

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

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ON TRANSITION IN RUSSIA

*Summary of a talk by Dr Chris Doyle, Senior Research Officer,
the Department of Applied Economics, University of Cambridge
to members of the Economic Research Council on 23rd February, 1993.*

Russia is embarking on the world's largest programme of economic transition, involving the wholesale change of political and economic magnitudes. Political changes are arising through democratisation and accountability, and economic changes closely linked to the political changes are resulting in the gradual transfer in the ownership of productive assets away from the state into private hands. The transition from planning (resources allocated through administered prices arrived at through quantity considerations) to the market on the scale evident in Russia is unique.

The end point of transition is the destination point; a successful market economy with resources allocated by private agents largely through decisions taken at a decentralized level. There are many different destinations that Russia could emulate, some more successful than others. There is the Japanese model featuring a strong role for labour (in organizational decision making and in terms of job security), personal capital markets (less anonymous and securitized than in the US), firms holding market share objectives (generally promoting long-term strategies) and where government is closely involved in cooperating with the private sector (particularly in R&D). There is the US model where capital is the dominant factor of production in organization, capital markets are anonymous and control is widely dispersed (leaving too much discretion to managers), profits are the ultimate goal (often promoting short-term outlooks and hostile take-overs) and government plays a neutral and largely administrative role. In between these two stylized representations is the European model.

Prior to arriving at the destination the state will change from being an economic master to an authority largely subservient to the needs of the newly establishing private sector. The degree to which the state withdraws from economic activity is the source of much controversy in Russian politics. Politicians point to different market economies as role models, depending on their prejudices with regard to state intervention. Japan is often cited as a country to emulate because it has strong state that has managed to blend successfully the private and public sectors. But Japan differs in many respects to Russia, not least in having an economy with little emphasis on military production. Nevertheless, there are many in Russia who regard the development experiences of other South East Asian countries (e.g. South Korea) as providing a role model for Russian development. Furthermore, many look to the market experiments in China as providing a way out of the present difficulties. The approaches of China and Korea, however, have taken place against a backdrop of authoritarianism, a direction many in the Russian parliament believe desirable – but not under Yeltsin. In many cases, however, those holding this view are not proposing the establishment of a state vigorously introducing structures needed to complement market institutions, but are instead promoting the status quo.

Despite differences of opinion, the present reforms are predicted on the need to

implement speedily the conditions required to support private sector development. Transition has involved the implementation of macroeconomic stabilization and microeconomic reform. It is argued that without stability in macroeconomic aggregates, then there is little chance for prices to work effectively on private markets. The emphasis has therefore been placed on macroeconomic conditions, but there have been considerable developments at the microeconomic level in some parts of Russia.

The macroeconomic variables involved in the stabilization programme include: the current account, the price level and the budget deficit. Problems in these areas usually surface as macroeconomic instability (inflation, growing government deficit and trade deficits). To restore stability measures required include: balanced budget targets (implying tight monetary conditions), devaluation and current account convertibility and incomes policies. The stress on macroeconomic stability was initially unavoidable because of the instability inherited from the final days of planning.

The policies have failed to date because they have been implemented through a big-bang approach that has misfired. The rationale for a big bang is predicated on the belief that coordination failures (between supply and demand) and intertemporal speculation (arbitrage) arising as a consequence of gradual reform will ultimately act to undermine reform. For example, if prices are partially freed, then there is an incentive for firms to hold inventories in anticipation of further liberalization. This exaggerates any shortages that prevail, which may result in political pressures to terminate reform. Although the arguments for the big bang were compelling at the end of 1991, the failure to secure control over the necessary machinery (such as the central bank) to implement the programme has resulted in a misfired big bang. In Russia the misfired big bang has, if anything, exacerbated problems of stability as hyper-inflation persists. This has resulted in growing opposition within the Parliament to the reform programme.

During the course of the transition programme in Russia the destination point has become blurred as political events, responding to increasing economic turmoil, have unfolded. The lack of clarity has led to calls for a change in the destination and a slow down in the pace of reform, leading to uncertainty and greater political instability. The problems of instability are amplified by the quasi-legitimization of strong vested interests within the Russian parliament, a legacy of Glasnost.

The destination and path of transition is being adversely affected by political manoeuvring within the Russian parliament, whose members in many cases fail to reflect the preferences of many in the population and instead promote strong vested interests wishing to block reform. The destination that many politicians aim for is shaped by observations of market economies elsewhere (many experiencing tremendous difficulties, which they point to sardonically), the failure of transition to date (which is in many cases a result of their own incompetence) and by their constituencies.

In the case of Russia successful transition now rests critically on political change. An apparent regressive step may well yield the best solution. This could take place through a temporary strengthening of the power of the state in the form of increased centralization within the Presidential Office. This will enable the establishment (say in five years) of genuine democracy to overcome the obstacles of false democracy prevailing in the

present Russian parliament. The period without parliamentary accountability would enable some harsh, but desperately needed, economic measures to be implemented. It will also enable the reformers to remove obstacles to reform (such as removing the discretionary powers over credit expansion held by those at the central bank). Furthermore, by removing temporarily the power held by the parliament, the path of reform is likely to become more balanced, as the President will no longer be forced to distance himself from those vehemently opposed to reform. Such political restructuring would create an authoritarian system enabling Korean or Chinese style reforms, ironically supported by many in Parliament. The middle road of holding new elections will only serve to heighten uncertainty and may result in another political impasse involving far graver consequences.

Confronted with the possibility of political repression as a way to resolve the problems in Russia the West faces a serious dilemma vis-à-vis its assistance programmes. It is recognized that the Russian parliament is a major stumbling block to reform, but its removal opens the door to dictatorship. Some influential figures have argued that a solution can be found by increasing dramatically the aid given to Russia. This scenario seems most improbable as an increase in western aid is unlikely to bring about the necessary political changes. Indeed, increasing western aid may exacerbate problems and bring about disintegration by strengthening the position of those opposed to President Yeltsin who will seize on the aid as further proof of Russia's decline under Yeltsin.

The strengthening of the Presidential Office seems the most attractive short term remedy to restore the momentum of the Russian reform programme. Unfortunately this raises the spectre of a military dictatorship and all the trappings of a Latin American militarily mismanaged economy. On the other hand, without increased Presidential powers the Russian Federation is likely to disintegrate and civil disturbances proliferate as the reform programme collapses and regional differences accelerate. The resolution to the problems of Russian transition will rest largely on internal politics and every option carries substantial risks.

THE CREATION OF A CIVIL ECONOMY IN RUSSIA: THE NEED FOR MERCANTILISM

A discussion meeting on the basis of a paper entitled "The Creation of a Civil Economy in Russia: The Need for Mercantilism" by Tony Baron and Robert McGarvey will be arranged for Wednesday 26th May. The following introduction has been prepared by the authors:

If Russia is to avoid total economic collapse and political disintegration it needs to be appreciated that the mere importation of western style market institutions and legal systems is insufficient. The ethical foundation for the proper functioning of such

institutions does not yet exist.

Russian reformers need to appreciate that it will take many years of transition before the social legitimacy and the ethical foundation for a free market economy is generated. It is therefore mistaken and ultimately futile to attempt a leap from a command economy to a totally free market economy. Instead Russia should move through a managed economy stage.

In its current state the appropriate model for Russia to imitate must surely be the mercantilist structures used by the Newly Industrializing Economies of Asia in the post war era, or Germany in the 19th century. The pursuit of modified mercantilist policies is much more likely to produce the social consensus that is vital for Russia to move towards a civil society than the present reform initiatives. Such policies would help re-establish the legitimacy of the Russian state and give the government effective means for revenue raising, while helping to build the ethical foundation for a market economy through widening the estate of ownership.

By far the greatest contribution the west can make to Russia's development along the road to liberal democracy and capitalism is to accept its need to pass through a period of mercantilism. Provided that the Russian reformers accept the need to go through the stages of capitalist development there is no reason why Russia, with its vast natural resources and highly educated population, cannot move relatively rapidly towards a fully functioning liberal capitalist democracy.

All those interested in attending this meeting and/or giving possible assistance towards the preparation of this paper for publication are asked to complete the slip below and return it to the Executive Secretary as soon as possible.

To The Executive Secretary
The Economic Research Council
239 Shaftsbury Avenue
LONDON WC2H 8PJ

I am interested in attending the meeting on the Russian economy taking place on the 26th May. Please send me further details.

Name

Address

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CULTURAL NATIONALISM IN CONTEMPORARY JAPAN

By Kosaku Yoshino

Published by Routledge 1992 Price £35.00

A moment's reflection tells us that militarily defeated nations often seek to preserve and enhance their identity and entity through some form of "cultural nationalism". Ever since defeat at Waterloo France has developed and defended its sense of "culture" and has even been described as the "keeper of a civilisation". The demise of the Roman empire was followed by the rise of the Roman Catholic Church. Khazaria, defeated by Ghengis Khan and with its people scattered around the ghettos of Eastern Europe, has preserved an identity through the maintenance of the Jewish faith. And so it is hardly surprising that post war Japan has seen an outpouring of literature, known as the *Nihonjinron*, which has sought to explore and define the "unique" cultural characteristics of the Japanese.

The drift and impact of these writings are seen by some as having quite dangerous implications. Peter N. Dale in "The Myth of Japanese Uniqueness" sees in it the beginnings or foundations of racism and even fascism. Karel van Wolferen in "The Enigma of Japanese Power" sees it as an opium for the Japanese people disguising a headless monster of the current Japanese power elite.

For those, however of a less excited disposition "*Cultural Nationalism in Contemporary Japan*" provides a sober and effective analysis. This is a source-book of ideas and a compendium of concepts for both aspirant writers on Japan and readers of the *Nihonjinron*'s multifaceted claims. And it is excellently done, based on the work prepared for a doctorate under the dispassionate guidance of LSE's Sociology Department.

Yoshino begins by carefully defining his terms to avoid semantic – and obviously dangerous – pitfalls. He discusses comparative perspectives, theories of ethnicity and nationalism and the make-up of ideas contributing to modern notions of Japanese identity. For those who would ask "What is English?" or "What is German?" or "What is American?" a framework for their thoughts and answers will be found in these chapters. And of course it is of the essence for such answers to be comparative. The *Nihonjinron* abound with comparisons – positive, neutral and negative. The point is not the criticism of others but rather the insights thus gained. For example, the large volume of recent publications in Japan comparing the Japanese with the Jews definitely should not be considered as evidence *per se* of anti-semitism.

ERC readers however will find a more immediate and practical value in reading this book. Surely all of us, at one time or another, find ourselves in the company of Japanese business people, mostly here in London, and find that the conversation turns at some point to questions about understanding Japanese ways, Japanese business methods, Japanese management techniques and Japanese culture. In fact, as Yoshino's research abundantly shows, Japanese business people constantly find themselves in the position of needing ideas and concepts to answer enquiries from foreigners. And in any case,

they need verbal conceptualisation of these ideas in order to grasp the nature of their own circumstances and perhaps to give their own organisations a sense of direction.

Where is a Japanese graduate in engineering or economics or accountancy, who finds himself asked such questions after 5 or 25 years work for his company, to obtain the answers he needs? This is the main market for the *Nihonjinron*. It is important to realise that these works are read because they contribute to work and career more than to political fantasy. Yoshino compares such businessmen readers with "intellectuals" – teachers in schools and other academics, and found that whereas this latter group have generally read a few of the more important works (such as Ruth Benedict's "The Chrysanthemum and the Sword") they generally reported that they didn't have the time or opportunity to read anything like as much as businessmen seemed to manage. Indeed they simply don't have as much use for it.

Although much of the *Nihonjinron* has been the work of Japanese authors a significant proportion has been contributed by foreigners. Some, such as works by Woronoff or Reading are highly critical, whilst others by such writers as Horsley or Reischauer are mainly descriptive, and yet others such as Vogel, are outright flattery. It is an odd feeling, all too often experienced, to be in the company of a Japanese who tells one point about the Japanese which one feels sure has come, not from the perception of any native mind, but rather from the unsure pen of some fellow *gaijin*!

There is no doubt in my mind that this book is an important intellectual contribution. "Cultural Nationalism in Contemporary Japan" should be the starting point for the seriously intrigued, the politically worried and the professionally concerned. Here is the sober guide and interpreter for the wealth of reading that lies ahead.

J.B.

THE EDWARD HOLLOWAY COLLECTION REVIEW

Climate and the Energy of Nations by S.F. Markham
Published by OUP 1942

In 'Climate and the Energy of Nations' Markham explores the thesis that one of the basic reasons for the rise of a nation in modern times is its control over climatic conditions and that the nation which leads the world is the one that lives in a climate, indoor and outdoor, nearest to the ideal.

He cites biologists as asserting that since for all other forms of life there are certain conditions which produce the finest stocks so for man there must be certain combinations of diet and climate which produce the most efficient and most energetic human beings. He concludes, largely on the basis of British studies by Dr H.M. Vernon and Dr

T. Bedford published in Vernon's *Principles of Heating and Ventilating* and Bedford's *The Warmth Factor: and American studies by the US Bureau of Mines*, that 'where indoor temperatures are above 60 degrees Fahrenheit and below 76 degrees Fahrenheit [15.5° C and 24.5° C] and relative humidities are between 40% and 70% men work much harder and more efficiently than at temperatures and humidities outside this zone.'

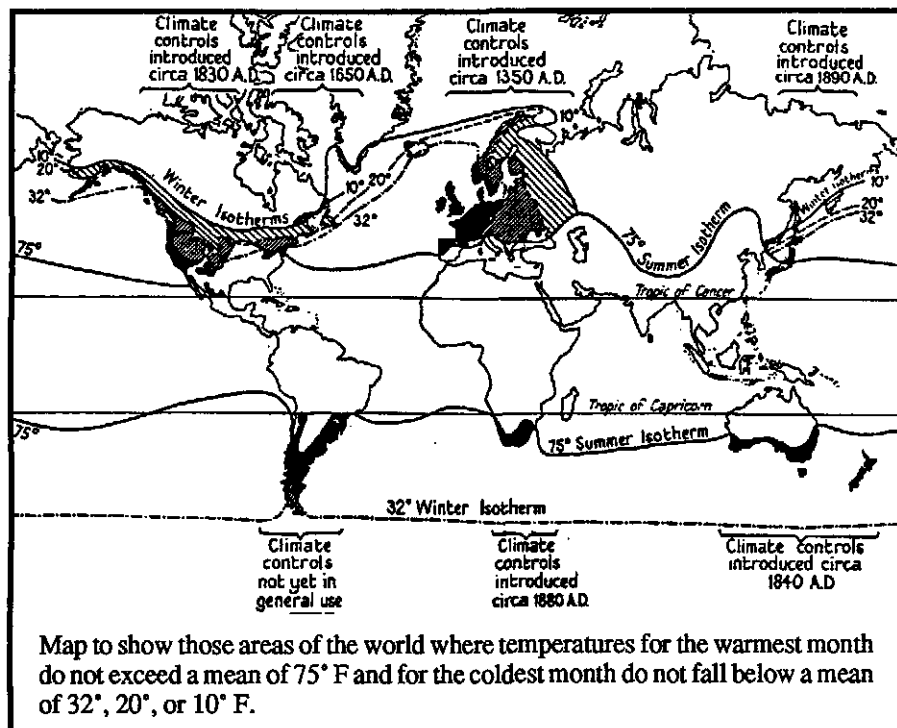
Nearly half the book is devoted to demonstrating that early civilisations grew up near the 70° F [21° C] annual isotherm bordering and to the east of the Mediterranean. 'Where the 70° F annual isotherm does approximately coincide with moderate humidities and with cultivable areas, as at Carthage, Memphis, Antioch, Nineveh, Babylon, Persepolis and Ningpo, and in Mexico, Peru and Guatemala, we find the early civilisations – the Phoenician, the Egyptian, the Assyrian, the Babylonian, the Persian, the Chinese, the Aztec, the Inca and the Maya – had their origins and development.'

This dependence on the annual 70° F annual isotherm and other stipulated conditions ended with the rise of the Hellenistic kingdoms when and where a means of controlling cold had been discovered that was better than an open fire or brazier. The discovery and development of the hypocaust system of heating in which the floors and walls of buildings were warmed by the passage of hot air through flues enabled people to enjoy an indoor climate that could be effectively controlled in all but the hottest months. This technology spread from Greece to Rome and then declined; and the focus on civilisation moved to Arabia and thence to Spain and Portugal and to central America and China.

Up to the fifteenth century, apart from Greece and Rome, every civilisation was centred in an area not far from the 70° F annual isotherm. The rediscovery of brickmaking in the thirteenth century saw the invention of the fireplace, grate and chimney, and soon after this came the use of coal as a fuel, made possible by a means of combustion that avoided pollution of the heated part of the building. This combination of grate, chimney and coal changed the whole condition of mankind. Indoor conditions of temperature and humidity could be controlled in northern Europe in winter, spring and autumn when fuel could be used to increase temperature and reduce humidity. Man had learned how to heat and dry but not, satisfactorily, how to cool and humidify. Coal had become commercial in the thirteenth century but it could not be used alone – it was used mixed with wood because of its unpleasant odour, tendency to smoulder without adequate draught, and smokiness. Indeed the burning of sea coal was prohibited in London in the thirteenth century because of its smoke.

By 1938 36 million tons of coal were burned in domestic grates in Britain to warm houses, almost invariably polluting the atmosphere and defacing and destroying building materials, decorations and fabrics with which the coal came in contact. Markham observes that the problem of successfully and economically warming buildings was as a science then still only in its infancy.

From Europe emigrants had gone to North America from the coal civilisations and were effective in the colder parts, less effective in the warmer. The growth of Japan in the late nineteenth and early twentieth centuries was accompanied by the development and adoption of the climatic controls which had done so much for Europe and North America. Coal mining began in Japan as late as 1890.



Markham next examines climates and climatic control at the time of writing (the book was published in 1942). He calculated mean annual temperatures experienced by the urban populations of selected countries by taking the average temperatures of the main cities and calculating weighted overall averages. He also calculated mean temperatures and relative humidities in the coldest and warmest months, and compiled a Table of National Climatic Conditions for 65 countries. He identifies a short list of 21 countries having an almost ideal summer and an easily controlled spring, autumn and winter, in none of which the mean temperature of the warmest month exceeds 68° F [20° C] or of the coldest month falls below 20° F [-7° C], where radiation is not excessive and where humidity declines in summer.

He concludes that:

civilisation may be expected to be at its highest in these 21 countries provided that other conditions are equal

no country has an ideal climate and if use is not made of houses, clothes, and heating appliances, variations from hour to hour and from season to season may sap energy and health

the regions with both an ideal climate and cheap and effective means of climatic control are New Zealand, north-west Europe, and parts of North America, South America and Australia

his work confirms the theory that man's energy depends basically on the climate in which he lives, that energy is a prime essential of any civilisation, and that civilisation follows climate control

Markham next discusses measures of national energy, derived from the idea that human nature is characterised by the desire (1) to prolong one's own life, (2) to be free from illness, (3) to make money, (4) to be of good repute among one's fellows. He considered that death and infant mortality rates were measures of the first two, and national income and world trade of the last two.

Markham tried applying his ideas to the British Isles. These, he says, fall into three climatic zones, the dry, warm south-east, the cold, wet north-west, and an intermediate zone which stretches from Devon and Cornwall through the Midlands and Lincolnshire to East Yorkshire. He concludes that the distribution of unemployment 1931-36, death rates 1935-36, infant mortality rates 1932-35, and wireless licences 1935 demonstrate the validity of his thesis.

Looking to the future Markham argues, on the evidence particularly of the attached map that 'if this area [from the Bay of Biscay to the Baltic] ever comes under a single direction, whether by conquest, federation or alliance, and has an inner unity, it will become the dominating aggregation in the world'. He goes on to suggest that when air conditioning arrives the desirable realms will be slightly further south (or north in the southern hemisphere) possibly along the 60° F (*sic*) annual isotherm. [60° F must be a misprint: possibly 80° F was intended – MHC.]

M.H.C.

RESEARCH PROJECT PROPOSAL

The ERC executive committee is initiating a research project designed to contribute to the debate on 'how to regenerate British industry'. Several members feel that UK businesses, particularly small businesses, have been disadvantaged by the relative difficulty in obtaining long-term fixed rate finance. Indeed, in his recent Budget speech the Chancellor of the Exchequer acknowledged that in the United States and Germany a large proportion of lending to small businesses is done at fixed rates of interest, while in Britain most borrowing is linked to the level of base rates. It could be argued that industrial investment in the UK has been constrained relative to that undertaken overseas by the substantial volatility in UK base rates since 1945. The provision of mortgage interest tax relief has blunted the impact of interest rate changes on consumers and has meant that, for any desired reduction in domestic demand, rate increases have had to be higher than they otherwise would have been. Furthermore, in contrast to many of the UK's competitors a greater proportion of domestic savings has been directed towards housing and property rather than productive investment.

Some studies of Britain's industrial problems have, however, suggested that availability of finance has not been the problem in the past. While this may have been so, the Chancellor himself has said that as the recovery progresses small firms may find that "their prospects for expansion are increasingly threatened by a shortage of bank finance". This is because following heavy losses in recent years the banks are bound to be more cautious in their lending in future, especially as the fall in property prices has reduced the security for their loans.

What can be done? The Chancellor has proposed a substantial reduction in the Loan Guarantee Scheme premium for guarantees on fixed rate lending. This measure, which is dependent upon the banks' cooperation, does not appear to be sufficient to ameliorate the credit squeeze which is affecting many businesses. One of the propositions that the ERC is considering is that there is a need for a new type of financial institution dedicated to providing long term fixed rate finance to small and medium sized enterprises. Could, for example, the ability of the building society movement to mobilize savings be refocused to provide funds for industry rather than house purchase?

The executive committee would be most interested to hear from members wishing to contribute views on the direction the research programme should take. The committee would also welcome comments on whether members feel the relative lack of fixed rate finance is a major restraint on investment. What other constraints do members feel should be included in any research programme? Those wishing to take an active part in the programme would be most welcome and are invited to contact the Hon. Secretary.

LETTERS

A response to *A Little Management, or a Question of Sovereignty* by Martin Pot, from Mr T.B. Haran.

Sir

In his article "*A Little Management, or a Question of Sovereignty*", Martin Pot maintains that banks can create money by lending out more of it than people have deposited with them. This is not the case.

Banks maintain creditor accounts with the Bank of England for settlement purposes and are able to do so because the incoming funds always exceed the outgoing. Moreover, deposits are always larger than advances.

Money was created by people (singly or in groups) before banks came into existence or governments took over the minting of coin and the issue of banknotes. This power has not disappeared; it has simply been facilitated by the later developments.

In a primitive society, A performs a service for B on the understanding that the latter will perform a reciprocal one at a later date. Money has been *created*; it is a credit in *services* of one party and a debt in *services* of another. B duly performs the reciprocal service; money has been *destroyed*. Thus, money is subject to a process of continuous creation and destruction.

As trade develops, many parties (individuals and groups) move into credit in terms of services (service creditors), while the rest (service debtors) get into debt to the same extent. The transactions then become so intertwined that the credits and debts become respectively due from and to the community in general, rather than specific parties. Nevertheless, total credits always equal total debts and the real money supply is either total.

For ease of exchange and settlement, the services are measured in terms of a unit of account, in our case, the pound. Banknotes, coin and balances of account, used for these purposes, are then incorrectly described as money, when, in fact, they are titles to it.

If wheat is measured by weight, it does not become something else and neither do services, when measured in a unit of account.

A borrower incurs two debts, one to the lender in terms of cash and the other, *on spending*, to the community in terms of services. The second debt has to be repaid first by the performance of reciprocal services in order to obtain the funds to repay the first. Thus, it is the second debt which affects the economy, while the first is simply a private arrangement. Money is not created by bank lending, but by parties spending themselves into debt in terms of services.

Raw materials and produce are provided free by nature. Consequently, it is only the services involved in production and supply that are paid for and are recouped by the sale of goods. The material element is always passed on without charge. Thus, it is not goods and services which are being exchanged, but services only. The concurrent creation of wealth is a by-product of the trading system in services.

Mr Pot (page 10, para 4) is quite wrong in saying that, when governments spend more than they receive in taxes and have to borrow, the money is created for them by financial markets. The money is created by the government spending itself into debt in terms of services. Remember there is a service credit for each of its service debts.

A distinction has to be made between transactions, which involve the performance of work, and those which are purely financial. The former affect the economy, while the latter do not. Thus, depositing, borrowing, currency exchange and other movements of titles to money would be irrelevant, but for the fact that they facilitate trade. Financial markets deal in titles to money; they do not create it. Banks, too, only create money by spending themselves into debt in terms of services, and not by lending. The subsequent spending of capital raised from the public, the latter a purely financial transaction, makes most organisations service debtors.

Governments under pressure, or irresponsible ones, may use the printing presses to facilitate the process by which they get themselves into debt in terms of services, thereby creating money. The presses may then become accomplices, but that does not make them the culprits or justify the notion that there is a monetary phenomenon.

Human greed puts upward pressure continuously on pay and prices. That fact alone makes it necessary for the government to counter the force by regulating the pay and price level. A government, such as our present one, which fails to do so has lost the economic battle before it has begun. The wages-prices spiral is not inevitable (page 11, para 3).

The Bank of England was correct in maintaining, in opposition to Ricardo's views, that it was not responsible for the depreciation in the value of its banknotes (page 11, para 5). These are titles to money, not money itself. They are purchasing vouchers for general purposes in the same way as luncheon vouchers are for specific ones. The Bank of England was simply meeting the demand for its vouchers.

A paper currency is a much better and more useful concept than the Gold Standard and there is no inevitable reason why its introduction should create inflation.

Currently accepted monetary theory is based on the false view that money once created passes endlessly from hand to hand. Banknotes can do this, but, as we have seen, they are not money itself. They facilitate a different transaction on each occasion, but do not always represent purchasing power.

Suppose that Britain became a cashless society and that the notes and coin in circulation were paid into accounts with banks and building societies. Savers would increase their deposits; borrowers would reduce their indebtedness to lenders.

The cash would be returned to the Bank of England in exchange for the government securities, which are presently held in cover. Bankers' Deposits at the Bank would not, therefore, increase.

The "money supply" (taken here as cash plus deposits) would fall! Moreover, since the main suppliers of goods and services, e.g. industry and shops, are bank borrowers, the fall would be substantial.

Where would the difference in purchasing power have gone? Nowhere. No-one would lose purchasing power, so the difference does not exist. The correct count is cash

in circulation less cash in the hands of borrowers (service debtors).

Now, assume that, when Britain became a cashless society, the country was on the Gold Standard and that the currency consisted entirely of gold coins.

Deposits would rise, advances would fall and the Bank of England would exchange government securities for the gold. The position in both cases would be the same.

It is quite wrong, therefore, to believe that if the country were on the Gold Standard, purchasing power would equal the total of the coins on issue. The correct count would be coins in issue less coins in the hands of borrowers (service debtors). Even a gold coin can never be more than a title to money.

The principle of the count applies also to all the other financial assets (deposits, investments etc.) which make up the various versions of the money supply. Thus, the real money supply is much smaller and has to be generated (and destroyed) on a continuous basis. A correct calculation – and there is only one – would give the same answer as total service credits or total service debts.

In truth, paper currencies are a great boon, but we must learn how to manage and protect them. Once again we need a correct diagnosis of the problems involved.

Revert to the transactions between A and B. Suppose that before the reciprocal service is performed, B is able to insist on it being reduced; the credit becomes less valuable and the debt less burdensome; *inflation* has resulted.

Alternatively, assume that A can insist on a greater service being carried out in repayment of the debt; the credit gains in value and the debt becomes more burdensome; *deflation* has ensued.

Thus, inflation and deflation occur in the economy, whether or not there is a monetary system in operation; indeed, the introduction of one merely allows their extent to be measured.

Inflation is not, therefore, a monetary phenomenon and can now be seen for what it really is – an alteration, on average, in the terms of trade favouring the service debtors. Equally, deflation is such an alteration favouring the service creditors.

All the features, which show up when a monetary system is introduced, are already present in the economy. The undesirable ones should not, therefore, be laid at the door of the monetary and banking systems.

These systems are highly beneficial and increase the capacity of the community to trade. That is what builds up deposits and advances, and not the imaginary pyramid of credit. In the arguments supporting that mythical notion, the service debtors only borrow; they never perform reciprocal services, which reduce the money supply and show up as payments from depositors to borrowers!

Bankruptcies, liquidations, major financial losses and increased unemployment, resulting from unsound management decisions, have destroyed a large part of our money supply, our capacity to trade and our ability to generate new money. These are the factors which caused the recession and the reduction in the rate of inflation. Thus, the economy has contracted and has been left with insufficient purchasing power to maintain the previous standard of living.

Monetary policy has been completely ineffective and, in any case, is irrelevant,

because it does not bear on the issues involved. Exchange and interest rates are not levers by which the economy can be manipulated, but simply reflections of its condition. Thus, attempts to maintain an artificial exchange must inevitably fail; devaluation simply recognises a state of affairs which already exists, while leaving the causes in place to force another one; and reductions in interest rates transfer purchasing power unfairly from service creditors to service debtors with no net benefit to the economy.

The quantity of money is the net result of the continuous creation and destruction of money by the performance of services. In consequence, it, too, is a reflection of the economy and not a catalyst. When the new money being created has greater or lesser purchasing power than the already outstanding, the value of the latter automatically comes into line. The laws the quantity of money obeys are not, therefore, those of supply and demand (page 11, para 4).

For these reasons the pay and price level is the key to the economy and the only lever by which it can be managed. Accordingly, successful economic measures have to affect human behaviour and not its reflections.

The correct remedy at present is to reduce pay and insist on the savings in costs being taken from prices. Moreover, the opportunity should be taken to reduce the excessive disparity between rewards at shopfloor and boardroom levels.

Since the main suppliers of goods and services are the payers of most remuneration and bank borrowers, less lending would be needed to finance the current level of production and interest rates would fall naturally. The released funds would become available to finance growth and the unemployed would be priced into work. There is no alternative, if we are to get out of recession.

Savers would lose part of their incomes through reduced interest payments, but would be compensated by the increase in purchasing power of their deposits. Debts, for borrowers in difficulty, would have to be rescheduled.

If cutting interest rates, or any other monetary measure, would result in the foregoing sequence of events, it would have some merit. Nevertheless, it would still, at best, be a sneaky way of altering human behaviour in the same way as open and honest incomes policy. Since, however, monetary measures simply tamper with the reflections of that behaviour, instead of the real thing, they inevitably fail.

We need to change our ways and not our paper currency. An absence of inflation, full employment and stable money could then be our rewards, provided always that we do not give up sovereignty over our currency.

Articles, such as Mr Pot's are of some historical interest, but the answers to our problems are not to be found in the past. My own book – *The Monetary Analysis* – still seems to be the only one dealing with our real problems and providing proper solutions.

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

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 1993.

Annual Subscription £12.00

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.

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APPLICATION

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

APPLICATION FORM

To the Honorary Secretary
Economic Research Council
239 Shaftesbury Avenue
LONDON WC2H 8PJ.

Date.....

APPLICATION FOR MEMBERSHIP

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

This application is for	Individual membership (£25 per year)
<i>(delete those non-applicable)</i>	Corporate membership (£55 per year)
	Associate membership (£15 per year)
	Student membership (£10 per year)
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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

