and better prospects for regional economies they have been of late slowly beginning to feel more optimistic. The invasion, however, has turned the tide of this optimism and exposed many of the underlying weaknesses inherent in Arab banking.

While much of the recent financial commentaries have focused on the short-term impact of the crisis, the more significant and deeper long-term effects have been largely ignored. Although the trauma and panic of the first weeks of August 1990 should not be understated, the initial withdrawal of funds and cutting of international credit lines are not the only problems facing Arab financial institutions. What is at stake is the survival of Arab banking as it is known.

Says Abdulla Saudi, founder and president of Bahrain's largest offshore bank, Arab Banking Corporation: "What is happening in the Gulf is very serious and is really damaging Whatever the outcome (of the crisis), amicable or otherwise, the damage will not be cured in a few months, but will take years." The key to the future is not just credit and deposits but confidence, and Saddam's invasion has shattered both international and domestic confidence in the region.

In pure political risk terms the illusion of stability within the six countries of the Gulf Cooperation Council (GCC) has been exploded and no government in the region can feel secure. Saddam's attack, however unjustified, has destroyed the fragile political structures that have emerged on the backs of British and French colonialism earlier this century.

In the Gulf the longevity of the small band of ruling families must be in serious doubt.

* The ERC is grateful to 'The Banker' for permission to publish this article.

The overthrow of the Kuwaiti regime signifies an important turning point in the political development of the region and, even if the Emir is reinstalled, change is inevitable. Before the invasion the Kuwait government had reluctantly toyed with a limited form of democracy; if the Al-Sabah get another chance, significant democratic reforms can be expected with similar changes taking place throughout the Gulf. While much could depend on the outcome of the immediate crisis, the region will not be allowed to return to the status quo ante.

Further domestic political upheaval is likely over the coming period, regardless of whether foreign forces remain in the Gulf. Although some prominent bankers in the Gulf forecast that the presence of strong forces will help stabilise the region, many others believe such a presence will have the exact opposite effect and help to undermine the current regimes even more quickly.

Saddam's rape of Kuwait has forced Arabs to address the sensitive political issues they have preferred in the past to either ignore or fudge. Riyadh bit the bullet and accepted US and other foreign non-Arab troops on its soil. Arab states are now forced to confront much of the hypocrisy surrounding Arab nationalist rhetoric. Unwittingly Saddam has opened a can of political worms and no doubt will prove to be a catalyst for change in the area.

The crisis over Kuwait, however, may only prove to be the tip of the iceberg as other serious anomalies and conflicts emerge in the Middle East to be unravelled. The gross differences between the have's and the have not's in the region and the Palestinian question are only two of many key issues which are likely to come into sharper focus as a result of the Iraqi invasion and the possible resolution of the conflict.

In short, whether the Kuwait issue takes one month, six months or longer to resolve, the region is in for considerable political turmoil in the years to come and there appears little that local or global powers can do to avoid it. While this turmoil may bring positive results, the political risk outlook is decidedly uncertain for some time to come.

In economic terms uncertainty translates directly into higher oil prices. Since August prices have more than doubled and bankers estimate that Saudi Arabia, benefiting from the hikes and an extra 2 million b/d in output, will produce an extra $25 billion in oil revenues this year. The Washington-based Institute of International Finance estimates that prices will continue high throughout 1991 with the OPEC Basket price averaging $25.50 a barrel compared to an estimated $22.75 a barrel for all of last year. Oil exporters, especially those in the Gulf, now enjoy considerably enhanced oil revenues and look likely to enjoy these windfall gains for the foreseeable future.

The question is whether the Arab banks will participate in the bonanza. In early October the Algerians announced that they would use their oil price windfall to clear $600 million in international debt arrears; Abdulla Saudi said the excess funds should be routed through the Bahrain market. With huge increases in defence commitments and aid programmes eating into Gulf revenues it is not clear that Arab banks will be able to reap the benefits. The critical issue is not just the availability of funds but basic confidence in the institutions.

Nothing frightens bankers more than invasions and Kuwait personified their worst

fears. The 2 August attack not only crippled the Kuwaiti banking system but highlighted the vulnerability of all institutions in the region. August was a nightmare for banks and central banks alike. The initial freezing of Kuwaiti bank assets by the West prompted panic withdrawals and a massive drain on bank liquidity. The central banks, openly declaring mutual support, emphasised that no bank would be allowed to fail and used all means to stabilise the banking systems.

Reports of initial withdrawals from GCC banks ranged as high as $15 billion or more, the equivalent of around 15%–20% deposits, but exact figures are unlikely ever to be known as government deposits in many cases were brought in to massage the totals. In the UAE early reports suggested that banks had lost as much as 25% or more of deposits owing to the fact that less than 30% of UAE residents are nationals. The UAE Central Bank insisted, however, that only 5.6% of deposits were withdrawn taking the total from Dh68 billion at the end of July to Dh64 billion on 15 August.

By the beginning of September central banks were pushing the view that withdrawals had stopped and deposits were increasing. The UAE Central Bank spokesman said recently: The crisis is over, the increase in deposit levels corresponds with the increase in economic activity after the summer." Abdulla Khalid Al-Attiya, Director- General of the Qatar Monetary Agency, was similarly positive: "We estimate 10% – 15% of deposits went out of the country initially but deposits are slowly returning." While it appears clear that countries such as Saudi Arabia and Qatar, with larger indigenous populations, were less affected by the withdrawals than the UAE, the overall impact on the banking sector was much the same. The level of withdrawals may have varied but the jolt to confidence was universal and severe.

Central banks can be expected to try and put some gloss on the situation, the UAE Central Bank even took the unusual step of producing a September book of economic statistics to show at the recent IMF/World Bank annual meetings. Few bankers, however, are convinced. The gloom in the Gulf is palpable. Most banks have tried to improve their liquidity as much as possible. Even large, prestige institutions such as Bahrain's Gulf International Bank sold off assets quickly, unloading LDC debt with a face value of $500 million to boost immediate liquidity needs.

Although most agree that the Gulf banks, with the strong support of the banking authorities, have weathered the crisis reasonably well in the short term, the longer term prospects are not that sanguine.

The reaction of the international banks to the crisis was and is an important factor in assessing the future of Arab banking, and especially the survival of the Bahrain offshore banking community. Early on, many banks saw all their credit lines to international banks withdrawn. This almost automatic cut in lines is not an unusual initial reaction by banks to a major calamity such as an invasion but banks tend to return reasonably promptly after assessing the situation and the relationships involved.

The reaction to Kuwait, however, provided a shock. Initial across the board cuts could be expected but it was only after that that Arab banks found out who their real friends were. Many institutions, especially the smaller banks, found that the interbank market had dried up. For those dependent on interbank funding, like some Bahrain offshore banks, the prospects were grim.

The UK banks, with the exception of Midland Bank in some cases, and the Swiss maintained their traditional strong links to the region. To the surprise of many, the US banks, usually the first to jump ship, kept up support. In terms of lines, the major US banks, such as Citibank, Manufacturers Hanover Trust and Bankers Trust, made a conscious effort to be seen to be backing the area. Says Shaukat Aziz, Citibank's regional head for the Middle East: "We have supported our relationships all over the region and we intend to continue to do so."

The Germans and the Japanese, however, were not so supportive and have clearly damaged relationships. Deutsche Bank cut lines to the biggest banks in the region and had failed to reopen them by October. Bankers were puzzled by Deutsche's move considering the volume of German business in the region but concluded that the bank may be focusing on unification and Eastern Europe and had written off the Middle East. The Japanese, however, provided the greater shock from the crisis with an almost blanket withdrawal from the region.

All Japanese institutions cut their lines throughout the Gulf and most were still out in October. Bankers as well as central bankers were surprised and angry at these institutions that have always prided themselves on their long-term commitments. Abdulla Al-Attiya, head of the Qatar Monetary Agency, was incensed: "Japan is the top exporter to Qatar so it should show some commitment to the area, there is no excuse for the Japanese not coming back after the second week (of the invasion)." The authorities were so upset that the GCC central bank governors formally asked for an explanation from the Bank of Japan. They appear to have been ignored. Japanese Banks, however, appear prominently on a "black list" being compiled by the GCC central banks on institutions that have proved unhelpful during the crisis. Al-Attiya noted that some institutions in Tokyo even refused to accept deposits.

Why have the Japanese deliberately shunned the institutions in the Gulf? The decision appears to have come direct from the government. Bankers and other Japanese working in the region were effectively ordered to leave by their embassies. Masayoshi Takatsuchi, managing director of Daiwa Middle East in Bahrain, said the Japanese embassy issued a letter on 9 August and the 50 Japanese staff of the nine Japanese financial institutions left the following day. Daiwa's Bahrain subsidiary, as with others, was manned by Bahrainis with key decisions being made in London or Tokyo. Whatever their reasoning, the Japanese have seriously damaged their reputation in the Gulf which is extremely puzzling since the region is Japan's largest supplier of oil and most of the Japanese institutions have spent a lot of effort on building long-term relationships.

While the crisis has shown that some major banks will still support the area it has also opened up new doubts and reinforced previous trends. The Bank of America closed its Bahrain branch on 22 August, not as a direct result of the invasion but due primarily to the decline of Bahrain as a cost effective financial centre (see Bahrain).

What are the prospects for Arab banking given the volatile political outlook in the region and the difficulties facing banking worldwide? In discussing challenges, Mustapha Serageldin, Chairman of the Arab Bankers Association, says: "One of the problems of Arab banking is that there is no real Arab marketplace in the way we talk

about a US, a Japanese and now an emerging European marketplace ... as a result the banking industry has remained indigenous to the country where it has been established. Arab banks, generally, have operated within their country of origin and have looked to Europe because trade flows went that way and also to place occasional surplus funds." After the invasion the concept of a real Arab marketplace looks even more remote.

Inter-Arab trade was increasing but had not exceeded 10% of total Arab trade. The disruption caused by the invasion along with the crippling of the Kuwait-based Inter-Arab Investment Guarantee Corporation has thwarted the development of inter-Arab trade and investment flows for possibly years to come. Also one of the most sophisticated financial centres, Kuwait, will take years to rebuild even if there is the will and capacity to do so.

On the international front, few Arab banks seem willing to comply with the necessary regulatory requirements and to compete aggressively in foreign markets with a variety of products. The issues of disclosure and the application of Basle capital ratios had already forced many institutions to reconsider their international roles.

Even some of the strongest, such as Saudi Arabia's National Commercial Bank, continue to take individual stances and ignore global mores. While banks such as Bahrain's Arab Banking Corporation and Investcorp have taken a determined international position, few others have the expertise or capability to stretch beyond their regional specialities.

In the immediate future, banks in the Gulf will have to face the fact that the damage has already been done and no resolution of the current crisis will provide a ready panacea. The flow of future business will be significantly different from that expected earlier this year and banks will be forced to restructure to handle the slowdown in private sector and investment banking activity. While governments, particularly Saudi Arabia, were hoping that the private sectors would help take over as the engine of the economies, the invasion has stymied the prospects for private direct investment. Although some bankers remain optimistic that the end of the crisis will bring with it a reconstruction boom in Kuwait and new opportunities for banks, most seem resigned to a gloomy picture ahead with a return to the complete dominance of public sector spending.

Central bankers now believe bank mergers are more likely than ever before. The UAE central bank, which supervises 47 banks (including 19 domestic banks) and has unsuccessfully pushed for mergers for years, says: "We had 3–4 weak banks before and the crisis has expanded those weaknesses." In discussing the Gulf, Sheikh Salem al-Sabah, governor of the Kuwait Central Bank, adds: "I think we have to stop here and think a lot about our experiences over the last six years, there are a lot of institutions in the area and perhaps the monetary authorities should think of reducing the number to produce bigger and more efficient institutions. It is better to merge a lot of these banks for their own sake and for the regional economy."

In Bahrain, the authorities will be reluctant to see the demise of the offshore banking centre but fundamental questions were already being asked about the rationale behind some institutions.

For those Manama institutions with strong international links, such as Arab Banking

Corporation and Investcorp, the maintenance of Bahraini registration must be of some concern. While both have their roots in the Gulf their business focus is outside; for ABC only 17.4% of its $22.4 billion in assets is in the Middle East with 8% in the Gulf. After a share issue earlier this year ABC is well on the way to establishing a new subsidiary, ABC Europe, to be incorporated in Europe. Both institutions are committed to their strategies and their shareholders and pure business considerations may dictate that they limit the risks of having a Bahrain base and shift their official registration to a safer address.

For Kuwait banks the future is a long dark tunnel but some light is possible. The National Bank of Kuwait is operational and although a transplanted NBK in London is only a fraction of its former self, a new structure may help enable the government in exile and Kuwaiti citizens to function better until a political solution for the country can be found.

Entering the 1990s the outlook for Arab banking is hugely different than it was a decade ago. While Arab oil remains a major international force, Arab banking has virtually disappeared as a concept. The fact that money is global and depends on confidence is a key reason why a volatile Arab world has largely failed to turn its oil resources into a major financial force. Arab banks will continue to play an important role in their particular regions but any broader role is extremely unlikely except in a dwindling handful of cases.

WHAT ABOUT DEVALUATION?

By Professor David Bell

Britain is now suffering from recession, high unemployment and a large Balance of Trade deficit. Present inflation levels could be described as modest, though worrying.

To overcome these problems it is now commonly – and rightly, acknowledged that a complex pattern of measures, both long term and short term, will be required. In the long term matters of training, education, social values, government-industry relationships and general trading conditions etc are all important. In the short term matters such as inward direct investment, the vagaries of credit expansion and political expectations are important. But for both the long term *and* the short term exchange rate policy is surely crucial.

Britain now seems intent on abandoning any use of changes in the exchange rate as a policy option and on using high interest rates as the sole variable to control the entire economy. These two points are of course inter-related. The policy of using high interest rates to reduce *all* economic activity is reminiscent of the use by dentists of yester-year of 'laughing gas' as an anaesthetic: it worked on the basis that the patient lost consciousness before being asphyxiated and if the patient began to turn blue it was time to turn off the gas. In the process of 'anaesthetizing' the economy high interest rates attract foreign short term deposits (otherwise known as 'hot money' or 'foot-loose capital') which help finance the current account deficit.

This situation is unsustainable. If an annual deficit of £20bn runs on for several years, one needs £20bn, £40bn, £60bn ... of short term deposits, on all of which high interest rates must be paid if further funds are to be secured. These interest charges first cut into 'invisible' earnings and eventually will need to be paid for out of a trading *surplus*. Devaluation, though delayable, is unavoidable.

Given the choice of devaluation later, after anaesthetic or devaluation now with fluoride, an improved diet and regular check-ups, it would seem pretty sensible to reconsider the latter. No doubt the Treasury could produce much more accurate figures on the interactions of any change, but the following gives some indication of the factors involved. In 1989 visible imports had a value of £120.8bn whilst exports amounted to £93.6bn, leaving a deficit on visible trade of £27.2bn – compared with GDP of £350.7bn. The ratio of imports to exports was thus 1:1.29 but if a devaluation increased export volumes as well as reducing import volumes then the appropriate devaluation would be much less than 29% and there should also be an adjustment to take account of 'invisibles'. In addition to any exchange rate benefit to invisibles there could also be a saving on interest charges to depositors from overseas. So perhaps 12% or 15% is a possible guesstimate of the appropriate devaluation.

It is surely a tragedy that suggestions for devaluation and reduced interest rates designed to stimulate investment, output and exports tend to be written off in the present political climate as merely 'inflationary'. This need not have even a grain of truth given appropriate fiscal policies – and in any case tends to mask the much wider context in which such decisions should be taken.

This wider context was put very well in a recent letter to the *Financial Times* by Austin Mitchell M.P. He pointed out that

"In a (international) market economy competitiveness is determined by price and nothing else. Every "non-price" factor of production has to be paid for like every other factor and its cost (plus a full margin of profit) recovered in the price if the firm is to remain competitive.

"The record shows that the huge increases in the German share of world trade after 1948 and in the Japanese share after 1952 were based on an invincible combination of low export prices and very high export profit margins. That made economic sense when they were rebuilding but because the Bretton Woods system lacked the symmetry imposed by the international gold standard before 1914, there was no way in which Germany and Japan could be stopped from pursuing beggar-my-neighbour policies once they had rebuilt.

"That impediment was removed in 1972. When the dollar fell in 1971–3 and again in 1976–78 German and Japanese exports took a hard knock. That is why the Germans agreed to the European Monetary System and why they are now so anxious to consolidate their present advantage through a single currency. That will achieve from economic aggression what they have twice failed to achieve militarily. Tied to an appreciating D-Mark other member countries will in effect pay reparations to third countries for the economic damage the Germans have inflicted.

"A marked change in the value of sterling has invariably been followed by a marked change in the UK share in industrial countries' exports of manufacturers in terms of volume, falling 12 percent in 1970–74, rising 2 percent in 1974–77, falling 22 percent in 1977–81 and rising 11 percent between 1981 and the first quarter of 1987. Since then it has begun to fall despite a huge increase in the import content. The loss since 1977 of £32bn of trade and 2m UK jobs in manufacturing can only be attributed to the increase in the value of sterling.

"In the absence of government intervention, the international division of labour is determined by the law of comparative costs in international trade. Provided the exchange rate is correctly positioned, every country can balance its overseas accounts in conditions of full employment at a high and sustainable rate of growth. We must reduce the exchange rate to a competitive level so that the relative earnings of shareholders and their employees in manufacturing can rise by at least 15–20 percent to solve our problems. That in turn will require a completely new fiscal, monetary and exchange rate approach to enable us to combine internal growth with external equilibrium."

Nigel Lawson said of high interest rates that "It worked before so it will work again." Yes, indeed. We are now in the later phase of the third successive go-stop cycle: is it not time to examine the possibility of doing something different?

EUROPE OF MANY CIRCLES: CONSTRUCTING A WIDER EUROPE

By Sir Richard Body *Published by New European Publications 1991* Price £14.95

There have always been subtle shades of difference amongst those who have opposed the alliance of naive M.P.s and dedicated federalists who marched Britain into the continental embrace of 1972. At one extreme were the jingoistic British nationalists of Scottish, English, Northern Irish and Welsh varieties who more often than not alienated others from their cause and contained within their ranks virtually no politicians of note. Next to them in purpose but vastly differing from them in philosophy and method were those who declared that Britain had its own furrow to plough and that this might well be co-ordinated with continental developments but otherwise our attitude should be one of disinterest rather than combat. This group was and is led by such as Enoch Powell, John Biffin, Peter Shore and Christopher Frere-Smith. For them, the idea now of fighting for reform on an anti-EEC platform from within the EEC is simply to allow themselves to be used to do the 'dirty work' of the pro-marketeers. Mostly they see the true anti-market role today as one of standing aside and devoting their energies more usefully elsewhere whilst recognising that the European train is simply gathering speed on its journey into collision. Yet a third group including Harold Wilson, Margaret Thatcher and George Thomas (now Lord Tonypandy) appear to have begun as naive supporters but have become informed – and eventually alarmed. But there is a fourth group amongst those who have raised their voices against Edward Heath, Geoffrey Howe and the 'gang of four'. These are a group who foresaw the dangers, recognised the problems but who saw from the outset the need for opposing voices to provide a rudder for Britain's passage into her "inevitable" continental entanglement. Functionalist rather than federalist and liberal rather than corporatist they have, in effect, sought 'the best of both worlds'. Nicholas Ridley voted many times 'for' entry and yet appears (and is) a strident opponent of developments today. Teddy Taylor has displayed the most remarkable persistence and consistency in his long standing critical stance of Brussels – and yet actually voted, under pressure from the whips, with the Heath government on the closest vote of all on the European Communities Bill in 1971. It is to this last group – though he never, to my knowledge, voted for anything pro-EEC, that I feel we should now assign Richard Body. Just as Nicholas Ridley now argues that "we are getting what we want out of the EEC," so Richard Body along with the Centre for European Studies sees campaigning for EEC reform and change rather than the clean cut of withdrawal, with faith in our ability to devise something better from a fresh start, as the practical way forward. Personally I have great respect for this 'Bruges Group' view though I cannot join wholeheartedly with it.

In *Europe of Many Circles*, the fourth in his magnificent series of books which have done so much to create that ever growing body of politicians and others whom I categorised above as 'informed and alarmed', Richard Body moves away from his more familiar role as commentator on rural and agricultural affairs to the central themes of constitutional development. The chapter headings define the theme. After discussion of membership, constitutional choice, the link of freedom to diversity and appropriate size for economic success, the headings read 'Customs union or Free Trade Area', 'Some overlapping circles', 'Circles of conflict', 'Pragmatic Europe', 'Churchill's Vision', 'Towards a wider Europe' and finally 'Europe on a Human Scale'.

Throughout the book the arguments are spelled out with pungent accuracy and the depressing implications of developments to date stare up at one page by page. One certainly has to admire, from whatever viewpoint, the fortitude of a writer who can compose at such length and assemble with such diligence such a brilliant account of events and prognostication – whilst remaining cheerful and hopeful (and not suffering a mental breakdown!).

For those whose knowledge of EEC developments has already progressed through curiosity to knowledge and maturity, the ownership of this book should be regarded as a campaign gesture and a welcome decorative addition to the bookshelf. But for those who know little even though they think they know enough; those who are and have always been so susceptible to the simplistic claims which power alone has forced repetitively upon their attention; those who, in the end have more than they can realise at stake, this book should be regarded as a gift from a true friend – and compulsory reading.

The conclusion of this review can be the conclusion of the book itself. "Europe has many overlapping circles. That we are failing to employ the means to identify them and the mechanics to act within them is a sad commentary on how far the idea of European co-operation has moved away from serving the interests of ordinary people."

J.B.

THE EDWARD HOLLOWAY COLLECTION REVIEW

Vested Interests or Common Pool? **by Nicholas E.H. Davenport**
Published by Victor Gollancz, London, in 1942

"A system of gentle exploitation" is the way the British economy is described in Edward Rutherford's *Sarum*, where property ownership, dominant market positions and office holding ensure the constant service of the many for the benefit of the modestly active few. In times of peace, attention is never focused uniformly on change and most of those who count are content to take their 'Danegeld' from the common purse and avoid the moral issues of inequality.

But during war – especially during the 1939–45 war – the anaesthetic of culture, law and custom can be briefly lifted and the question posed anew in sharp relief, "Why should men fight and die to protect somebody else's property, to protect assets given value by the efforts of all but which yield their benefits principally to those who have established claims at another time, in other circumstances?"

Your reviewer has seen no more forthright exposition of this question than in Nicholas Davenport's war time contribution *Vested Interests or Common Pool?* The author scorns war-time propaganda as wasteful, disheartening and divisive urging the government instead to call upon the nation in the name of truth, common heritage and a common goal for the Total War Effort. Chapters 2 and 3 "The Vested Interests at Work and at War" are a superb account of corporatism, of protected producer interests and monopolistic trade unions conniving together at the expense of the weakly organised – especially the consumer. Is the big vested interest, he asks, to be the only form of wealth which is to suffer no irreplaceable destruction of itself in this war? A full named list of the great financial and industrial combinations is given (pp 58–60) together with a merciless exposition of the ways in which war time circumstances were being used to secure private gain and the maximisation of post-war profits. This "seamy side" of the events of the war is the part we have preferred to ignore, but a vital one for those looking for a true account of that time.

Davenport is scornful of Labour Party plans – of nationalisation with Trade Union placement in grey control, he clearly loathes the self interested methods of the Tories whose class interests had proved so divisive during the inter-war period (I.C.I., for instance, comes in for special condemnation), and he has scant regard for the Civil Service Bureaucracy saying (p 129) "The great wen of Whitehall horrified me for a year when I was at close quarters with it. I have no one competent to judge who has said that Civil Service administration is fit to run a business. I have seen incompetent and harmful men retained in their jobs because they cannot be sacked under the canons of Civil Service law. I have seen the stupid blind hand of the Treasury holding up the efficient organisation of an office because of its out-of-date conditions of pay and service. I have seen Committee after Committee wasting time, stupefying thought, stultifying action. The Committee system is an ideal one for avoiding individual responsibility or excusing individual effort. That is why it flourishes like a green bay tree in the sheltered walks of the Civil Service. I often wonder why Civil Servants individually appear so normal and intelligent when they live and move and have their being in mental institutions."

The basis for his proposed solution is "state lease for the entire national capital" and the last one third of the book is devoted to an exploration of this concept. Existing boards of directors and teams of managers would continue but ownership of land, of shares, of the banks and indeed of all substantial assets would be in the hands of the state which would lease them to the highest bidder in the market place. Clearly right for Total War, one nonetheless has doubts about the State's abilities in such vast tasks of estate management in times of peace.

But so much of the book makes lesser points – and makes them with refreshingly clear insight. For example he writes (page 167), "The Engishman's ability and willingness to get his food and materials cheaper than any of his competitors have given him in the past a head start in competition. It is the only advantage that remains. There must be no interference with cheap food and cheap materials". Advocating his scheme for "Common-Wealth" he anticipates current debates when he says (page 154), "Believe me, 'sound money', cheap labour and free trade are not a practicable alternative" and into the debate over excess or under saving he weighs in with the suggestion that under his scheme of banking "You will not receive interest on a deposit account, you will be asked to pay a fee for the safe custody of your money – according to the size of your deposit. This will constitute a tax on hoarding".

For those with open minds and a sympathy for the evolution of ideas this pleasant and honest book will be found to justify its dedication "To all democrats who hate political humbug and commercial privilege, who love free thinking and speaking, I dedicate this war-time essay in constructive, sociological criticism".

J.B.

£ 4000 EACH PER YEAR – FROM AN ENERGY TAX

Introducing a New Concept in Taxation: An examination of proposals for Fundamental Reform. John Dunlop, The Resource Use Institute Ltd., 17 Randolph Crescent, Edinburgh, EH3 7TT. Price £1.00.

Bearing the discouraging title "Introducing a New Concept in Taxation: An Examination of Proposals for Fundamental Reform", the Resource Use Institute has published a fascinating pamphlet by John Dunlop advocating both a change in the tax base and a reform of government transfer payments – social security, unemployment pay, pensions etc. Strictly speaking the two suggestions stand independently – but there are certain synergy advantages in considering them together. The two ideas *are* complimentary.

Most taxes are expensive to collect, haphazard in their effects, and unpopular. The pamphlet lists very plausible reasons for suggesting that a tax on the producers of energy, levied according to the physical energy inherent in the fuel has the minimum disadvantages of all kinds whilst its major side effect –the likelihood of people economising on energy use, is environmentally attractive. Using such a tax it is suggested that many other taxes – poll tax, income tax, even VAT (with EEC permission) could be abandoned. There is certainly something very attractive about just "a few hundred" suppliers of coal, oil, gas and hydro power/nuclear power handling all our correspondence with the tax authorities for us!

Ideas for a guaranteed minimum income without strings for every citizen have been around for some time now. Some have talked of a 'national dividend' and Samuel Britten has suggested that £4000 each could be managed. Here again, there are indeed genuine advantages – to start with over incentives to work and over simplifying benefits of all kinds.

This little pamphlet is valuable because it presents the arguments the politicians and the professors will require to make their case. The surprise is that it is convincing. The disappointment is that it is poorly presented and deserves to be rewritten with a clear title, an opening statement of the propositions, a bold typeface and a political history of the progress in advocating these ideas.

Modern history is about the development of individual rights. The 18th century was dominated by the development of *civil* rights (rule of law etc) and the 19th century with *political* rights (votes etc). The 20th century has been dominated by the development of *social and economics* questions. If simple principles eventually prevailed to clarify developments over civil and political developments, then it just might be that this unimpressive but persuasive little publication points the way towards a clear resolution of much 20th century confusion.

J.B.

LETTERS

A response to *Increased Land Values and Inflation* by John Hatherley from Mr Lawrence Linehan.

Sir,

It was encouraging to find in your summer issue an article advocating land value taxation, a subject barely understood by professional economists. Although I doubt that inflation means anything other than a fall in the value of money, I do support John Hatherley's main proposition. We should all stop and think why it is that we all want low prices except when it comes to property.

A land tax would discourage the property price spiral and encourage the banks to fund wealth–creation, but as things are industry, and small firms in particular, has to rely on loans secured by property assets unless funds can be raised through share issues.

Since property is prime collateral it follows that most so-called loans to industry are effectively investments in real estate, with lender and borrower conspiring together to boost property prices. In the result we all have to pay large fees merely to gain access to homes and workplaces, with farmers and businessmen forced to reflect these access fees in their prices, and so the upward spiral continues on remorselessly. Moreover, while everyone contributes to land appreciations, only the few reap the harvest – mainly the financial sector which, apart from invisible earnings, creates no wealth at all.

The way to get stable prices is to bring down access costs by way of an annual land value tax and in the process return to the people what is rightly theirs anyway.

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The Work of the Economic Research Council – 50 years on A contribution from the Duke of Montrose.

Sir,

Day after day we read in the papers of the burden of interest upon the National Debts of all countries. Since its inception as the Economic Reform Club it was I believe the principal object of the ERC to seek ways and means of releasing into the monetary systems of the world such additional chips, counters, cowrie shells, cash or credit, call it what you will, that facilitate the exchange of the product of one man, or one Nation's labour for that of another.

Over recent years the ERC's magazine, Britain and Overseas has seemed to forget the above objective: indeed rather to obfuscate the whole issue with would be esoteric conundrums and calculations so that I was on the point of resigning when a couple of days ago your Autumn 1990 issue arrived.

With the not uncommon bad habit of thumbing through a casual magazine from back to front, so I began and got a pleasant surprise.

The last item "Islamic Economics" and their "determination to avoid the use of interest", I first heard of seven years ago and I have thought much of them lately as an almost certain casualty of the Gulf Crisis, just as the theories of Dr Schacht went out on the flood of World War II – though I think Germany fought the war without borrowing a "sou" while we piled up unpayable debt plus interest thereon. Then in 1948 when Dr Ludwig Erhart defied the economic theories of the occupation authorities yet coped with the influx of refugees from the East with bombed flat infrastructure facilities and factories. And so it goes on, Japan, Jersey, the Isle of Man but of course none as those who won't see.

Then the penultimate paragraph – a good contribution by Eric de Mare, but, bless my soul, have we still got to persuade our members that the banks create money? He quotes four of his collection of sixteen statements by authoritative sources. I could probably add a few more to his collection. In my own experience as a Minister in Rhodesia when Mr Harold Wilson "et al" cut us off from sterling and the dollar, the Rhodesian Annual Financial Statements showed a regular increase in deposits of all funds. I used to ask Ian Smith and my colleague, the Minister of Finance, "where do you think it is coming from? Did the bank managers and the Governor of the Reserve Bank have it under their beds?"

Then I flipped back another couple of pages and lo and behold, a review of Vincent Vickers' book, Economic Tribulation (1941) with a note by his daughter. So we really *are* back to square one.

Well I personally made my major effort when in the Rhodesian Cabinet, with the support of a few other ERC members. At that time we had a Prime Minister (Field) who would listen and a Secretary of a Finance (Greenfield) who agreed it was all possible but a Minister of Finance (Wrathall) who could not or would not understand. Then we changed our Prime Minister to Ian Smith and he crushed all further discussion on the subject.

I am eighty-three now and not prepared to join in the fight again. The present chaotic situation can only end by complete collapse and a new start.

Duke of Montrose.
Nether Tillyrie,
Milnathort,
Kinross-shire,
KY13 7RW

A response to *Popular Inheritance* by Gavin D.R. Oldham from Mr Lee Cheney.

Sir,

HAS THE VISION BEEN LOST?

It seems to me that since the death of Edward Holloway, the ERC (or "Monetary Reform Club" as it was called in the old days) has lost its vision and purpose for its existence. The original vision was "monetary reform" (as opposed to "tinkering with this or that system"); the purpose for its existence is to provide a forum for open and honest discussion of the monetary reform vision. Prior to the death of Edward Holloway a number of important articles appeared in "Britain and Overseas" which stirred the waters of thought and heated the political waters considerably. Since his death, however, the temper of the Council seems to be less towards focus upon monetary reform and more upon less relevant matters. And when discussion does emerge related to the monetary reform issue, the focus of that discussion seems to be toward the "distribution" of capital rather than toward genuine monetary reform.

The fundamental vision of Major Douglas was, indeed, the vision of "inherited capital" but that vision was not watered down in any way. The original vision of "inherited capital" was within the context of *DEBT FREE* capital. The article by Mr. Gavin D.R. Oldham entitled "Popular Inheritance" (page 12, Britain and Overseas, Vol. 20, No.2) presents a strong case for the importance of the original Douglas vision. However, when Mr. Oldham suggests that "... Government bonds ... be issued ... equally and freely to all ..." the fundamental vision of Major Douglas has been cast to the wind. There is a profound difference between *DEBT* capital and *DEBT FREE* capital. Bonds are, by their very nature *DEBT*. To suggest that the transformation of tax from Government revenue into the re-distribution of that tax will achieve the Douglas objective of "inherited capital" may be appealing to the debt/tax bankers and to those who would be the recipients of such a free gift but the "negative income tax" proposals of Richard Nixon a couple of decades ago would have accomplished the same thing without the pretence that such a tax redistribution constitutes "inherited capital". Merely transferring tax from one group to another Robinhood style has nothing to do with the inherited capital vision of Major Douglas and the original Monetary Reform Club.

Abraham Lincoln created "inherited capital" when he printed the American "greenback dollar" debt free and tax free to the chagrin of the debt/tax bankers. Unfortunately the Lincoln experiment was eliminated shortly after his assassination with the enactment of the 14th Amendment to the U.S. Constitution, which says, "... the public debt ... shall not be questioned .." As long as the debt/tax bankers are left to their own devices of creating "bonds" (debt instruments) as the money base, genuine inherited capital of the kind envisioned by Major Douglas is an impossibility. The "inherited capital" vision of Major Douglas (or "national dividend" as he liked to call it) was *DEBT FREE AND TAX FREE MONEY PRINTED BY THE GOVERNMENT AND DISTRIBUTED DEBT FREE AND TAX FREE TO THE PEOPLE PER CAPITA*. This is a profoundly different vision than the mere re-distribution of banker printed debt/tax money.

It is understandable that debt/tax bankers do not take kindly to the Social Credit vision of a debt free and tax free system of free enterprise. But the ERC has a responsibility to carry on the brave tradition of Edward Holloway and the other gallant men who bravely stood in the face of political heat. With the current trend of "National Socialism" emerging throughout Eastern Europe in those nations that are demanding the constitutional right to print their own money, the need for free and open discussion of the monetary reform issue is needed more than ever, for these nations are demanding the freedom to create their own "inherited capital" ... for the government, not for the people. The idea of "popular inheritance" put forward by Mr. Oldham is a fundamentally important idea but to suggest that "bonds" are the same thing as "inherited capital" betrays the vision of Social Credit.

Social Credit involves *TWO* fundamentally important ideas. The first is that capital must be created *DEBT FREE AND TAX FREE*; the second is that it is *PEOPLE PER CAPITA* who must be the *DEBT FREE AND TAX FREE* recipients of that "inherited capital". To lose sight of either of these two fundamental ideas is to effectively betray the original Social Credit vision put forward by Major Douglas.

It seems to me the ERC has a profoundly important role to play at this particular time in history. The entire world is struggling with the global monetary crisis. Unfortunately, the capitalist world seems to have no use for the vision of debt free and tax free money creation while the communist world seems to have no use for the per capita issue of government printed money. The ERC stands alone as the voice of the original vision of Major Douglas and the global Social Credit movement. Populists around the world are in desperate need of the leadership that, at this point in history, the ERC desperately needs to provide.

The ERC needs to open debate on the "national dividend" question and to have the courage to face the political heat without flinching. That is the stature of the man who took the old monetary reform club into the states of the ERC. I submit this letter for publication in Britain and Overseas in the memory of Edward Holloway and Major Douglas.

Lee Cheney
1415 E. Pecos
HOBBS, NM 88240

The ERC

Neither the Economic Reform Club nor the Economic Research Council have ever regarded themselves as or claimed to be the banner carriers of the movement known as 'Social Credit' founded by Major Douglas. The ERC always welcomed the efforts of the Social Credit movement on the basis of its contribution to the debate on monetary reform but key aspects of its analysis and proscription such as the 'A+B theorem' and the issue of interest free credit without inflation never gained full acceptance by the ERC executive, by Edward Holloway or by the members as a whole. The work of notable past ERC members such as Sir Anthony Vickers, Sir Arthur Bryant, Frederick Soddy, Edward Holloway and many others reflects this independence from the Social Credit movement. I personally witnessed Edward Holloway's annoyance in 1985 when some correspondence the ERC then had with both the Prime Minister and the Centre for Policy Studies was misinterpreted (and dismissed) as "just Social Credit". 'Britain and Overseas' welcomes the continued debate on these issues as a first priority and is grateful for this challenging letter but cannot accept the assumption that the ERC is the standard bearer of 'Social Credit'.

Ed

OBITUARY – LORD (FREDERIC) SEEBOHM

18th January 1909 – 15th December 1990

Lord Seebohm was a Vice President of the Economic Research Council. He was tragically killed in a motor accident, from which his wife died shortly afterwards.

He was a philanthropist of Quaker origins and a banker. He was deputy Chairman of Barclay's Bank and Chairman of Barclay's Bank International. Here he made his principal contribution when the Bank operated mainly in the Caribbean and Africa, which appealed to his concerns for the developing world. He was sorely grieved when the Bank was criticised for its involvement in South Africa; for he detested apartheid and did everything possible to advance the lot of black people in South Africa.

He became Chairman of the Export Credit Advisory Council and became knighted in 1970, when he was High Sheriff of Hertfordshire. He became a Life Peer, Baron Seebohm, in 1972, and sat as an Independent. He was Chairman of the Friends Provident & Life Office.

Lord Seebohm had a lifelong interest in improving society as a whole which he served in many capacities. He was Chairman of the Joseph Rowntree Memorial Trust and chaired a Government commissioned inquiry into Social work. The Seebohm Report (1968) recommended that there should be a central government department responsible for overall planning of social provisions. He was related to the Rowntree family of York where he helped form the York Council of Social Services.

During the Second World War he served in the Royal Artillery, was mentioned in dispatches and became a Lieutenant-Colonel. Amongst the many positions he held was presidency of the Chartered Institute of Bankers and Chairman of "Finance for Industry". This had been set up by the Bank of England and the clearing Banks and was a means for straitened industry to raise £1 billion in medium-term money. He was Chairman of the Overseas Development Institute and of London House; President of the National Institute of Social work, Age Concern, the Royal Africa Society and of Project Full Employ; Vice Chairman of the Volunteer Centre and a Governor of L.S.E. and Haileybury. He was also a director of Merchants Trust, and Gillett Brothers Discount Company.

Apart from his Banking interests and philanthropic concerns, he had many hobbies - playing real tennis and golf, he fished and shot, was a keen gardener and a skilled water colourist, he designed his patterns for his petit point chair seats and screens. He was extremely approachable and interested in all men; his talents had laid in many directions which he used to the full.

Lord Seebohm leaves a son Richard working for the Monopolies and Mergers Commission, and two daughters who are writers.

D.J. McKenzie
January 1991

OBITUARY – WILLIAM A. GUINNESS

9th June 1895 – 3rd December 1990

William Guinness was a founder member of the Economic Research Council. He was an engineer by profession, but was interested in financial and economic affairs and wrote frequently to the Financial Times which published his letters.

He was a loyal and conscientious member of the Council and attended its functions more frequently than anyone else. He was small of stature, with a serious face and twinkling blue eyes, with a great sense of humour. He had a tremendous zest for life and for helping with Community and Voluntary services. He was a generous man who contributed much to the village of Bolney where he lived and was, inter alia, President of the Horticultural Society.

William Guinness was the last male descendant of the founder of the Guinness Brewery Company. He was very proud of the reception given to him for his 90th Birthday by the family and members of the company, and brought the menu with details of the presentations to the next meeting of the Council.

He continued attending meetings which entailed a train journey long after that birthday, and it was only the journey which compelled him to give up. His brain and activities were active to the end, which came very suddenly, during a morning's shopping with his daughter, Sylvia Smith.

William Guinness was always admired and is greatly missed.

D.J. McKenzie
January 1991

MRS THATCHER'S RESIGNATION: A PERSONAL REFLECTION

by Anne McCosker

On the 22nd November 1990 Margaret Thatcher made a speech in The House of Commons

after

'The greatest peace time Prime Minister of this century has been toppled by a squalid conspiracy, led by a light-weight political opportunist backed by the rottenest lot of so-called Tory M.P.s to have disgraced the Conservative parliamentary party in my experience.' Lord Maude of Stratford Upon Avon, The *Daily Telegraph*, 23rd November 1990

Then she, so gloriously guided,
Turned to her tormentors.
Row upon row the faces
Distorted with deceit.

A cabinet of cowards
Watched and saw,
Not a woman broken
But God moving to His people.

Her spirit rose, then soared
Up, up until it touched
The nation's desperate soul
Waiting for release.

Then she, so gloriously guided,
Stood alive in fire
Of intellect and passion -
And played with all those traitors.

Truth, now, will one day walk
The British Isles again
And a Christian heritage
Heal the Anglo-Celtic world.

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.

SUBSCRIPTION REMINDER

Britain and Overseas subscription is included in membership of the ERC. Subscribers who are not members of the ERC and who have not yet paid, are asked to do so now if they wish to continue to receive the journal during 1991.

Annual Subscription £10.00

APPLICATION FORM

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

APPLICATION FOR MEMBERSHIP

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

This application is for	Individual membership (£18 per year)
(delete those non-applicable)	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 ....