BRITAIN & OVERSEAS

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

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POLITICS AND THE ECONOMY IN SOUTH AFRICA

Summary of the talk by Sir John Leahy, former British ambassador to South Africa, to members of the Economic Research Council on Tuesday 15th January 1991

The future of democracy in post-apartheid South Africa is by no means assured. The successful conclusion of the constitutional negotiations that we all hope will start before long is, of course, the precondition for a new form of democratic government based on universal suffrage. But that in itself will not guarantee its survival.

If democracy is to take root in the new South Africa, and survive, it must be seen to meet the basic needs of its citizens. They will quickly become disillusioned unless they can feel that things are changing for the better.

Demographic Forces

Their needs are conditioned by relentless demographic forces. The population is growing by 1 million people a year. It will double from 30 million in 1980 to 60 million in 2010. During that period the proportion of black South Africans will increase from 72% to 82%.

Population growth is matched by rapid urbanisation. The population in the major metropolitan centres will treble from 9 million to 27 million between 1980 and 2010.

There is a need for 1,000 new jobs every day of the year. If that is added to the over 5 million currently unemployed, then over 500,000 new jobs are required each year between now and 2010 if unemployment is to be properly addressed. In recent times the average rate of supply of formal jobs has been 81,000 a year.

127,000 new homes are required each year to reduce the backlog of 850,000 housing units and meet the needs of new families. Last year only 40,000 houses were provided. At this moment no less than 7 million South Africans (ie 1 in 5) are living in shanty-towns, which have mushroomed in the past few years since the abolition of what was termed influx control.

When people are bringing up their families in densely-packed and overcrowded shacks, and have no regular employment, is it any wonder that they spend more time thinking about their own survival than the survival of democracy? What, they ask, can democracy do for them?

Then there is education. The school-leaving population is increasing by 250,000 pupils a year. There is a backlog of some 35,000 classrooms and a need to build about 7,000 classrooms a year for the next 20 years if the backlog is to be reduced and the increase accommodated.

30% of South Africa's black workforce has had no education whatsoever. 36% has had only primary education. In other words two-thirds of the black workforce has not gone beyond primary school.

Lack of Resources

Because of the inexorable population growth these problems can be expected to get worse, rather than better. Any further delay in attending to them will increase the burden. In the past this has been frustrated by apartheid policies. Those policies resulted in the creation of jobs in uneconomical localities, prevented the construction of housing in metropolitan areas and directed educational investment on the basis of racial formulae.

Although those policies are currently in process of being abandoned, South Africa's capacity to meet its basic needs is now constrained by lack of resources. Between 1981 and 1988 real domestic product grew by 1.1% a year, while the population grew by 2.6% a year. I have not got the latest figures to hand, but I feel sure they are no better. Moreover economists have been saying for some time that the economy needs an overall growth of some 5% a year just to keep up with the population increase. It is nowhere near that figure.

One further statistic. At a time when South Africa needs to be spending far more money than it has been doing in order to catch up on this backlog of deprivation and neglect, at a time when it needs to be a net importer of capital, it finds itself in the position of devoting between 2% and 3% of its GDP to the repayment of its international debts.

Having said that, I should also acknowledge that the South African government has at least decided to grasp the nettle and is beginning to allocate substantial resources to these daunting problems. Almost a year ago it announced that in order to help deal with the most urgent needs it was making the equivalent of some £500 million available to a new independent development trust set up under the leadership of Jan Steyn, the former head of the Urban Foundation since its creation in 1977. £500 million is a lot of money and is to be welcomed, but compared with the scale of the problems it is clearly nothing like enough.

The Urban Foundation

I suppose at this stage I ought to declare an interest, so to speak, and let you in on the fact that I am myself an active member of the Urban Foundation, and direct their London office. There is also an office in New York, incidentally.

The Foundation started, as I said just now, fourteen years ago in South Africa as a business-financed campaign to improve conditions in the black townships. Harry Oppenheimer was instrumental in bringing it into being and still takes a close personal interest in it.

Over the years the Foundation has evolved into a multi-pronged development agency. Its main concerns are housing, education and what is now called community enablement, which includes various activities from campaigns for deregulation of small business to setting up community resource centres. It also does research on urban issues, promotes appropriate new institutions (for example for housing finance) and has become a respected heavyweight lobbyist for change.

It is still financed almost exclusively by business (including British and American companies with interests in South Africa), is independent of government and has no political affiliation. The combination of practical, intellectual, entrepreneurial and lobbying work to achieve fundamental change in society is possibly unique, at least in South African terms. Although the appeal of the Foundation is essentially charitable, and it has charitable status, for its business supporters it represents a productive investment in the peaceful transition to a free market society.

Political Change

These, then, are the basic problems which face those who govern South Africa and which will continue to face those who govern it five years from now, ten years from now, and way into the future. There are no quick solutions. Those shanty-towns are not going to be eradicated overnight. Much can be done to alleviate the problems, but however much money is thrown at them there are no quick fixes or dramatic comprehensive solutions. It is going to be a long haul.

In the meantime much has been made of the ANC's continued espousal of nationalisation and other command economy panaceas that have been discredited elsewhere. Would-be overseas investors, including companies in this country, are understandably worried about the prospect.

I would be less worried myself. Obviously such prominent features of the ANC's charter have been articles of faith for too long to be lightly tossed aside. That is not to say, however, that they are embedded in concrete and I would be surprised if the ANC leadership did not begin to show more flexibility on such matters as it continues to make the transition from being a liberation movement to a party of government. Indeed there have already been clear indications that important members of the leadership are having second thoughts, although they are often understandably coy about saying so openly to their rank and file supporters.

I think that is where I will stop. I hope I have said enough to convince you that just because the way is being opened up in South Africa to reach a political settlement on the future government of the country it does not mean that its problems are near their end. It would perhaps be wrong to say that its problems are only just beginning; on the other hand it would not be wide of the mark to say that in some ways the hardest part is yet to come.

I believe, therefore, we all have a vested interest in helping South Africa survive as a democratic and economically successful country.

What is more, we shall not only be helping South Africa itself, we shall be helping other countries in Southern Africa too. For a stable and successful South Africa has the capacity to be the economic power-house for the region as a whole if it is allowed to be.

As you can see, the stakes are high.

A VIEW OF WESTERN EUROPE

By Damon de Laszlo

1990 was a year that brought Europe into the middle of the UK political arena. For industrialists, Europe had been a market like any other around the world for a very long time and the possibilities of the Common Market was a subject much discussed between international salesmen and corporate policy makers.

Many industrialists were somewhat bemused in 1988 by the Government's discovery of the Common Market as a political platform. They were suddenly bombarded with glossy brochures put out by the Department of Trade and Industry and other government departments, usually with a Minister's face and exhortation prominently chastising industry for not doing enough to export to our European partners. These pamphlets and advertisements were an interesting phenomena as they covered up a strange lack of understanding in many of the corridors of Whitehall. A burst of public debate about European currency union followed through 1989 and 1990 with industry fundamentally supporting the idea so as to make the complexity of trading in multiple variable currencies less of a barrier to our industrial efforts.

One of these extraordinary quirks of fate that change the course of history happened in 1990. A Prime Minister under pressure for being 'anti-European' and distracted with the local UK problem of poll tax, decided just before the Conservative Party Conference to announce that Britain would join the E.R.M. The timing was certainly politically expedient but it was strange in the extreme to link us in at the high end of the exchange rate. Britain as an industrial country is now one of the world's highest cost producers and probably will be the last currency to join the E.R.M. - and the first to have to re-align!

1990 also produced the momentous historical events of the re-unification of Germany. The disintegration of the Soviet Union, coinciding with the desperate need for Chancellor Kohl to have the East German vote in order to win another term of office, culminated in the fall of the Berlin Wall.

The financial consequence of bringing approximately 16 million people into the Common Market was hardly examined and certainly not on the German agenda. It is still impossible to estimate the cost of this exercise. The old East German state is virtually as it was at the beginning of the last war but with very little maintenance spent on it. Added to this there is no concept of western capitalism in the management of industry or the economy. Also Chancellor Kohl promised an exchange rate of one OstMark to the DeutschMark which was subsequently varied to between one and two OstMarks to the DeutschMark. The consequence of this exchange rate is to effectively bankrupt an already low productivity economy.

The re-building cost of the ex East German states will, I believe, drain the capital resources of Europe and the funds required will run into thousands not hundreds of £billion during the 1990s.

By way of examples, nearly 60% of residential drinking water is below European quality standards, the German Environment Ministry believes there is a need for twenty-seven new water treatment plants. Major renovation to sixty would be required. 5,000 Km of sewers need renovating and a further 6,200 Km need building. 278 Power Stations are producing vast quantities of sulphur dioxide and soot from brown coal. The need to build roads, houses, gas pipelines, telephone networks and electricity grids to bring an area that stopped developing in 1935, up to the European standards of the 1990s, is mind-boggling. Motorways cost, in round figures, £10m per mile – telephone networks cost £1,500 per line. This is before the question of re-educating the present generation, as well as the next generation, is added to the equation. And how do you sustain the livelihoods of 15 million people when there is minimal productive employment?

One more statistic to conjure with: a low estimate of the capital cost of an industrial working place is £10,000 per employee. This level of cost might be held to if the plant and machinery and factories already in place can be utilised. It does not require a great deal of mathematical or economic knowledge to work out the implications of this number.

The question for the economist is, how does the EC pay, as we are now all linked through the E.R.M., and what is the consequence for the currently identified development areas of Europe of this shift in the allocation of capital? In the UK we will find development areas in Scotland and Wales in intensive competition with Germany for capital resources. The question for the politicians will be how to hold the EC together when all of this produces a noticeable economic impact.

I believe the break-up of the EC could be economically disastrous but it is difficult for national politicians not to take the short term view that their own re-election is of over-riding importance. So there is a danger that divergence may become politically popular.

If we look across the Atlantic we see another enormous market for GB Ltd in the USA. At the moment there is a powerful move towards a North American free trade area of Canada, US and Mexico that will vastly enhance the North American continent and make it a trading block of greater significance than the EC with the added advantage that the US$ area is now a relatively low cost industrial producer.

As an industrialist with a vested interest in UK and EC industrial growth, one has to hope that there are policy makers in Brussels who can work with National Governments and understand the consequences of their actions for general prosperity.

To one side, the EC is faced by "the Far East", a loosely knit area of "laissez faire" Governments with industrial policy greatly influenced by Japanese drive, and, to the other side, America with the potential for expansion as its own free trade area starts to percolate over the South American Continent.

These questions certainly bring to mind the ancient Chinese curse "May you live in interesting times."!

THE PROPOSAL FOR A BASIC INCOME OF £4,000 PER HEAD, FINANCED FROM AN ENERGY TAX

By John P.C. Dunlop

Following the interest expressed by ERC members in 'Introducing a New Concept in Taxation; An examination of proposals for Fundamental Reform' published by The Resource Use Institution Ltd, (review, B&O Winter 1990) Britain and Overseas invited the author, John Dunlop, to explain the background and the advantages, of this proposal.

The genesis of this proposal, appropriately enough, stemmed from two sources.

First was the perception that the ways of raising the bulk of government revenue were basically inefficient requiring endless legislation year after year authorising modifications to "improve" them. Taxes raised for specific purposes usually had side effects not intended, expected or desired. You only have to look at the 'stooshie', to use an expressive Scots word, raised over the Community Charge. Also they were expensive to raise, 70% of them costing nearly 5p in the £.

Second was the observation that modern capitalist economies have developed tremendously powerful ways of organising and producing goods and services for both the consumption and capital markets but have still not solved the problems of organising their distribution in ways which enable them to be taken up in a regular and smooth flow to prevent the occurrence of the disturbances caused by the shakes and bumps associated with the periodical decelerations and accelerations that are characteristic of economic activities today – and have been since the beginnings of the Industrial Revolution.

The link between the two is not obvious, possibly because there may be no rational connection, but there could be if a modification in the first could lead to a solution of the second.

Aggregate Purchasing Power and a 'Basic Income'

We are all familiar with the cycle of increasing demand prompting increased production bringing increased employment boosting further demand, and, to meet this, increase of stocks/inventories and increased competition, oversupply, falling prices, bankruptcies and lay-offs of workers. But employees form the main body of customers, so if you get rid of workers you are bound to lose customers.

What is not familiar is the remedy, I mean the remedy that works. Nobody so far has come up with one that does – except in the short term.

Politicians have argued about the best solutions and have succeeded on too many occasions in egging on their supporters to go to war over them in attempts to prove the validity of their ideas, and particularly this century have subjected the world to a series of peculiarly frightful wars and revolutions during which both the best and worst traits of humanity were displayed raised to the nth degree in what an eminent historian,

Professor Norman Stone, described as "not the most intelligent way of settling disputes" (Newsnight TV broadcast 26/1/91).

That problem still remains unsolved but it is becoming increasingly obvious that it has to lie in keeping up levels of demand. In between the two Great Wars extended credit was tried, as it was again after the second one. This certainly worked for a while but in times of stress it produces serious social consequences resulting in social security legislation which has developed almost as much complexity as Income Tax and possibly more serious inequities.

Extended credit has displayed its perils not only inside national economies but increasingly in the international arena. It has failed and is now providing increasing problems for and even menacing the existence of the providers of this credit.

For some time now I have thought that the answer must lie in producing a painless way of providing unearned incomes to all citizens.

Fifteen years ago I was involved in the promotion of a number of unit trusts at a time when the unit trust movement was developing momentum. It was also a time when the Government was pumping fresh capital into what were 'dying duck' industries in a desperate attempt to prop them up and boost employment.

As an additional measure to increase employment, a special payroll tax was tried, the Selective Employment Contribution, levied on the basis of the number of employees on the payroll. From the fund thus created employers who took on a worker from the register of unemployed were paid a weekly contribution for six months for each such worker employed.

The obvious anomaly of fining employers for having workers on their payrolls in order to encourage employers to put still more workers on their payrolls did not seem to have reached the upper levels of consciousness of those who put the scheme in force.

Nevertheless it struck me at the time that it was a very straightforward and simple way for the government to extract money from business and it suggested to me that a better use for the SET would be for the fund thus created to be invested as it grew weekly in profitable British concerns in the manner of an investment or unit trust.

So in 1976 an 'Instant Community Chest' could have been created very quickly and easily, funded by a levy of only £1 per head per week exacted from employers for every person employed in each business. After 52 weeks the fund would have amounted to some £1,000 million.

Initially after one year of investment the net income would have been available for distribution to the most elderly age groups in the population. My calculation was that after one year of management by commercial managers the Fund could have provided an extra £10 per week onto the pension of those who were eighty years of age and over, quite a comfortable addition fifteen years ago. The Fund would grow organically and each year lower and lower age groups would come into entitlement until eventually all adult citizens were in receipt of an unearned income.

Unbeknownst to me round about the same time a similar idea had occurred to an American space scientist, James S. Albus, who published his book "Peoples' Capitalism" that same year. I contented myself with sending my proposal to the then Prime

Minister, James Callaghan. I got back a curt acknowledgement expressing no interest. David Steel's reply was more courteous and Margaret Thatcher's reply was much more cordial and positive. But nothing more was heard, so as my business was demanding more and more of my time I put the correspondence away.

Six years later I sold up and retired and took up other interests. Then in the middle of 1986 as a result of a letter I had published in the "Scotsman" I was invited by one of the organisers, a mineralogist, Robert H.S. Robertson, to submit a paper to a Workshop on "The Better Use of Money" to be held in the Centre for Human Ecology at the University of Edinburgh. There I was introduced to the work of Albus and a recent book by another American, Stuart M. Speiser, on the subject of Universal Share Ownership, applying ideas not dissimilar to my own and those of Albus to the American scene. Their schemes were less gradualist than mine.

Towards 'Unitax'

I also met a scientist and energy analyst, Professor Malcolm Slesser who introduced us to a completely new way of looking at and analysing the economy of the country and its use for development planning. He was at that time just completing an analysis of a ten year period of the British economy, not using money as a numeraire but the international unit of energy, the Joule. I became interested, too, in a simplified system of taxation explained by its originator, an engineer, Farel Bradbury, which he called Unitax. This is linked with the ideas of Slesser because it is based on the taxation of the primary energy sources of the country. An Energy Excise Duty, it is adaptable for national and local finance.

Both these men used a different way of thinking to what I had been accustomed to all my life. Possibly due to my accountancy training and experience I was used to a linear way of looking at problems. They on the other hand thought in circular terms, in terms of feedback loops, no doubt due to their scientific and engineering training. This was very stimulating.

After an initial disagreement with Bradbury over the effect of VAT and some nine months of gestation, I was won over to Unitax and had a long letter published in the 'Points of View' columns of the "Scotsman" (1 October 1987) under the headline "A brilliantly simple tax reform". Bradbury followed this up with a further expository letter shortly thereafter.

Further letters to the press followed and support grew but not in the quarters where support was needed, and many misconceptions were aired in opposition to the idea. It was interesting to note that these came not from scientists or engineers but mostly from people with academically trained minds. Bradbury, who is prolific in expositions of his ideas, talks in terms that are foreign to most accountants, economists and lawyers who form such a great part of the body of opinion that has to be convinced before we can get any changes in tax legislation. Slesser has also given a great deal of effort to publicising the reform and has published several booklets describing Unitax and pointing out that in the form they call Ulitax it can be applied to local taxation to replace the poll tax and the

old rating system with considerable economic and environment benefits.

Their efforts bore fruit last year by the award to them of the Social Invention 1990 by the Institute of Social Inventions and the Body Shop Plc for their work on ULITAX (Unified Local Indirect Taxation) as a proposed replacement of the Community Charge (Poll Tax).

Linking The Proposals

It was long clear to me that an essential complement to the reform of taxation is the reform of the transfer payment system. This new tax would cause increases in the prices of the most energy intensive products, coal, gas and electricity, so that without any income support the lowest income groups would have an unbearable burden of expense thrust upon them. But the importance of the provision of a basic income had not escaped Bradbury and he includes it in what he calls the 'resource economic proposition,' a term which seems to have the facility of raising the hackles of economists.

In terms that businessmen and 'vinegar veined' accountants can understand the proposed tax reform meant that their profits and the wages of their employees would henceforth be free of all taxation whether Income Tax or NI contributions, and they would also be free of VAT, not an unattractive idea.

For economists it means the recognition (long overdue) of a fourth factor in production – energy. So perhaps they should start looking at the resource economic proposition.

Along came Samuel Brittan with his observation that the country was wealthy enough to stand giving all adults an unearned income of at least £4,000 a year financed by a 50% income tax. Then came Cedric Sandford, Michael Godwin and Peter Hardwick showing us what it costs to collect taxes.

Click! The pieces all fell into place. The Blind Watchmaker strikes again! Here was the *painless* way of providing a basic income for all, capable of being introduced more quickly and cheaply than any of the others already mentioned.

Basic incomes can be funded by the cheapest form of taxation, an excise duty levied on the primary energy used to fuel all business in the country at less than one halfpenny in the pound and unevadable.

Some Implications

The tax base of the country would be shifted from being an appropriation by the state of hard earned incomes to being a part of the make up of the prime costs of all economic activity via the prices of the primary fuels which supply all the energy on which we depend.

The implications of this shift in the tax base are very profound. It means that governments are provided with a much more powerful tool for the control of their economies. It means that without borrowing they can find all the money needed - painlessly!

Everyone would pay tax. No one would notice it any more than they do on their glass of whisky or gin and tonic today.

A reminder!

It is not generally recognised that we, for many years, have had access to incredibly cheap energy. Slesser has pointed out that a fit and healthy male performing a heavy manual task expends 70 watts per hour which at today's electricity price of 6.24p (domestic tariff) would earn him just .4368 of a penny!!

Some Advantages of UNITAX

- It is simple. It is cheap. It is unevadable.
- It does not interfere with the free play of the market but provides the climate for lower interest rates.
- It frees profits and incomes from taxation and encourages the return of tax exiles and the reversal of the brain drain.
- It will encourage British investors to invest in Britain.
- It frees government from the necessity to borrow, reduces costs of administration and gives it a method of almost instant control over the economy.
- It helps exporters and home producers.
- It provides incentives to save energy and adopt more environmentally sound practices.
- It can provide the simplest, least expensive and only painless replacement for the Poll Tax.

And of a Basic Income

- It can provide salaries for housewives, students, the unemployed, the sick and the elderly, cutting out bureaucratic controls and necessity to prove poverty.
- It can provide automatic help for farmers resulting in the abolition of the C.A.P.

Time scale? This depends on the political will. VAT could be abolished virtually right away and the Customs and Excise VAT division re-employed on Unitax while a start could be made on introducing Basic Income. At the same time preparations could go forward for levying the Local Energies Excise Duty - staff redundancies minimal.

After a year's operation preparations could go ahead for phasing out Income Tax, National Insurance and Corporation Tax, over, say twenty or maybe even ten years, but the sooner the better if we are to see the benefits in our life times.

U.K. MONETARY POLICY – THE CHALLENGE FOR THE 1990s

Paul Temperton, Macmillan 1991

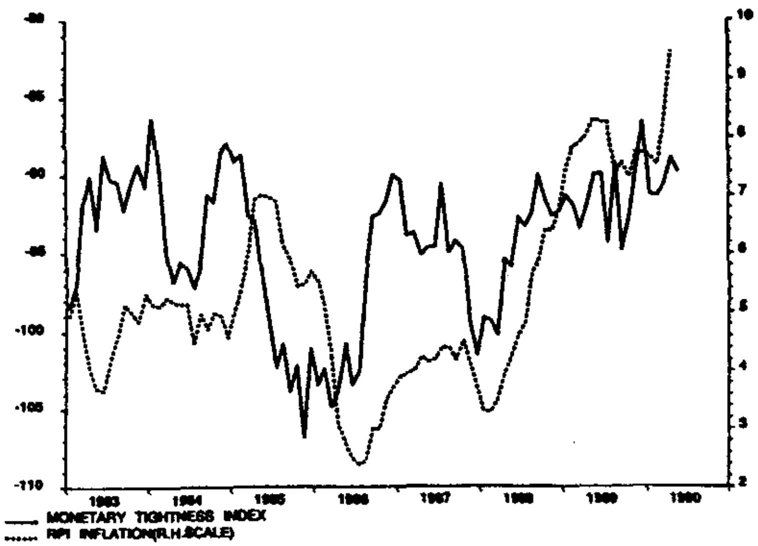
Paul Temperton is a city-based economist and analyst whose experience covers research at the Bank of England and with brokerage houses. This is his second book on monetary affairs. It is an impressive one. In its recommendations however, it will be judged by some to be politically naive. One has an image of all those internal memos and background papers prepared for endless top exec's discussion meetings being carefully sifted and re-worked into a thesis that backs the tide of events. One has the feeling of being 'unable to see the wood for the trees'.

But an examination, and in this case, a valuable and competent one, of the trees is nonetheless important. There are chapters on the definition of the 'money supply', on central bank policy, on targeting, on controls, on funding policy, on credit, on deregulation, on the gilt market and much else that gives a sophisticated, clear and authoritative account of both events and concepts. Detail, imagination and context are well handled. Where appropriate, comments and recommendations and criticisms of those comments and recommendations, by participants in the debate, are given. References abound to such as Nigel Lawson, Gordon Pepper, Alan Walters and Tim Congdon. For those needing to go beyond his text-books, for that new man in the research department, this book is invaluable. Much that goes on in monetary management and regulation today is complex, is changing rapidly, bears obscure nomenclature and is often hard to link conceptually with the shifts in government policies. As our guide in these matters we can be grateful indeed to this author.

Grateful also for his analytical contributions entitled "Bringing together information on monetary conditions" – chapter 10. This little ten page chapter is the part that ERC readers should first turn to. Relating growth in the 'money supply', variously defined, to changes in inflation, variously defined, subject to time lags, variously calculated, has been the sport of pundits during the past two decades. But mostly, if one time period appears to support one man's claims, the next appears not to. It has all been very frustrating given the obvious common sense of the basic proposition. Paul Templeton however shows how this nut can be cracked and this reviewer enjoyed reading about it. Concepts of 'tightness' for important variables are developed, measured and assigned weights. They are then aggregated and correlated with inflation.

Exchange Rate	40%
M40	30%
M4	10%
Real interest rates	10%
House Prices	5%
Equity Prices	5%
Total	100%

Figure 10.7: Monetary tightness index and inflation



The table shows the variables used and the weighting given and the graph is the summary given on page 160. On this superb little exercise it is an expression of interest rather than criticism to ask why that data was not taken over a much longer time span – say back to 1950 – to see if the relationship holds good?

Thus on the detail of this book there is little to oppose and much to admire. It does seem however, somewhat frustrating to be told on every set of figures and charts that the source is 'Datastream' rather than whoever first published the information. This certainly confirms the impression that perhaps this book is just for those with computer access to this data-bank organisation, rather than the general reader who may want to check things out in the library.

But it is at the broader level that one feels disappointed. The book was published in 1991 but went to print just before Britain's ERM entry. The author concludes in favour of entry -in fact this seems the major policy recommendation running throughout the book. But he indicates that an appropriate entry level would be at around DM 2.50/£. That ERM entry might end up a matter of political manipulation seems not to have occurred to him – or to exist as part of the equation weighing the desirability of joining. Is he now inclined to join the 'Times Six' in suggesting withdrawal? Again he makes much of the need for Britain to relate now to the DM rather than to the US$ on the grounds that Britain's trade with Germany is now the more important. But this is to have accepted a propaganda illusion. The largest part of Britain's exports to Germany are such as oil and gas for which exchange rates are irrelevant. Britain's exports of manufactures to dollar based markets are still crucial and it could in any case be argued

that such increases in manufactured exports and in food-stuffs that have taken place to EEC partners are the result only of hardly defensible 'trade diversion' arising from EEC impositions and tariffs.

On so many issues conclusions are reached which are deeply disturbing but the underlying policy debate is left unexplained; even unmentioned. We are told that interest rates will be set by international factors, that international financial deregulation means the impossibility of avoiding disruptive capital inflows and outflows and that fiscal rather than monetary policy should be used. All this is indeed the fashionable wisdom of the moment but it contrasts dismally with the essential features of the post war consensus described by Keynes in a speech to the House of Lords in 1944:

"The experience of the years before the war has led most of us, though some of us late in the day, to certain firm conclusions. Three, in particular, are highly relevant to this discussion. We are determined that, in future, the external value of sterling shall conform to its internal value, as set by our own domestic policies, and not the other way round. Secondly, we intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of international capital movements, or flights of hot money. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instruments of the Bank rate and credit contraction operating through the increase in unemployment as means of forcing our domestic economy into line with external factors." (Collected Writings of J.M. Keynes, vol. 27, p. 16).

It seems, quite simply, very worrying that this excellent book can state conclusions as uncontroversial gospel which are precisely the opposite to these maxims. One doubts whether the debate is really over yet.

J.B.

THE EDWARD HOLLOWAY COLLECTION REVIEW

***The Economic Consequences of Mr Churchill*, by John Maynard Keynes.**
Hogarth Press 1925

Winston Churchill had just returned Britain to the gold standard at an exchange rate at least 10% higher than that which would have allowed British exports to compete on equal terms on foreign markets. Inflation at the time was not a problem. The reasons for this action seem to have been matters of following a 'doctrine' of 'sound money', restoring Britain's international credibility and, in the name of these *political* objectives, having the side effect of bringing *economic* gains to rentiers and to those receiving fixed interest income from bonds. One is reminded of Britain's entry into the EEC when one found politicians extolling lofty *political* objectives supported by agricultural interests and others counting their selfish gains to come.

In retrospect we can now all see that this return to the gold standard at the pre-war parity was a dreadful mistake and Cabinet papers released 50 years after the event show that Winston Churchill himself was only persuaded against his own judgement by Montague Norman and others at the Bank of England (then still privately owned), in the City and in the Treasury. Still, Churchill carried the responsibility and the scorn convincingly heaped upon him by Keynes in this little 5 chapter booklet.

Keynes sees the move as an attack on the standards of living of wage earners because it must lead first to depression in the exporting industries (causing unemployment and reduced income levels there) and then to depression in the 'sheltered' (ie non exporting or non import competing) industries as the government is forced through credit restrictions to raise general unemployment and force down wages in order to enable to export sector to eventually regain competitiveness. The point he hammers home is that with an overvalued exchange rate the *only* thing that can retrieve the export industries' position is a general fall in *all* internal prices and wages. He criticised the authorities for their naive assumption that such reductions could or would take place 'automatically' or be 'diffused' throughout the economy. There is, he said "no machinery for effecting a simultaneous reduction". Keynes claimed that the results required could only be achieved via massive and costly unemployment, and that even then there would be a very unequal sharing of the burden.

There is, of course, an uncomfortable echo of these arguments in the current debate over the effects of Britain joining the ERM at an exchange rate and with interest rates that have caused even 6 leading 'monetarists' to attack government policy in the columns of The Times (whilst Samuel Brittan writing in the Financial Times represents, 1990's style, everything that Montague Norman ever stood for). During the 'Lawson boom' both borrowers and lenders implicitly assumed that the 1990s would involve something like 10% interest rates and something like an annual 5% to 10% reduction in the exchange rate. The decisions were made, the deals were struck, it is water under the bridge. If the government now insist on a maintained exchange rate, a 5% level of inflation and high interest rates, the effects are much the same as the *reduction* in wages and prices implied by the 1925 return to the gold standard. Real wages have to be reduced now, just as nominal wages had to be reduced then, in order to restore to the export industries, a competitive framework of wage-costs.

Keynes' recommendation, of course, was for the policy mistake to be recognised and reversed. But he realised that the government may need an alternative and in the light of the many claims of modern Keynsians in favour of incomes policies it is interesting to see Keynes' own ideas on this subject. Firstly he argued that an incomes policy was better than market forces for achieving fair wage sacrifices. Secondly, after recognising that there needs to be reductions in *both* wages *and* prices (in today's terms, reductions in the rate of increase of both) he says, "Can we not agree, therefore, to have a uniform initial reduction of money wages throughout the whole range of employment, of (say) 5 per cent., which reduction shall not hold good unless after an interval it has been compensated by a fall in the cost of living?" Thirdly, to avoid benefit to rentiers and bond holders he suggests an additional income tax of 1/- in the pound on all such income. All this is pretty sophisticated Keynesianism but Keynes himself is not too keen on it – preferring a correction of the original monetary mistake. Which brings us pretty well back to the present.

But within the policy of an overvalued pound Keynes saw that by offering higher interest rates than other countries, the Bank of England could arrange a sufficient inflow of capital to balance the books against a balance of trade deficit for quite some time. But he says, the policy of high interest rates during a time of high unemployment, is totally perverse. "The proper object of dear money is to check an incipient boom. Woe to those whose faith leads them to use it to aggravate a depression!"

There seems no doubt that this booklet is well worth a re-read today and this review can end with a quotation from page 13. "To begin with, there will be a depression in the export industries. The cost of living will fall somewhat ... but the export industries will not be able to reduce their prices sufficiently." "It will not be safe politically to admit that you (the Government) are intensifying unemployment deliberately in order to reduce wages. Thus you will have to ascribe what is happening to every conceivable cause except the true one. It will be about two years before it will be safe to utter in public one single word of truth. By that time you will either be out of office, or the adjustment, somehow or other, will have been carried through."

J.B.

LETTERS

A response to *The Future for Britain's Free Enterprise Economy* by Alan Beith M.P., from Mr D. Chapman

Gentlemen

I may be a bit late but I would like to make one or two comments regarding the article in the Autumn Issue Vol 20, No 3 which gives a summary of Alan Beith M.P. in his remarks to the members of the Economic Research Council for Tuesday the 3rd April 1990.

So Mrs. Thatcher is a "little Englander?" Well now, was she of that category when she was organizing the nation to regain the Falklands? What is a little Englander? I suppose Henry VIII was one of the first and all of those loyal to Elizabeth the 1st must have been. Especially Shakespeare, he must be the little Englander of all time; "Nought shall make us rue, if England to herself doth rest but true". Unfortunately England has not rested true to herself, particularly since 1914. I would also guess that most of the Victorians were little Englanders, Kipling would be a good candidate.

Please understand I do not want to wave a flag for the Tories, indeed there are no Tories. The Tories of today are more liberal than the liberals of yesterday. The Tory Party is meant to stand, although not many of them know it, for the protection of home trade. Since the thirties the last thing the Tories have done is protect home trade. The goods we need to export have to be spawned in a protective home trade environment otherwise they can never be developed and brought to market. It does not necessarily demand legislation to protect home trade, very often it is protected by the fierce nationalism of the countries concerned, France, Germany and Japan being notable cases in point, whereas the Englishman has been subtly educated by the government and the media to believe that everything that is foreign is best and dutifully turns away from anything British-made unless he is rich enough to own a Rolls Royce!

So we have fallen down and we do not make hardly anything any more, before long we shall not have the skill to make anything at all. We do not make ships or aeroplanes or railway engines or wireless sets or machine tools or motor cycles and not many cars.

Turning to monopoly there was a man who once said that "Competition is a sin." He set about proving it. Today there is not one pint of oil comes out the ground anywhere in the world but that his sons and grandsons profit thereby. As for government monopolies, well, it is my humble opinion that the government should not be in business at all. It should not be making electricity or distributing gas, or running hospitals for that matter. If it got rid of all that weight and clutter there is a chance that it could begin to govern equitably, fairly and economically also perhaps rapidly nullify at least half the laws and legislation that stifle us today. Then who knows, at the same time it might even find the inspiration to make sure that the laws that are left are kept and that justice once again begins to raise its head on the land where "Justice has fallen in the streets".

D Chapman
55 Eastfield Road
Louth
Lincs, LN11 7AL

Responses to the letter concerning *Social Credit* by Mr Lee Cheney and associated editorial footnote concerning the ERC, from Mr Eric de Mare and from Mr Donald Neale.

Sir,

As a Social Credit campaigner of some sixty years frustration, may I point out for the umpteenth time that the issue of National Dividends would *not* be inflationary if Scientific Price Adjustments were applied. The first job of a National Credit Office would be to calculate the extent of the gap that obviously exists between prices and purchasing power. This gap would then be precisely filled by paying retailers new, debt-free and interest-free government grants to enable them to sell their goods below cost prices - a sort of VAT in reverse. So prices would fall, consumers' purchasing power would be increased, industry could sell its products without going bankrupt, and inflation would be prevented. National Dividends could come later.

It's all so obvious. Why then do so many people – even some Social Creditors – make such heavy weather of Douglas's perfectly simple, rational and ethical solution to a problem of the deepest concern to us all? His ideas are plain common sense. Are we burdened with unconscious, self-immolating guilt that inhibits honest thought and open debate? Or is there a more sinister reason why the Social Credit creed is so difficult to disseminate? As far back as 28 March 1929 Douglas wrote in Orage's *New Age*: "In this country the Institute of Bankers allocated five million pounds to combat the subversive ideas of ourselves. The large Press Association were expressly instructed that my own name should not be mentioned in the public press. During the last five years the seed of Social Credit has been driven underground".

What, I wonder, does the Money Mafia spend today, under chronic inflation, to squash any sign of Social Credit advocacy, and is the cost added to that egregious con-trick called the National Debt? As the situation worsens, perhaps we can begin to hope for a Palace Revolution among the more responsible and intelligent members of the Establishment.

Eric de Mare
The Old Chapel
Tunley, Nr. Cirencester
Gloucestershire GL7 6LW

Sir,

THE DOUGLAS ANALYSIS

In your editorial footnote to the challenging letter in the Winter 1990 issue from Lee Cheney of New Mexico, you say in regard to the Social Credit movement that "key aspects of its analysis and proscription (sic) 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."

That is clearly not to say that the analysis is incorrect or the prescription inappropriate to the diagnosis. At issue is ERC acceptance of them.

We are now enduring yet another "recession" with its attendant evils of irredeemable debt, bankruptcies and foreclosures, unemployment and poverty. These co-exist with such abundance of production and of unused productive capacity (both human and material) that elaborate and expensive means have to be set up to deal with "unsaleable surpluses" and to restrict productivity. Meanwhile consumer credit soars to record heights as tomorrow's incomes are mortgaged to meet today's prices. Manufacturers, distributors and retailers all await a resurgence of demand.

Is all this not compelling evidence of the chronic deficiency of consumer purchasing power compared with prices as identified by Douglas, encapsulated in his 'A + B theorem', and justified by his mathematical proofs?

If it is still not acceptable to the ERC, can we please be told why not?

Donald Neale
The Social Credit Secretariat
21 Hawkhead Crescent
Edinburgh, EH16 6LR

A further response from Mr T.B. Haran to members' letters following the review of *Monetary Analysis*

Dear Sir

Perhaps I may be allowed to explain why banks *cannot* create money by lending, and to show where money actually comes from.

Banks (and building societies) run their businesses on the same lines as any other major company. Thus, they raise fixed capital from the public to buy assets and borrow their working capital from the banking system!

A bank balance sheet, stripped down to its essentials in relation to money, could in percentage terms read:-

Deposits	100	Advances	92
		Cash	8
			100

What is not generally known is the Advances include an overdraft granted by the bank to itself under a name such as "Bank's Account Current".

It follows that, since the banks are not behaving differently from other borrowers (a) that they cannot be creating money or (b) that they are not the only ones so doing.

Which conclusion is correct? There are three main ways in which a bank can make a loan: (1) by granting an overdraft, (2) by crediting a customer's account and debiting a loan one, or (3) by issuing cash or a draft.

Nothing concrete has happened. The net positions of the bank and the customer are unchanged. In the first two cases, the customer could cancel the facility and, in the third, return the cash or the draft. So, lending is not the criterion in the creation of money.

A further step is necessary. The loan has to be *spent*. Thus, money is created by parties spending themselves into debt. This means, of course, that other parties become creditor to an equal extent. As a result, savings always equal debts.

Transactions resulting in payments from borrowers (including the banks) to savers increase the money supply, while those resulting in payments in the opposite direction reduce it. Thus, the process is one of continuous creation and destruction.

The *second conclusion is, therefore, correct*. The banks are not the only ones creating money. Indeed, the simple truth is that any individual or group can create money by getting into debt and can destroy it by repayment. No-one can create money by lending.

In a primitive society, transactions were settled by barter and there was no money. If then bank lending were necessary for its creation, money could not have come into existence in the first place.

What then is the true position? Raw materials are provided free by nature so, whether the work is productive or unproductive, only the services involved are paid for. Consequently, the earliest money was created when an individual first performed a service for another against a promise that the latter would perform a reciprocal service at a later date. Thus, money is actually a credit in services of one party and a debt in services of another. Total credits always equal total debts.

As trade developed, it became necessary to have evidence that the credits and the debts existed. Early media of exchange, such as cowrie shells, gave way in time to IOUs. The evidence, however, is not the thing it represents. Consequently, media of exchange are titles to money, and not money itself.

Their introduction enabled the credits in services to be negotiated, borrowed, lent, gifted and stolen and all these practices were in existence before banks were formed. The only additional feature banks provided was security.

Each step made trade easier, but did not interfere with the process by which money is created and destroyed. Thus, money is still created by parties getting into debt and a bank loan is simply the most convenient way to facilitate the procedure.

A borrower issues IOUs (cheques) and a bank buys them on presentation. It already has an overdraft, so it has no money of its own for the purpose. Accordingly, it uses the deposits of its creditor customers. Thus, money is always created and destroyed outside the banking system and only the settlement procedures take place within it. Banks deal only in titles to money and not in money itself.

Money is intangible and so is a share holding in a company. The Stock Exchange carries out the settlement system for the buying, selling, lending and borrowing of stocks and shares. Yet, no matter how sophisticated its procedures become, it will not create a single stock or share. Equally, the banking system will never create even a single penny. The values of (1) stocks and shares and (2) money are entirely dependent on trading conditions which are extraneous to the settlement systems.

Each credit in a bank's books (apart from cross entries and creative accounting) is matched by a corresponding debt and is a correct reflection of money (and wealth) created. There is nothing, therefore, in that situation to cause too much money to chase too few goods and the fact that deposits are 12 1/2 times cash is irrelevant.

Every argument claiming that banks can create money by lending can now be refuted. As far as I know, the true position is only on record in my book. Moreover, that work shows that much more is wrong with current monetary theory than can be revealed in a letter.

The economic establishment has gone terribly wrong in attributing the nature of money (credits in service) to the titles to it (media of exchange). As a result, current monetary theory is almost entirely unsound and this, in turn, is preventing the introduction of the remedies needed to cure our economic difficulties.

T.B. Haran
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Note

Members are asked to address all letters intended for publication in *Britain and Overseas* to The Economic Research Council at Benchmark House.

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

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

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

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

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

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

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

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APPLICATION FORM

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

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