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Executive Committee

PAY AS YOU SPEND INSTEAD OF PAY AS YOU EARN

by Tony Baron

In his very thoughtful article, *It's the elite who matter, The Times, 5 January 1995,* William Rees-Mogg put forward the radical suggestion that income tax should be abolished and replaced with a progressive expenditure tax system. There is much merit in this suggestion and it deserves to be thoroughly explored.

Rees-Mogg argues against the imposition of income tax on gross income on the grounds that it discriminated against savings. Only certain savings, mainly pension contributions up to certain levels, are eligible for income tax relief. However, savings are vital to provide the resources for investment, which in turn promotes stronger growth, higher employment levels and better standards of living. Ress-Mogg is surely right in arguing that taxing income, in most instances, before savings rather than, after puts at risk the process of capital formation and with it the wealth creation process.

He could have further argued that the current unequal treatment of savings leads to a distortion of the allocation of resources and substantial inefficiencies in the use of savings. If all savings were made out of gross, untaxed income, almost certainly more resources would be made available for genuine venture capital projects. Experience of Government initiatives to promote the flow of savings to businesses such as the Business Expansion Scheme, have the tendency to suffer from being used primarily as tax avoidance schemes. Equal treatment of savings would help promote a shift of human talent out of the tax avoidance industry into more productive pursuits for society. Moreover, personal financial planners (AKA insurance salesmen) would not be able to extract their current excessive levels of commission and charges from a captive market once individuals no longer have to use approved pension schemes to obtain tax relief.

The need to foster a higher level of efficiently-used savings is, however, not the only or indeed the main argument against income tax. The various Thatcher Governments recognised that high marginal rates of income tax were a serious disincentive to individual effort and proceeded to simplify and reduce the higher marginal rates and to reduce the standard rate. However, it needs to be recognised that any level of income tax whatsoever is a disincentive to work. Rees-Mogg argues that in the future we should 'concentrate on educating the top five per cent, on whose success we shall all depend'. However, to be supremely successful a society must efficiently utilise the skills, talents and energy of all its citizens, according to their individual capabilities.

There is no logic whatsoever in taxing an individual's contribution to society, whether it be that the individual is contributing his/her labour, capital, or willingness to take risk i.e. entrepreneurship. In an efficient free market economy the rewards to that labour (wages), capital (interest) and entrepreneurship (pure profits) will reflect their relative importance in the factor markets. The more vital the contribution, the higher the reward and it makes no sense to discourage the contribution by progressively taxing the reward. This is especially true of pure profits since the willingness to take risk is essential to initiate new business undertakings (there is conversely a strong case for taxing monopolistic rent).

Our society today contains hundreds of thousands of people caught in a poverty trap because the potential, after-tax earnings from jobs they could perform are less than their benefit entitlements. The addition of marginal contributions to the nation's output from these individuals would represent a substantial improvement in economic efficiency and social welfare. Tinkering with the benefit levels and marginal tax rates, including National Insurance Contributions, could ameliorate the poverty trap to some extent, but its very existence is symptomatic of the fatal flaw in the underlying principle of taxing income.

Instead of taxing income or the individual's contribution to society, it would be clearly preferable to tax the individual on what he/she draws from society i.e. to tax his/her consumption. Conservative Governments since 1979 have effected a switch in the burden of taxation away from income taxes to expenditure based taxes. However, this switch has been effected by increasing specific duties and VAT, which have the serious drawback of being regressive in nature. It has long been held that taxation should reflect the ability to pay and that the taxation system should be generally accepted as being fair, otherwise the system would fall into disrepute and be widely evaded. Clearly income and corporation tax cannot be abolished if it means a dramatic increase in regressive, sales-based, expenditure taxes. It is, however, possible to construct a progressive consumption tax.

Rees-Mogg argues that in the not too distant future most payments will be made electronically and that once expenditure can be aggregated for the individual, it will be possible to introduce a progressive expenditure tax with, for example, the first £3000 of expenditure being tax free. It is not necessary, however, to wait until most payments are made electronically or to base the tax on an aggregation of actual expenditure for the individual. Indeed, basing a progressive consumption tax on actual expenditure would be open to evasion since high marginal consumption tax rate individuals could pay lower rate payers to undertake expenditure on their behalf.

Instead it is possible now, with the introduction of self assessment, to convert the current Pay As You Earn system into a Pay As You Spend system. Essentially it would be assumed that all an individual's income is spent as it accrues and the employer would deduct consumption tax like income tax. Each individual would be given a tax code based on a tax-free allowance of say £4,000 a year, with additional amounts for dependent children etc., together with an allowance pound for pound for any contractual savings he/she has undertaken. At the end of the tax year the individual would fill in a self-assessment form giving an opening balance of savings, total income received during the year and an end-year balance of savings. If the individual saved more than his/her contracted savings during the year he/she would receive a tax rebate. If, on the other hand, the individual has run down savings, by say £1000, he/she would be liable to pay tax, at the appropriate consumption tax rate, on that £1000. Spending financed by the proceeds of gambling, or by inheritances would be subject to tax and the receipt of inheritances and gambling winnings would be

reportable both by the recipient and the payer. People of retirement age would be given higher personal consumption allowances since they require to spend more on health services, heating etc.

Investment in stocks and shares would count as savings as would investment in human capital i.e. spending on education and training. Changes in the value of stocks and shares would not prompt a tax liability. Only if shares were sold and the proceeds used to finance consumption would there be a tax liability. If the market price of shares fell and they were then sold there would be no tax liability provided the proceeds were fully re-invested. The purchase of property including a home would count as investment but interest payments would not and thus would receive no tax relief.

Given that those now retiring will have made some savings out of tax incomes (although pensions will be out of gross incomes), there will have to be, in equity, some transitional arrangements giving pensioners for the next twenty years or so higher personal consumption allowances.

It would thus be administratively possible in the coming Parliament for the Government of the day to abolish income tax and replace it and the current regressive indirect taxes with a much fairer and economically more sound progressive consumption tax. As Rees-Mogg states in his article, the first party to promise to abolish income tax inside one Parliament will be the first to show that it understands the emerging requirements of the 21st century.

THE CHALLENGES FROM FINANCIAL DEREGULATION

A talk by Stephen J Lewis, Director of Research at the London Bond Broking Company, to Members of the Economic Research Council on Tuesday 7th February 1995

Financial deregulation was hailed in the 1980s as a new spur to economic growth. Central banks in the developed countries, and in many of the developing ones, have scrapped exchange controls, lifted restrictions on the commercial banks' activities and fostered the growth of capital markets. There have been benefits from this approach. Company borrowers have enjoyed a wider range of sources of finance, with competition between lenders, internationally and in domestic markets, paring effective borrowing costs. The monetary authorities have been slow, however, to appreciate the problems which deregulation brought in its wake.

In the retail banking sector, liberalisation of deposit and lending rates has fostered competition between banks to increase their assets, namely, their loans to personal borrowers. This process was a key feature of the US and UK economies in the 1980s and, more recently, has spread to Continental Europe. The result has been an upward shift in personal spending relative to incomes or, in other words, lower personal savings ratios than would otherwise have obtained. It took some time for economic policymakers to come to terms with this shift, with the consequence that fiscal and monetary policy settings were more expansive than they should have been to ensure steady non-inflationary growth. Such policy errors were an important element in the Reagan and Lawson booms in the USA and UK respectively. In both instances, the economic upswing came to an end as official attempts to stoke up economic activity generated an inflation threat. If the authorities had taken full account of the changes in personal spending behaviour generated by credit liberalisation, they might have avoided these errors.

Deregulation of banking also distorted the monetary statistics. On the one hand, freeing of deposit interest rates prompted banks to quote more competitive rates, thereby raising the opportunity costs of holding non-interest bearing deposits. 'Broad money' measures, therefore, rose relative to more narrowly-defined indicators, sharpening the controversy over which were the more appropriate targets for official policy. Divergent trends between monetary measures tended to undermine confidence in money supply targeting as the proper approach for central banks to take. Only the German Bundesbank and the Swiss National Bank retain monetary targets as the centre-piece of their macro-economic policies. Other central banks have reverted to discretion as the lodestar for policymaking.

Yet central bankers' discretion was found wanting in the 1970s. This was the main reason for the general move to adopt monetary targets towards the end of that decade. There had been a tendency for central bankers to err on the side of credit expansion. This imparted an inflationary bias to economies which eventually proved difficult to correct. The danger is that the US Federal Reserve is already acting too late and in too measured a fashion to rein back the inflationary momentum which its earlier policies of credit ease have imparted to the US economy.

Financial innovation has also transformed the wholesale money markets, bringing with it a fresh range of challenges for the monetary authorities. One of the most notable developments has been the growth in derivatives markets in financial assets (futures, options, swaps and hybrid versions of these principal types of derivative transactions). These markets are extremely liquid and fast-moving. Participants typically take highly-geared positions in them, providing margin payments which are only a tiny fraction of the total value of their dealings. Most of the approved derivatives markets are well aware of the risks, which is why they are rigorous in policing calls to top up margins when positions turn sour and to close out defaulters. The problem is that, in recent years, several banks and investment houses have developed the practice of entering into tailor-made derivatives contracts with their customers. These fall outside the established market regulations.

For the authorities, the growth of derivatives poses a range of problems. The fact that companies, and even individuals, can hedge their financial risks by taking positions in derivatives effectively means that their own perceived financial comfort, for any net balance of wealth or liquidity, is greater than it used to be. From the point of view of the economy as a whole, the growth of derivatives represents a relaxation

of financial conditions. If left uncountered, this may have inflationary results. The authorities' difficulty lies in accurately assessing the potential impact of this factor.

Then again, the regulatory problems raised by the growth of derivatives are of a different order from those which bank supervisors are used to tackling. The speed with which transactions are processed may leave even the managements of the banks which participate unsure of their overall risk unless they devise intelligible systems for monitoring electronic data. Even then, the contingent nature of some derivative transactions and the dependence of many of the strategies undertaken in these markets on probability theory means that managements may not be able, at any one time, to say what liabilities have crystallised. It is difficult in such circumstances to define a standard of prudence for the supervisors to deploy and the banks to observe. In this situation, the authorities have thrown up their hands and appealed to the market practitioners to come up with a system of regulation of their own. It will be a surprise if the practitioners devise a system which hinders their more lucrative trading practices.

In markets where ground rules have yet to be established, accidents can happen. Over the past two years, there have been widely publicised cases in which relatively unsophisticated investors have come to grief as a result of their derivatives exposure. Hammersmith and Fulham, Metallgesellschaft, Procter & Gamble and Orange County are names that spring to mind in this connection. Each time such 'scandals' erupt, there is pressure on the authorities to 'do something' either to rectify the current situation or to ensure that it does not recur. At such times, the authorities have to bear in mind the 'moral hazard' that arises if they bail out those who have been guilty of unwise investment. Their support might encourage others in the future to engage in similarly risky strategies in the knowledge that the financial downside will be underpinned by official intervention. On the other hand, there may be some genuine systemic risks from failing to intervene. In all, derivatives open up uncharted territory for the authorities. They cannot expect to be footsure from the outset in their approach to the fresh problems that confront them. Their inevitable mistakes represent an economic cost of the development of derivatives.

Partly as a consequence of the growth in derivatives markets, there has been a tendency over the past ten years for those seeking to raise funds to have recourse to the capital markets rather than rely on bank loans. Active futures markets have allowed investment banks to hedge very large commitments as they underwrite new bond and equity issues. The size of these issues has, therefore, grown substantially, giving companies and sovereign borrowers access to the capital markets on a scale which was previously inconceivable. This, too, is creating problems for the authorities as they try to conduct economic policy smoothly.

The point about the capital markets is that they are diffuse and anonymous. In the old days when banks were the primary providers of funds to companies and to those governments which did not enjoy active domestic markets for their bonds, the authorities could easily keep tabs on what was happening. If a borrower defaulted, it was a relatively simple matter to establish which were the chief lenders who stood to lose. It was then possible to form those lenders into an orderly group and to lay down a schedule for the liquidation of the debt that was mutually satisfactory to lenders and to the borrower.

The hope was that the substitution of capital market finance for bank lending would make the flows of funds around the international financial system much more stable. This was founded on the assumption that a wide range of investors typically takes part in capital market financing rather than the few banks which had usually been at risk in lending to a particular borrower. The latest Mexican debt crisis has shown how mistaken this assumption was.

Unlike the 1982 crisis, when Mexico's borrowings were almost exclusively from banks, the December 1994 collapse in the peso found Mexico's foreign indebtedness concentrated in the hands of a few US holders of short-dated government debt instruments. These investors tried to make for the exits simultaneously, dumping their holdings of Mexican securities on the market. This drove the peso even lower, increasing the sense of panic. The monetary authorities, in Mexico and the USA, had no obvious point of entry into this vicious circle of attrition. Only when Mr Clinton came up with a US package of support for the Mexican government which effectively underwrote all the outstanding Mexican securities did a semblance of stability return to the peso markets.

The Mexican debacle was a severe shock to the international monetary authorities. They are resolved that nothing like it should ever happen again. They have no schemes ready to hand to prevent a similar threat of financial meltdown if one of the other emerging countries should forfeit the confidence of international investors. This is probably the most serious of the dangers stemming from the deregulation of financial markets.

BANKRUPT CANADA EH!

by Robert McGarvey, Managing Director of the Gibraltar International Management Corporation; he is an Economic Research Council committee member presently living and working in Edmonton, Canada

It may come as a bit of a shock to Britons to realize that, according to the Wall Street Journal and the Washington Post, Canada is now to be considered an 'Honorary member of the Third World'. In a series of recent articles published by these major American newspapers, the Canadian government was portrayed as a fiscal basketcase, on par with Mexico. It was clear that, as far as the east coast financial establishment in the United States is concerned, Canada can no longer continue to be ignored – nor be treated as the Switzerland of North America. To the credit of the American authors, these articles were well researched and offered a lot of interesting insights into the Canadian public debt problem. But there is more to this American criticism than meets the eye. In the first place, the articles demonstrate clearly that many

traditional American misperceptions of Canada are still alive and well. So, in order to see the truth there is a need to explode a few long standing myths about Canada and its social programmes. Secondly, although it was never mentioned overtly, the authors were clearly attempting to justify the present choices the U.S. is making in regard to its own social welfare priorities. Behind all that Yankee bravado, and those snide references to the 'Third World', I sense a lingering and unspoken American fear that, maybe, just maybe, the U.S. – facing 'meltdown' in its inner cities – is being fiscally prudent, but ultimately, tragically wrong.

But, first things first. Is the WSJ's assessment true and fair in regard to Canada? There is no doubt that Wall Street, and for that matter all foreign holders of Canadian debt, have good reason to be concerned over government spending. The Canadian government's traditional lack of resolve over budgetary deficits and the rising national debt is becoming a serious problem. Holders of Canadian government paper have every right to question whether Canada can continue to meet its commitments in future. The article correctly identifies a giant problem which the Canadian government hoped could be swept under the carpet. The myth, of course, is that this is a singularly Canadian problem. In reality, the Canadian debt crisis is a symptom of a deeper systemic problem which Canada shares with many other Western nations, including the United States. The root of the problem is the Welfare State, that giant social edifice created to modify the capitalist system during and after the Great Depression of the 1930s. Although it has served the purpose in the past, the Welfare State has now become part of the problem and is clearly unsustainable economically. All Western nations now face the daunting task of finding a 'just' way of dealing with the disadvantaged and the poor in our societies, while staying reasonably competitive in the global economy.

So is the WSJ criticism of Canadian fiscal policy well founded? Does Canada in fact have a fiscal crisis? Yes, that is clear. Does Canada need a crisis in order to change? Absolutely! Will Canada come out of the crisis stronger and more unified than ever? Of this I have no doubt. Canadians should wake up every morning and thank God for the deficit. For it is clear that without it Canadians would have no real incentive to deal with the deep seated structural problems affecting national unity and the debt crisis.

Canadians have enjoyed a remarkable run in the past post-war era. They have enjoyed almost continuous expansion in their economy, massive increases in the standard of living, and unparalleled degrees of social harmony. Unfortunately enormous prosperity creates its own set of problems. The vast wealth accumulated by Canadians has allowed them the luxury of passing responsibility, from the family, from the local community, and from individuals, to the government. And, being Canadian, the government assumed that responsibility – with pleasure – for it brought with it power and influence.

Fortunately for Canadian liberty, the twin towers of budgetary deficit and accumulated national debt have forced a crisis which will help resolve the problems. They will exert real 'market' driven forces which will force a solution to Canada's public debt crisis while simultaneously addressing and reversing the seemingly inexorable growth of government and regulation in Canada. In doing so these market forces will not only resolve the government spending crisis but help greatly in resolving the Constitutional impasse by removing the most damaging impediment to national unity – an outdated over-centralized federal structure. By forcing a restructuring on Federal Government finances, market forces will facilitate the birth of a new Canadian federalism, through an orderly and natural devolution of power and responsibility within the Canadian Confederation.

Tragically that crack about the Third World was misdirected. The society in real danger of falling apart is south of our border. The level of crime, violence and dislocation in the American inner cities today is unprecedented by civilized Western standards. This meltdown of civil order in the heart of America is surely the most serious problem facing any Western nation. Ironically, it is the United States, not Canada, which is embracing a 'Third World' policy of abandoning its poor and dispossessed. In the face of one of the gravest political and social crises in its history, the United States is opting to institute radical downsizing of its welfare system, effectively unravelling the social safety net for American Blacks and other disadvantaged minorities living in its turbulent inner cities. This will help the US balance its budget by 2002, while allowing Congress to give the American middle class a considerable a tax break. Using the logic of the WSJ and the International Monetary Fund, this is prudent fiscal management, but it leaves unaddressed the problems of inner city violence, dislocation and social collapse. What, ultimately, are the consequences for American liberty?

Americans today are critical of Canada, not simply for being proliferate social spenders, but, in part, because Canadians refuse to believe this course of action is reasonable. Canadians, although not faced with the scale of the problem, will always opt for preserving a strong sense of social harmony as a top priority – we may suffer higher interest rates for it – but in my view the results are there on the streets. Unfortunately for the US, their dispossessed, being American, will not simply sit back and take this lying down. As in so many other periods of crisis in American history, revolutionary violence will be the inevitable consequence. It is not possible to simply build increasingly powerful networks of protection around the problems of urban poverty and racial violence. While this will buy some time it will not solve the problem. What it will do, of course, is make the inevitable explosion all the more damaging to American life and property.

STUDENT NUMBERS

On March 8th 1995 the following letter was published in "The Times".

Student numbers

From Mr James Bourlet

Sir, Under the headline, "A hidden army will go on to higher education" (Education, March 6), you report that the proportion of 18-year-olds who will go on to higher education would be likely to rise substantially from the present 60 per cent as soon as "students and employers meet more of the costs of education".

An "army" indeed! What are we doing? Qualifications for entry and for passing courses are being reduced so that students need do little more than serve their time in order to obtain a "qualification". Meanwhile more and more students are being housed at university in residential blocks for all the world resembling servicemen's barracks.

I suggest that what we are doing is replacing the old National Service with university study. At similar cost we are enticing every 18-year-old to spend a period before work in the bidding of the State.

This seems an abuse of what university education should and did stand for.

Further it allows secondary education to evade any responsibility for preparing our children for competition in the job market by allowing schools to claim success merely on the basis of university placements.

Surely it would be better to allow universities to prepare the academically outstanding for intellectually challenging careers and work towards the German model where the majority of school leavers do some sort of real "professional training" or apprenticeship in a real business.

Yours faithfully,
JAMES BOURLET
(Honorary Secretary),
Economic Research Council,
239 Shaftesbury Avenue, WC2.
March 6.

Two days later "The Times" published a response from David Plunkett M.P., Shadow Secretary for Education expressing his sense of depression at the comments made. Further letters were then received by the ERC and these are published below.

Members wishing to contribute thoughts on this subject or to participate in a seminar discussion are asked to contact the Hon. Secretary.

Sir,

I felt that your excellent letter on above in "The Times" deserved comment – and all my praise. I agree entirely with what you say. As a one-time grammar school teacher, years ago now, I laboured to get really able pupils, often from unhelpful backgrounds, into higher education.

There was really no place for me in the anti-intellectual egalitarian world forced on us by permissive educational utopians in which all were equal and destined for higher things at will, whether able or not! And this goes on still!

Secondary schooling in this absurd non-selective system so favoured by our libertarians is, as you note, evading true responsibility or purpose. No one is left to do scores of useful non-academic jobs. Students so-called abound, but where are they heading? It is a ludicrous abuse of schooling and after; a prostitution of learning; an abasement of true standards; a national folly.

I feel very annoyed, having spent years giving off along these lines. Perhaps your Council could sponsor an angry pamphlet with contributions from various hands to combat this lunacy? Just a thought!

Yours sincerely,
John Lockart,
21b Kings Avenue,
London W5 2SJ.

Dear Mr. Bourlet,

Can I congratulate you on 'speaking the unspeakable' in your recent letter to The Times. During my 30-odd years as a university teacher I witnessed a steady decline in standards, starting with the expansion following the Robbins Report and gaining pace as departments intent on increasing their student numbers (and hence their share of the financial cake) progressively lowered A-level entry requirements at a time when these A-level standards themselves were being relaxed. One aspect of this is high-lighted in the recent report of the Engineering Council on the mathematical preparation and ability of engineering undergraduates, and another by the low level of entry requirements in many science and engineering departments, which is plain to see in the autumn lists published in The Times of the A-levels required by departments seeking students through the 'clearing house scheme'.

In parallel with this decline in academic standards, there was a significant change in student attitudes. Instead of young people arriving for their first term full of enthusiasm for their chosen subject, many now drifted on to a university course as their 'right' (after all, they had two or even three A-levels at grade E), and an easy way of postponing having to earn a living. And, of course, subjects such as science and engineering which made bigger demands on student time in terms of laboratory classes and the like, became progressively less attractive when compared with those offered in certain other faculties.

Now, of course, a considerable proportion of the academic staff in universities is made up of those who were themselves students in the 60s and 70s and their 'politically correct' attitudes are, in some cases, quite astonishing. A copy of a letter I have sent to The Times is enclosed as it is unlikely to be published: in it I recount one example of such an attitude. Sadly, in my experience, the system whereby external examiners are involved in some parts of university examinations seldom provides any real check on the constant lowering of degree standards.

In the light of all this, is it any surprise that the market is flooded with graduates unable to obtain positions which they regard as commensurate with their qualifications? Years ago we used to smile at third-world countries where, it was said, one had to possess a degree from a local university before becoming a lorry driver. Sadly, our degrees have been debased almost to this level.

Your last paragraph puts the whole question in terms with which many of us would agree. For my own part, I became so disillusioned with the abysmal level to which we had fallen that I took early retirement some years ago. From what I hear from colleagues who have remained in universities, things have not improved recently.

Please accept my apologies for writing at such length – there is so much more I could have written – but I felt your letter was the first time I have seen this issue put so clearly and succinctly.

Yours sincerely,
Emeritus Professor J. A. Barnard,
'Eversley',
Netherhay,
Beaminster,
Dorset DT8 3RH.

Dear Mr Bourlet,

Your letter in the *Times* on 8th March hit several nails very squarely on the head. I remember as a graduate student in the USA in the late 1960s being amazed at how little seemed to be achieved in American secondary schools and on bachelor's degree programmes, and at the time I thought "Presumably the USA is rich enough that they can afford to squander years of their young people's time in this way, but it isn't clear why they want to and Britain could never afford it". I didn't expect that I'd in due course experience the British academic system moving in exactly the same direction. I still cannot understand (and I write as a longterm Conservative voter) what advantage Government sees in degrading the education system as it has done; they surely cannot be so naive as to imagine that we are achieving the same things with large numbers of students that our predecessors achieved with fewer students and more funds to spend on teaching them.

Yours sincerely,
Geoffrey Sampson,
Mountain Ash,
Firwood Rise,
Heathfield,
Sussex TN21 8LX.

Dear Mr Bourlet,

As an academic of almost fifteen years standing, I read your letter to The Times on the issue of student numbers with great interest.

I thought you might be interested to know of another phenomenon within the growing student body – that is, the well heeled mature student, predominantly but not exclusively women, for whom studying for a degree has become a central part of their social activities.

From their point of view, the advantages are numerous: they meet like minded people, usually from the same geographical region; the pace of study is not too fast nor the standards too demanding to involve any real stress (or danger of failing); and they have three years to develop a social life to replace the gaps left by departing teenagers. Indeed many remain on after the three years to take postgraduate degrees.

These students too have little to do with business or the needs of professional training. Counting their numbers amongst those now gaining access to higher education tells us nothing about the education of the nation's workforce.

Yours sincerely,
Anon

Dear Mr Bourlet

I write with reference to your letter 'Student Numbers' in *The Times* of Wednesday, 8th March.

I cannot emphasise enough how much I agree with your comments. What has been taking place for the past five years in the name of education is quite disgraceful and represents an even bigger confidence trick than decimalisation.

The GCSE syllabuses and examinations are of such a Mickey Mouse standard that they serve only to delude both pupils and parents that something worthwhile is being achieved. Certainly, more and more pupils are ending up with Certificates, and I suppose it might be argued that this 'carrot' dangled in front of the very large percentage of merely average and below average pupils is an incentive and serves to boost their confidence and to persuade them to work harder.

But to what purpose are they working? Unfortunately, even the A grades at GCSE are scarcely worth the paper on which they are written. Much of the so-called hard work, and certainly most of the course work, the pupils are being asked to do is no more than the mindless copying out of material from encyclopedias and other reference books.

Every day the public libraries are full of pupils (many accompanied by mothers, who in helping their 13-16 year old offspring to read (an appalling indictment itself of our educational system), never mind understand, what they are writing down, are virtually doing the examination themselves) copying out what they think they need for this or that project or piece of course work, but understanding, I venture to say, very little. As a result, the illiteracy, to say the least, remains; the spelling is appalling, the lack of vocabulary frightening, and the understanding almost nil. And yet, they and the general public are being led to believe, quite erroneously, that standards are rising. They may appear to be rising from the ever increasing tide of statistics emanating from various relevant Government Departments, but these are no more than proverbial dust being thrown in people's eyes.

Even more importantly from the viewpoint of the future of this country, the top, say, twenty-five per cent of the pupil population is being fed this same Mickey Mouse diet, so that neither they nor their potential is being stretched in the slightest. Moreover, far from encouraging these people to work hard, the present system simply makes them more idle, since the work they are being asked to do they can do virtually with their eyes shut.

To see, year after year, what would have been former O-level candidates, sitting GCSE type examinations, which are scant preparation in any case for A-level courses, or should I say the A-level courses of, say five years ago, since these syllabuses, too, have been watered down under the guise of altering their format, is a national scandal and a disaster waiting to happen.

I mean by this that if the present complacent system continues for the 'period of stability' proposed and, who knows, perhaps even longer, this country will reap in twenty to thirty years' time an educational harvest, with, by then, the blind leading the blind in our schools since the illiteracy of teachers themselves is already apparent, which will be as disastrous and frightening as the social harvest which has been bequeathed to us as a result of the ill-conceived ideas and decisions, the excesses, the lack of discipline and the growing insistence on tolerating the insupportable in so many areas of private and public life during the last forty years.

During this time there has been a total elimination of any sense of shame, fear or respect among individuals either with regard to themselves or in relation to others and when one adds to this the fact that far too many people, almost from the cradle upwards, are allowed to have far too much to say about far too many things they know far too little, if anything at all, about, one can see quite clearly disaster looming.

The most frightening thing of all is that the so-called education of today is simply not teaching people how to think. Just consider where that is going to lead us if the situation remains as it is. The Education Reform Act has done very little to give the average and below average in our schools what they need; all it does is to give them false hopes and persuade many that they are suitable A-level material when manifestly they are not in any way. The Government's answer to that has been to allow students to take the examination in stages over *n* years, which makes an absolute mockery of the whole system.

I agree with you entirely about the German model, but that will cost money, and that is why we rarely, if ever, do anything properly in this country. What this country really needs is for enough interested and wealthy people or organisations to set up an alternative education system, and as a former Headteacher I would willingly ally myself to any such venture.

I am sorry to have written at such length, and I should be pleased to hear from you.

Yours faithfully
David M. Platt
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THE EDWARD HOLLOWAY COLLECTION REVIEW

***Life and Money* by Eimar O'Duffy**
Published by Putnam 1932

This is a book of its moment – of 1932, a time when economic circumstances were dire indeed. A quarter of the population were unemployed, prices had fallen, factories lay idle and poverty was obvious. And all this in the richest countries of the world and in a Britain which had been victorious in war.

"Orthodox economics", whatever that was supposed to be, was held responsible, and well meaning imaginative souls felt impelled to offer their opinions for a cure. The sub-title of this book is "A Practical Scheme for Remedying the present Industrial and Financial Chaos".

Britain's present situation is also troubled. 1995 sees a Government relieved to note unemployment at "only" around 8%, a Government that would be pleased with just a couple of percentage points of economic growth, a Government, indeed a Conservative Government, that must contemplate severe hardship for a great many of its middle class, home owning supporters. At present the proportion of jobs that are full time, long term, career oriented and family supporting is declining whilst for many the only work available is part-time or insecure or poorly paid – or all three. The incomes of the top earners are rising spectacularly – in some notable cases outrageously, whilst the incomes of others are stagnant or falling.

But in contrast to the 1930s we now look to marginal and incremental change for a solution, not to wholesale, radical reform. Today we worry about public utility regulation, about increased levels of industrial investment, about relatively small tax changes – and about non-existent inflation.

In the 1930s things were very different and Eimar O'Duffy was a lucid and persuasive voice amongst many who wanted to build new Utopias. For him, those who sought to learn from the past were labelled "Procrustean" and those who thought in terms of job creation he labelled "Sisyphants". In contrast to these Aunt Sallys his own thought and analysis is clear and perceptive, analysis based on the production and delivery of goods and services rather than on accounting balances – an analysis of the "real" economy before the "monetary" economy. And there was much to comment on – hardship in the midst of plenty, idle factories unable to employ the unemployed, surplus production to be dumped; protectionism, restrictive practices – and much more.

But like Karl Marx 90 years earlier O'Duffy was far more impressive in analysis than in prescription. Whilst throwing out in contempt the ideas of John Maynard Keynes, he enthusiastically embraced Major Douglas and the ideas of Social Credit. Now the core idea of Social Credit is perfectly reasonable. It is the idea that the seignorage value of new money creation should be shared and not kept by the private banking system. Social Credit would give all citizens a hand-out whilst others would hand it to the state to set against lower taxes. Yet others such as F. A. Hayek, would urge that competition between banks should enable this value to passed on in the form of lower interest charges etc. O'Duffy's extension of Social Credit, however, now looks plain comic.

For O'Duffy, the only way to solve the problems of the monetary and economic system is to create a "Currency Board". This board would then create two different sorts of money – one to be used for the process of production and the other for the process of consumption. The Board would issue "P" (production) money credits to firms who will use them to pay for production costs and would issue "C" (consumption) money to citizens in a fair manner to enable them to buy all the production anticipated. After use, all the money would be returned to the Currency Board which would then decide the "correct" amounts of "P" and "C" money to issue for the next period in the light of the country's output potential. If anyone charges too high prices or pays themselves too much, then the relevant office supplying the Board's money would find itself short of funds for other things thus providing "automatic correction" for such abuses.

Such tortuous proposals have to be read to be even properly imagined – and the idea of price as a resultant of a balance of forces repeated millions of times daily throughout a complex economy, is nowhere in sight. Thus this book can only be called a curious period piece, interesting enough and full of homely truths. But not much use, one fears, today.

J.B.

LETTERS

A response to "VAT – the Unacceptable Face of Taxation" by John Davison, from Dr Bernard A. Juby

John Davison's review on VAT – the unacceptable face of taxation, is timely. When the Richardson Committee first looked into the comparison between the then Purchase Tax and the proposed VAT, they rejected it on the grounds that it was a highly complex tax which would adversely affect small businesses administering it – a view which was prophetic. However, in certain parts of Europe (such as Germany) who suffered from a cascade tax (i.e. a tax on a tax on a tax) VAT was a godsend.

As I have previously explained in these columns the current system of administering VAT within Europe is the biggest drain on commercial cash-flow ever devised by man! The only time that any money is collected **and kept** by government is at the point when someone within the system (i.e. a trader) deals with someone who is outside that system - usually a member of the public.

Money laboriously added on, charged, collected and paid over to the state during all interim transactions, is effectively taken off again when that same money is returned to the one higher up the chain in the reclaim. All of this money is effectively taken out of the system while creating cash-flow problems in the process.

Since the start of the new Common Market on the first of January 1993 we have all been allowed VAT-free trading between member states. That this works well has been proved in the past two years.

Furthermore, member states *are* allowed by Article 27 of the Sixth VAT Directive to simplify their methods of collection *provided that the final yield of tax due is not affected (i.e. diminished) at the final consumption stage as a result*, **even** (and I quote Mrs Scrivener in a written answer given on behalf of the Commission on the 19th December 1993) **if the entire yield "is collected at a single stage in the economic circuit".**

If VAT-free trading (which, incidentally, should be continued as the norm when discussions on the VAT definitive system take place in October) is allowed and has been shown to work between traders in different member states, it is a logical question to ask, why not between traders within the same member state since the *entire* percentage of VAT is levied *on the final sale price* irrespective of the number of interim transactions that may have taken place?

It has been calculated that in the UK alone for the year 1993 some £25 thousand million pounds was taken out of the economy by locking it up in this financial money-go-round. In addition vast sums can be saved when VAT is not lost by the current system in fraud and insolvent companies. Who knows, with £25billion put back into the UK economy – to say nothing of the many billions more within Europe – fewer businesses would go bankrupt.

At a time when deregulation is the name of the game, allowing an extension of VAT-free trading as already practiced would clear the way for the biggest piece of red-tape to be removed from small businesses – at a considerable saving to the governments of the member states.

As the Barcelona Small Businesses and Craft Conference several years ago clearly showed, the intellectual and logical arguments have long-since been proven.

What is now required is the political will to allow us to do this, combined with a suitable phasing system to allow the Exchequer to recover from the shock of having to pay back £25billion to British industry.

Dr Bernard A. Juby
1 Wash Lane
Yardley
Birmingham
B25 8SB

Three questions posed by Brian Lewis – answers requested by the ERC

Sir,

I have now been a member of the 'Economic Research Council' for some 20 years, but having been abroad since 1979, it is of some regret to me that I am unable to attend the monthly dinners and discussions. Nevertheless, I would like to express my appreciation for the continuing correspondence and, perhaps more important, for the commentaries on economic affairs that I receive from time to time, which I always find stimulating.

One question has intrigued me over the past few years which I have never really seen discussed in any detail: that is, where do governments get the huge sums necessary at short notice to support sudden emergencies – and who in the economy pays?

I refer to such events as the periodic devaluation of the Pound Sterling. Two billion pounds seem to have been spent in two days! And more recently, the United States and her allies have put together a package worth US$49 billion in a few days to support the ailing Mexican Peso. I can see in this case that the full amount is not necessarily spent, being only a guarantee, but if the worst happens, who pays?

When talking about taxation for example, H. M. Government is often concerned about a few hundred million pounds, more or less. And yet a few days later is discovered spending a few billion without turning a hair. How is it that these events, *entailing the spending or guarantee of "billions", seem to cause so little political fall*-out for those concerned, and who pays and what parts of the economy suffer the consequences?

Another interesting question is to what extent nation states are really in control any more? As one who has spent 23 years of his career outside the UK, it seems to me that I now belong to an international group of almost stateless people, who nevertheless are extremely influential internationally. This has been aggravated by the very considerable early retirements and redundancies of people (like myself), who are not able to find suitable work in the UK because – it seems to me – we are in fact too well qualified rather than the reverse! I note that the Chief Executives of such companies as British Gas and The Prudential seem to have very limited international experience and consequently a lack of judgment that would come with global experience. And Mr Heseltine seems to think that good senior UK executives are hard to find!

A final point when everyone seems to worry that the burden of looking after the old will be too onerous. With the development of international communications, I am in contact with the whole world on a daily basis, unimaginable when I started work 35 years ago. Retirement as such (rather than health) is no barrier to a continuing contact with the 'Great and the Good'. Indeed it still seems to me distinctly odd to make people redundant in their 40s and 50s, and then in the same breath complain of the cost of looking after the old!

Sincerely
Brian Lewis
c/o Sabic Marketing
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Riyadh 11422
Saudi Arabia.

A response to "The Twilight of Meaningful Economics" by C. Gordon Tether, from Mr D. Chapman

Dear Sir,

I take somewhat of an exception to C. Gordon Tether's statement regarding the handling of the economic aftermath of World War 1. To quote, "The blunders perpetrated in the infamous – as it has now come to be labelled – Treaty of Versailles – were essentially economic."

I admire Gordon Tether for his integrity and courage but I am afraid this statement is completely erroneous.

Versailles was under-written and over-written by top international financiers, and the main strategy was to lay the foundations of the Second World War. This is not my assessment or anybody else's but comes from the actual statements of the perpetrators themselves.

Indeed Gordon himself goes on later in the paragraph to state that this strategy came to fruition in the emergence of Hitler and World War 2. What Gordon does not do, and I think it is very important, is state that this was a deliberate and conspiratorial plan and not some mistake in economics or the lack of the knowledge of economics in the men who attended the thrashing-out of the Versailles Treaty.

Those men deliberately laid the foundation for the destruction of millions of people in the later years, and yet, the men who perpetrated this infamy are not and never have been charged with it, whereas the world propaganda machine of the last fifty years vilifies and charges Hitler with the sole responsibility for the immeasurable stain on humanity and history that the Second World War represents.

The average man in the street goes about his daily life believing that what is happening in the world today and what has happened in times past is accidental and that the whole of humanity is struggling against adversity. The fact is that all the affairs of nations and the consequences and the blood baths are deliberately planned to bring about an ultimate end which may or may not come to fruition.

In conclusion, I cannot go along with the statement that economics is a science, I think a better description is that it is a religion somewhat like the theory of evolution.

Regards,
D. Chapman,
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Louth,
Lincolnshlre,
LN11 7AL

A response to "Taxation: Practice – Principles – Prospects" by John D. Allen, from Mr Stephen Hill

Sir,

In his address on *Taxation: Practice – Principles – Prospects* (Winter '94, Vol. 24/4), John Allen asks the question "How could tax reform based on classical principles [i.e. the taxation of 'economic rent'] become practical politics?".

Certain aspects of this key question are more complex than Mr. Allen allows for. Relying on Adam Smith (published in 1776) he assumes that an income tax on payrolls is inflationary *per se*. This assumption, however, omits two centuries of structural evolution towards the modern mixed economy. As he rightly says PAYE was introduced in 1944 to pay for defence. A year later our greatest civilian institution – the NHS – came into being. Now we all need defence, health, education and much else besides. Most of us receive these essential services "for free", which of course is an economic nonsense as we pay for them through PAYE (and many other taxes and levies). To the extent that these mandated exactions pay for services we require, they are merely a non-discretionary transfer to drive productivity elsewhere in the economy. And we cannot discuss inflation without considering productivity, for what causes the last vicious twist towards hyperinflation but an increasing non-availability of essentials?

No. The tenet of the "Single Taxers" of the 1909/10 elections is now redundant. In the 1980s, for example, we learnt that monetary policy is a vital part of the inflationary equation too. What the classical economist has to do in 1995 is to analyse the incidence of every form of taxation as it falls on the two primary factors of production – land and labour, which is no easy task. Just as the monetarists have developed their tools in the 1980s, the classical economist must do the same for the new millennium.

In *Lions Led By Donkeys* *(published in 1992) I attempted to answer the question Mr. Allen poses. Allowing for the limitations of the methodologies adopted, I concluded (see Table 9 on p. 150) that a tax on economic rent would raise £34.4 billion and lead to the elimination of non-productive (i.e. inflationary) taxes of a similar amount, particularly in conjunction with monetary policy to subdue inflationary rises in property markets.

John Allen also asks "Could it [the taxation of economic rent] be translated into the realm of the art of the possible?". Another good question, to which the answer is "Yes, if the Treasury allowed Local Government to operate autonomously". By my calculations, the General Government Expenditure could be reduced by £50 billion, even allowing for much fine tuning to boost productivity at the same time.

* *Lions Led By Donkeys: How to Make the Real Economy Work*, 1992, Duckworth p/b £8.95. Described by *The Spectator* as "One of the most brilliant polemics yet written as an assassination of the traditional economy".

Yours sincerely,
Stephen Hill, FCA,
24 Charles Street,
Mayfair,
London W1Y 7RL

A response to "Taxation: Practice – Principles – Prospects" by John D. Allen, from Lee Cheney

Sir,

John D. Allen hit the nail square on the head when he said in *Britain & Overseas* that taxes for labour and costs of supply, and interest on money lending, cause inflation. Mr. Allen's suggestion that taxes be abolished for labour and costs of supply has significant merit. It is interesting, however, that even though Mr. Allen recognized that interest on money lending is also a cause of inflation, he did not suggest that interest on money lending should also be abolished.

Mr. Allen's proposal to abolish taxes on labour and costs of supply must also include tackling the issue of monetary reform. Simply transferring the tax burden from the labour class to the capitalist class leaves the root cause of the tax problem (the debt/tax system of printing money), and the problem of the monopoly of capital, untouched.

Rather than merely doing a taxation juggling act, Louis Kelso, co-author of *The Capitalist Manifesto*, has provided us with a very different and a very profound vision ... a vision of TURNING LABOUR INTO PROPERTY OWNERS (i.e. capitalists), of everything from homes, land and farms to labour owned business and industry, which is what Kelso called *the universal private property society*.

Kelso also recognized that the only realistic way to stop the capital concentration syndrome in its tracks is with the 2-K Factor.

Within the context of the 2-K Factor and a debt free and tax free money system, there is NO NEED FOR TAXATION OF ANY KIND FOR EITHER LABOUR OR CAPITAL.

The 2-K Factor is a provision laid out in his book *Two Factor Theory: The Economics of Reality*, which places an upper limit on the accumulation of wealth. Why would the co-author of *The Capitalist Manifesto* place an upper limit on the accumulation of wealth and what does the 2-K Factor have to do with taxes and propertyless labour? Very simply, it is the elimination of propertyless labour by transforming labour into new capitalists that is the missing link in Mr. Allen's tax reform proposal.

The original title proposed by Louis Kelso for his book *Two Factor Theory: The Economics of Reality* was *How to Turn Eighty Million Workers into Capitalists on Borrowed Money* which, in spite of the distracting and contradictory addition of "on borrowed money" to this title, I thought it was a much better title than the one approved by his publisher because it focused on the vision of turning the labour class into new capitalists.

Kelso recognized that it is the *debt/tax system of money printing* itself that is the root cause of propertyless labour and the capital concentration syndrome when he supported the use of debt free and tax free government printed money, instead of bank printed debt/tax money, for the creation of new capitalists. Furthermore, Kelso recognized that creating the *universal private property society* can not be achieved within our debt/tax system of money printing. However, Kelso's vision of the *universal private property society* CAN be achieved by combining the abolition of taxes on labour and the costs of supply with a debt free and tax free money system in the context of the 2-K Factor.

Mr. Allen inadvertently alluded to the debt/tax money printing problem when he said that Jesus had access to a source of funds (to pay taxes with) that no other taxpayer could rely upon. However, Mr. Allen either rejected the arguments put forward in my book *Bible Slave Law* or he has not read them. It is obvious that Jesus was not very concerned about offending the tax collectors and bankers when he sacked the money changers' temple nor was he very concerned about offending the establishment and teaching authorities of his day when he taught people how to effectively share the available wealth (the fishes and loaves story where the capacity to produce far outweighed the capacity to consume).

The story about Jesus getting money from the mouth of a fish to pay his taxes is not a fanciful account of magic as Mr. Allen portrayed it. Rather the way in which this story is told in the Bible is typical of the commonly accepted pedagogical methods used in those days and Jesus merely used that same pedagogical method to explain to his disciples the magical way in which bank printed debt/tax money systems create money *OUT OF THIN AIR* (including money used to pay taxes with).

It is admirable that Mr. Allen supports the abolition of taxes on labour and costs of supply but unless our debt/tax system of money printing is also abolished and replaced by a debt free and tax free money system for both labour and capital, and unless the class separation between labour and capital is abolished in creative and positive ways that will transform the labour class into new capitalists in the context of the 2-K Factor, there is precious little hope of solving the class conflict between labour and capital that is still plaguing the world.

Those concerned about how to finance essential government services without taxes can read what I have to say about the matter in my book *How to Convert the Inland Revenue Service from a Tax Collector into a Money Issuing Institution.*

Lee Cheney,
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USA

An (extended) response to the review of "Coping with Debt" by the Rev. Dr. Francis P. McHugh, from Hugh Walton

Sir,

The review of "Coping with Debt" by the Rev. Dr. Francis P. McHugh raises issues of great concern. One's own experience confirms that post-war consumer debt grew at times in the expectation that its real value, and hence the effort required to repay it, would be wiped out quite quickly by inflation.

Thus it is tempting to trace the housing boom of the late 80s, along with its legacy of negative equity and debt, to a generation of speculators who, unlike their grandparents, had never learned how to look after themselves in a regime of stable money, and could only blame the government of the day for allowing them to believe that house values would always be on a one way ladder.

The historical background is however more complex than this. The question might for example be asked, at whose expense did these speculative gains ever occur? It may indeed be surmised that high inflation cheated savers of their money, but why did not the losers protest? Is there a wider picture of which the conventional wisdom exposes but a part, an underlying mathematical mechanism which needs to be understood? As an engineer I would answer "yes".

The starting point is easy for those who remember the war and its aftermath. Many people who had lived in reasonable comfort from their investments or savings before the war found themselves impoverished by massive taxes and inflation. To protest would have seemed immoral, even when there followed a Socialist restructuring of society. Houses were "converted" and let as flats to make ends meet. Others decayed due to lack of money for repairs.

With the exhaustion of this initial source of funds, who were to be the new "losers"?

Socialist thinkers were well aware that such a process could not continue indefinitely, without eating away at the capital base of industry. So this duly happened and was welcomed in that it would "destroy the capitalist system": that is to say eliminate all those who lived off rents or distributed profits, as opposed to the proceeds of employment or political control.

However the revolution was never consummated. Financial capital had become too diffused, for example through pensions institutions, and now commanded enough votes to resist further predation.

As funds thereafter were freed from governmental control they flowed out of weakened UK manufacturing industries into service industry, and of course abroad. Capital learned to protect itself by a *de facto* linkage between interest rates and (forecast) inflation, measured by an internationally competitive real rate of interest.

In the UK a new government adopted so-called monetarist policies which at last held the control of inflation to be paramount, a conclusion which can also be reached on engineering grounds. Normal fiscal controls did not however suffice to hold a highly innovative – and sometimes unscrupulous – financial community within bounds.

So the speculative boom which arrived within the last decade was not immediately brought under control. Interest rates rose: this now represented an automatic market reflex upon which our government could no longer have more than a marginal influence.

It transpired that by 1988 we in the UK were faced with a novel combination of high inflation and continuing high interest rates. The latter had a corrective purpose which eventually succeeded in preventing escalation after various comings and goings on the "ERM" and exchange rates. The transient effects of this combination however had a profound influence upon present-day issues of negative equity and personal debt.

I will now contend that high interest rates at a time of high inflation are a misnomer. What happens is that the lender calls for capital repayment, to offset the foreseen decline in the real value of the outstanding loan balance. This capital component is lumped in administratively with interest, but is not in fact a cost to the borrower since it merely cancels the advantage he would otherwise have expected in repaying the principal with depreciated currency.

A simple computer simulation confirms that the borrower need not spend more eventually in real terms, but is repaying more quickly than he intended (or contracted?) to do. This puts the ethical position of the mortgage defaulter in a new light which I argue should be recognised in law.

It is only the mortgager forced to sell who seriously loses out, and to whom the

situation is in the long term unfair - even if he has compounded it by over-estimating his earnings or unwisely buying at the peak of the market.

A measure of the length of credit enjoyed may be found in terms of the time taken to reduce the loan by half, given a pre-arranged combination of principal and interest payment as in the normal form of building society agreement. For a 25 year loan the time for half-repayment might appear as 17 years. The peak inflation of the 1980s as I estimate reduced this time effectively to 4-5 years.

One may deduce from this calculation that as much for manufacturing industry as for the individual, inflation of itself makes long term borrowing impossible without defrauding the lender. This helps confirm the nature of the mechanism whereby UK manufacture reached such a parlous state, during the latter part of the twentieth century, as to require overseas investment for its very survival.

Does all this history relate to the economic problems of the individual in the here and now, a situation in which the "Mum down the road" cannot cope? I would firstly cite economic stability: so long as government is not allowed to use inflation for political ends, it will continue learning fast. Knowledge about how to manage a free market economy will spread, particularly to the Eastern Bloc. This will help to maintain peace.

After all, what makes life tolerable for the underprivileged is not a few pence more on the state hand-out but a reliable supply of low-cost goods and other facilities which free markets on the whole create and inflation destroys.

It is my further belief that a government which wills economic freedom has also to will the means, whereby citizens must be educated from an early age to temper desire with evaluation of risk. In this respect our post-war education system has let us down. When one is faced by a salesman, a pen in the hand has to qualify as a dangerous object!

To which your editor replied, "But is there not something useful about inflation?".

Yes, there is something rather useful about inflation, even if one excludes letting it rip as a means of social engineering, or as an hallucinogenic drug to capture the voters for a time. We cannot entirely do without it because low or negative inflation creates genuine political instability as Marx implicitly pointed out. Both high inflation and lack of any inflation at all bring disaster.

The type of engineering analysis that I have in mind would go roughly as follows: an accumulation of money left in a bank to gather interest must not increase its real purchasing power with time, otherwise a spontaneous and ever increasing transfer of physical wealth will infringe "system stability".

This means that surplus purchasing power has to be continually removed by some combination of taxes and inflation. For a variety of reasons, taxes alone cannot do the job even when inheritance tax is included. So inflation is a necessary feature of the economy.

How much inflation can be tolerated? To gain perspective one notes that, mathematically speaking, a continued inflation of even 3% doubles wage rates and hence the price of labour intensive products in one generation.

Even if eventually controlled, high inflation acts through interest rates to inhibit long term borrowing, so that more and more sectors of the developed economy are enfeebled. Enough people's disposable incomes decline to form a political trap. So in practice an upper limit to allowable inflation must also be held to exist.

This reasoning leads me to accept the view that a market economy can be stable (i.e. survive to the satisfaction of its citizens) only if inflation is steered along a narrow pathway, say from +1% to +4% at most. Above this range there are not only a variety of diminishing returns, but eventually triggers for hyper-inflation.

J. H. D. Walton,
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'LETS' SCHEMES – A REQUEST TO ERC MEMBERS FROM CHRISTOPHER HOUGHTON-BUDD

Can you help me with a research question, please? The LETS schemes (Local Exchange Trading Systems) effectively create their own money. They reckon that they do not contravene laws on currency emission because when accounted the system as a whole always results in zero – debits equalling credits. In view of the fact that most such schemes have been ended by being outlawed, can any ERC members comment on this aspect in today's Britain?

Yours sincerely,
Christopher Houghton-Budd,
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Canterbury,
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