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BRITAIN, THE £1,400 BILLION GLOBAL INVESTOR

A talk by Bill Jamieson, Deputy City Editor and Economics Columnist for the Sunday Telegraph, to members of the Economic Research Council on Tuesday 16th May 1995

My talk this evening is based on a particular theme, Britain's global investment portfolio, of my book *Britain Beyond Europe**. It is one of the biggest in the world, it is widely spread and in gross terms it is valued on a conservative basis at £1,400 billion. Put another way, it is approximately double the entire market capitalisation of all United Kingdom companies quoted on the London Stock Exchange, or 'eight Australias' in terms of GDP. It is equal to around £70,000 for every household in this country.

My aim is to set out what this portfolio comprises, how much it earns for Britain, where it is to be found and why it has been overlooked and neglected in economic policy making.

In setting out details of Britain's overseas assets and investments, I seek to advance three arguments: that the scale and extent of global capital shifts is fundamentally re-writing the global economy; that Britain's assets and investments overseas are coming to play an increasing role in the economy; and that, looking at the global spread of these investments, we should now draw a line under further political and economic integration with the European Community.

The opportunities for Britain in finance, trade and investment in the global economy are greater now than at any time since the turn of the century and overseas trade policy should pay far greater attention to the importance of Britain's earnings from invisible trade, in particular investment income.

Britain should now shift from its over-concern with Europe to enhance that opportunity. Britain has nothing to fear and everything to gain from drawing a line under further integration with Europe and building her already formidable trade and investment links with the wider world.

'Britain Beyond Europe' also touched on the debate about Britain's place in the world. That debate has been haunting the country since Suez and the collective collapse of confidence suffered by the political class in the wake of Suez. Remember that at the time there seemed to be no part for Britain in the global economy and or Europe, given the dazzling post-war success of the European economies led by Germany. Membership of the Common Market offered a way out for the domestic economy which seemed trapped in a box of balance of payments constraints, rising trade union power, the threat of inflation and growing demands on government spending. In the wider world there seemed no opportunity for expansion, only retreat.

Forty years on, that debate still preoccupies us, yet for many its outcome seems predetermined. What is there left to discuss when the government is committed to our future in Europe and to a programme of economic and political integration? We may

* Britain Beyond Europe, Duckworth 1994. Reviewed in 'Britain and Overseas', vol 24, no 2.

argue about the timing of monetary union – whether it is going to be in 1997 or 1999 – but a consensus among the three major political parties leaves little doubt of the general direction.

I do not share that conclusion at all. This debate has still to begin in earnest – and debate there will be, not because of the eloquence of the Euro-sceptics but because the continuing shift in the balance of global economic power will force us into a re-examination.

Global capital flows have now become the elephant in the room of contemporary economics. Be in no doubt that they are the single most important development in the wake of the collapse of the former Soviet Union.

Last year the total capital flow into developing country economies totalled just over $227 billion, a sum greater than the combined GDP of sub-Saharan Africa – ten countries with a combined population of 130 million people.

Taking the five years 1989 to 1994, total resource flows into developing economies came to $820 billion. The average annual figure is equivalent to the move of eight Ford Motor Corporations from the developed to the developing world each year. Asia will come to account for 25 per cent of world trade by the end of the decade against 17 per cent currently.

In any debate about Britain's place in the world, arguably the best starting point is an analysis of our overseas investments. Put aside for a few moments what it is that the leaders of the three main political parties have sought to predetermine for us. Where is it that British business and British investors choose to invest?

Perhaps we could look on overseas investment as votes of the corporate and investor wallet. The truest and most honest vote there is. Where is Britain's place in the world as defined by her overseas corporate and portfolio investments?

Britain, the Global Investor

I have a theory of Britain as a nation of frustrated investors: every businessman and economist wants to build the perfect portfolio if only they had the chance. But meagre though our efforts seem we are one of the most global minded investors in the world – a typical UK private portfolio is more geographically diversified than its counterpart in the United States or Europe.

Britain in aggregate has one of the largest portfolios in the world, extending to £1,400 billion. It is growing at a rate of £17 billion a year – equivalent to the outward movement every twelve months of three companies the size of the Prudential.

One of the first questions I would ask is: would we confidently leave it to the British government to manage?

Supposing that the government was to say, well, actually, only 25 per cent of that portfolio is really interesting and worth looking after, the rest is just bibs and bobs in iffy faraway places, would you be happy with the government as your portfolio adviser? And would you value its advice very highly when you later discover that the

25 per cent it said was interesting was growing rather slowly, while the value of the 'bibs and bobs in iffy places' was shooting ahead?

Or suppose you confined the government's involvement simply to collating the figures on interest and income, how confident would you feel on discovering that the detailed figures were produced almost a year late and the global totals for movements in investments and earnings were relegated well behind misleading and constantly revised and corrected figures on visible trade? If you were a director of ICI needing to update on global assets and liabilities of your business around the world, how would you feel about being sent figures on the previous month's trading, stamped provisional, estimate only, subject to revision?

But this is what happens in Britain, and out of this muddle commentators opine and policy is made. The big numbers are crowded out and ignored while the insubstantial and the minutiae constantly jostle for attention.

Every month a complex and esoteric ritual is played out in Whitehall and the City of London. The cycle begins with the publication by the CSO of provisional stats for the UK's monthly visible trade with countries outside the EC. This is followed, some weeks later, by the release of provisional stats on the UK's visible trade with EC countries. Barely have these been digested by commentators and markets than a revised set of visible trade statistics is released, altering the earlier provisional numbers on EC visible trade for the previous month but one.

These are not to be confused with subsequent revisions to visible trade with non-EC countries and, of course, the continuing flow of provisional 'flash forecast' numbers for visible trade in the month that it has taken the markets and pundits to digest all the earlier numbers.

Confused? When you consider that visible trade accounts for barely half the total of the UK balance of payments current account and that the numbers for service and 'invisible' trade are released quarterly in arrears and are apt to throw into disarray all the previous monthly prognostications on Britain's balance of payments, it is a wonder anyone in the DTI or the Treasury has got a grip on underlying UK trade at all. In addition to this continuing flow of estimates, revisions, corrections to revisions, revisions to corrections, quarterly and annual compilation of additional data, much of it conflicting, the CSO cannot provide a geographic breakdown of movements in assets – that huge figure of £1,400 billion – or with which countries we have an invisibles surplus and invisibles deficit until November or December the following year. Imagine the ICI pension fund writing to Mercury Asset Management and asking for a portfolio valuation and geographic breakdown and being told: 'Dear me, that's quite impossible, you'll have to wait eleven months.' After all this, it may be said that Whitehall has added to a firmer understanding of the global reach of the British economy by being, in a statistical sense at least, all over the place.

It is in that nonchalant and offhand manner that Whitehall handles and (as a result) belittles the importance of Britain's global endowment that our analysis must start. For were these figures treated with the care and diligence they deserve, Britain's policy establishment would not be in the conceptual mess that it is in.

The True Scale of Invisible Earnings

By far the largest, and fastest growing, component of the invisibles surplus is investment income. Last year we enjoyed a net surplus on investment income of £11.2 billion. But this figure is itself the residual of two much larger gross totals. Total gross investment income credits last year came to £78.7 billion, whilst total gross debits, that is interest paid by us on foreign loans plus profits made by foreign firms in Britain, came to £67.5 billion. Of the £78.7 billion the biggest contributor was earnings on lending to overseas residents by UK banks of £32 billion, followed by direct investment income of £22.2 billion and portfolio investment earnings of £16.6 billion.

Thus, earnings on overseas corporate direct and portfolio investment together in 1994 came to £38.5 billion, or more than £10 billion above the entire exports of finished manufactures by the UK last year.

The total of £1,400 billion of gross external assets is also made up of a number of different items. The largest of these is loans outstanding to overseas residents of £603 billion, portfolio investment overseas of £418 billion and direct investment overseas of £186 billion (this is a book value estimate, estimates of market value suggest a figure double this sum. Even that may prove conservative. For example, the CSO gives the level of UK direct investment in South Africa at around £2.3 billion. The actual figure is more than three times this level at £8 billion. According to the CSO we have nothing invested in China. In fact, we are the largest European investor there with 600 joint ventures reckoned at around £2 billion.

Where around the world is this stock of assets to be found? The CSO provides a geographic breakdown for overseas direct investment only, and the latest available figures (for 1993) show a total of £165 billion. The flow of annual outward direct investment is around £17 billion. Of the £165 billion total, just over $112 billion or 68% is invested outside the EC. The most popular area is North America which accounts for £64 billion or 39%.

But, once we adjust for the Netherlands which is accorded £23 billion of UK investment or 46% of the total level of investment by Britain in the EC (only the CSO could come up with a figure for UK investment in the Netherlands which is 150% of the total) the contrast becomes even more stark. The EC accounts for 21 %t and non EC for 79%t.

Of equal interest is the changing pattern of UK investment flows. In 1993 these totalled £17 billion. Of this total £10 billion or 61%t went to countries outside the EC. While the EC remains a strategically important area for UK corporate investment, it is not the fastest growing. Investment in south east Asia is accelerating dramatically, albeit from a low base. Over the six years 1988 to 1993 there has been an underlying shift in the flow of UK investment towards south east Asia. Between 1991 and 1993 UK investment flows into Asia and the developing countries came to £10 bn., against £9.1 billion going into the EC.

Finally, what of the geographic distribution of portfolio earnings? Of the £16 billion total in 1993, £12.2 billion or 74% is derived from outside the EC. The

Commonwealth is the single most important source of direct investment income, accounting for 30% of the total, followed by the US (30%) and the EC (25%).

Britain's Super-League of Global Companies

So much for the abstract figures. These huge figures can mean little unless illustrated by real life examples. What practical form does the investment take? How does it find expression in the real economy?

One of the biggest changes in the UK economy is in the composition of earnings of some of our largest companies. The fastest growing slice of the pie chart of UK plc is what until now has been dubbed as Rest of World – for 'RoW' read unimportant or marginal. Now it is coming to be very important indeed, and likely to be accounting for between 15% and 25% of UK plc earnings by the end of the decade.

Britain is creating a super-league of global companies deriving half or more of their earnings from outside the EC, and we have more international companies than any other EC country. While there is much to congratulate ourselves about in this development, bear in mind that these companies are tiny in comparison with their American counterparts.

As impressive as their size is their diversity. They can be found in construction, oil and energy, textiles, civil engineering, chemicals, metal refining, electronics and power engineering, paper-making, media and financial services.

Nor does a company need to be among the super giants to be global. Many substantial, second line companies can be found which are building promising portfolios of overseas businesses, often overlooked by analysts who tend to focus on the performance of domestic operations.

The most obvious examples are **Hanson, GEC and British Oxygen. BAT** is one of our biggest companies, deriving more than half its profits outside Britain and the EC. Its biggest areas of investment in the tobacco side are currently China, eastern Europe, where it has made major acquisitions in Hungary, and in central Asia, where it has recently put a marker down on acquiring the state tobacco company in Uzbekistan.

In the textile industry globalisation has been around for 100 years. Globalisation has changed the character of **Coats Vyella** which has gone from being a predominantly UK manufacturer of clothes and textile products to being a managing agent or co-ordinator for a cluster of globally spread joint ventures, subcontracting and licensing arrangements. It is not just that 57% of its sales are outside the UK; two thirds of operating assets are located abroad.

Pilkington: Europe accounts for just 15% of profits. Rest of world is already 57%, and of that total south America accounts for more than half, investing $160 million in two float glass plant in Brazil, Argentina and Chile. Pilkington is a major supplier to the South American car assembly industry and between now and the end of the decade America's biggest car companies plan to invest between $10 billion and $12 billion in new South American car assembly plants.

GEC in China: China has been the biggest market for GEC Alsthom in each of the past seven years. The bulk of recent orders totalling £220 million is expected to go to the group's factories in Rugby.

ICI plans to have 30% of its sales in the Asia Pacific region over the next five years. It already has 60 subsidiaries operating in 11 countries in south east Asia. To this list can be added **Cable & Wireless, Johnson Matthey, Morgan Crucible, BTR, United Biscuits**. The recent trade mission to China was the biggest ever in the history of the UK with 104 participating companies.

Conclusion

The world has changed radically in 40 years and particularly so during the last five. Those who set out a European future for Britain could not have foreseen the collapse of the Soviet Union, the spread of market economics, the shift in the balance of global economic power and the relative stagnation of the continental European economies.

The dynamics of the global economy will increasingly come to enforce a re-appraisal and re-examination of our economic self-interest and our place in the world. In the light of the changes that are unfolding, this debate has only just begun.

JAPAN'S STOCK MARKET SEEN AS THE KEY AS THE SUN SETS TO RISE

By Jim Bourlet

The stock market as a barometer of the Japan's economy has been warning us that all is not well with the land of the rising sun. The market hit 14,295.90 on the 3rd July breaking the August 1992 low of 14,301.81. By July 12th it had hit a high of 16,833.95 giving a range of nearly 18% in just 9 days. This range warns us that matters are very serious and that we could be heading for some kind of a crisis. The dramatic jump from the Nikkei 225 low on the 3rd July to 16,833.95 on the 12th July 95 suggests that, apart from engineering a bear squeeze, something fundamental may have changed. When events are moving fast it is hard to be reflective. As a comment on the current situation in Japan this report is based on City reports – and City gossip. It aims to explain what has been happening – and why.

The Problems

Japan's problems, which are both structural and cyclical, can be summarised as follows:-

a) No strong government and only the 2nd time Japan has had a coalition government.

b) A banking system buckling under deflation as land prices fall (also a new post war experience) leaving banks with huge non performing loans. These non-performing loans are currently being written off using hidden equity profits but still, according to Mr Obuchi, Vice President of the ruling Liberal Democratic Party on the 4th July amounting to somewhere between ¥ 50 and ¥ 100 trillion. To equate this to the US savings and loans (SxL) problems of the early 1990s the non performing loans of the SxL's in 1990 was 1% of US GDP. The US authorities put in public money to the tune of 6% of GDP. If similar action was taken in Japan say on a figure of ¥70 trillion of non performing loans it would come to ¥420 trillion equal to Japan's GDP for calendar 94. This indicates the magnitude of the problem and very creative remedies will have to be found to overcome this huge burden which continues with deflation to get worse.

On the 7th July 95 Moody's confirmed that they would downgrade some of the Japanese banks, this is both a big dishonour for Japan and international recognition of the possibility of a banking crisis. It can also be presumed that the banking authorities around the world are putting pressure on the Bank of Japan and on the Japanese government to take urgent action.

c) Structural changes in the investment industry with many of the major institutional investors reducing the percentage of risk investment that they are willing or allowed to make. Thus there is a continued unwinding of cross holdings in stocks indicative of the breaking down of Japan's "Keiretsu System". In the short term, this is a major negative factor for the stock market (and in turn for the banks as their hidden securities profits are reduced or wiped out).

d) The differential in interest rates between Japan and the other major industrialised nations is not sufficiently wide to encourage recycling of Japan's trade surplus. This factor is worsened by the fact that Japanese investors incurred huge losses from investing overseas in the 1980s. The impact of this is that the full consequence of Japan's industrial/trading success has had to be absorbed by its currency. This higher yen in turn is forcing Japanese industry to transfer at an increasing rate an increasing amount of its manufacturing overseas. Unemployment as a result has for Japan being growing alarmingly. In February 95 the official figure was 2.9%, rising to 3.2% in April. The April figure of 3.2% is the worst since 1953 when statistics began to be compiled in the present form. It is estimated that this figure may double by the financial 95 year end.

The impact from the speed at which the Yen strengthened in calendar year 95 can best be explained by an Economic Planning Agency (EPA) survey in February 95 of 1261 listed Japanese companies. *Only 0.5% of the companies surveyed last February 95 said they can generate profits if the Japanese currency stays stronger than the ¥90 level.*

The survey of listed companies also found that 55.8% of the firms will be manufacturing overseas in financial year (FY) 99 to reduce the impact of the stronger yen, as compared to 48.3% in FY 94. The ratio of overseas production was 12.9% in FY 93 but is expected to rise to 18.2% in FY 99. Some 64.9% of Japanese companies said they think it is inevitable that Japanese domestic industry will hollow out to some extent. This is just one indication of the upward pressure on unemployment – a big negative for consumption.

While Japan's trade surplus with the US and the rest of the world may have stabilised, the US trade deficit continues unabated and unless US savings increase it will have to go on sucking in savings from overseas, resulting in further dollar weakness.

Again while the US/Japan auto talks seem to have reached a compromise, the US/Japan semi conductor agreement ends in July 1996 and they should start discussing that issue fairly soon. It can be argued that targets here should be met but with the US Presidential election coming up that Autumn who is to say that the targets will not be changed with the threat again of an invocation of section 301?

e) Japan's economy, as acknowledged officially by Mr Takemura the Head of the EPA at the end of June, appears to be going into another dip. The money supply figures for June 95 (M2+CD) due out on the 18th July are forecast at 3.3% (flat compared to May 95). Also with many of the forecasts for the Japanese economy based on a soft landing for the US, the Fed funds rate cut on the 7th July 95 of 25 basis points from 6% to 5.75% (on the back of the expectation that the US April – June quarter GDP may be negative) must also be of concern for the Japanese authorities. Chiyoda Mutual Life Insurance on Friday 7th July estimated that Japanese GDP for financial year 95 could go into negative territory of -0.1%, the first negative growth in the post war period. Many institutions have been aggressively revising down their estimates and the average is now around +0.6%. These forecasts would be done on a rate of ¥85 to US$1. If the Yen were to weaken to ¥90 to US$1 the GDP outlook would probably improve to 1.6% for FY 95. However, a lot depends on consumption which accounts for nearly 60% of GDP and has been hard hit by the Hanshin earthquake, the hollowing out of Japanese industry, deflation (diminished confidence) and the sarin gas attacks.

However, one has to be cautious here because what we are now seeing is a divergence opening up between the macro economy and companies earnings as companies restructure their group having concentrated on the parent company up to last year. This will include putting operations abroad. Thus while the economy seems to be getting worse many individual companies consolidated positions are getting better, in spite of the fact that the parent companies are suffering from the strong Yen.

The other major factor contributing to GDP growth is capital expenditure and this can best be explained by a survey of over 10,000 small and medium sized companies which came out on the 4th July 95. In FY 94 capital expenditure by these companies fell 4.5%. The scale of the decline has been getting smaller and compared to the 2nd half of FY 94 it was +3.3%. This increase is for the first time in the last 3 years. However, for FY 95 the estimate is -15.1%.

The Government

Japan is an excellent example of how important it is for a country to have a strong and stable government. The country's current paralysis owes its origins to the lack of vision in government thinking and policies when times were good during the 1980s

and the guidance it got from the bureaucrats at that time. It is an excellent lesson for us that success carries with it the seeds of its own destruction. The country's success led to corruption, infighting and the disintegration of the Liberal Democratic Party (LDP). The disintegration began in 1993 with the breaking away of a number of factions to set up independent parties. These in turn in August 1993, under Mr Hosokawa formed the second, though short lived, non- LDP government since the war. This government was replaced in June 1994 by a coalition of 3 parties encompassing the LDP, the Social Democratic Party (SDP) and the Sakigakae party led by the current Minister of Finance Mr Takemura. The Prime Minister, Mr Murayama is a member of the SDP.

The current government seems unable to seriously address Japan's problems. This is because some of the policies deemed necessary for Japan run counter to SDP ideology. Thus if they capitulate on these policies at a time when a general election could come at any moment they may see themselves committed to a political wilderness. Recent local government elections have also given no indication to any of the parties that they would do well if a general election were called now. However, some comfort may come from the Upper House elections scheduled for the 23rd July 95. This is because the socialists are being blamed more and more for Japan's current problems. Additionally, while 50% of the 252 Upper House seats are up for re-election the SDP has to face re-election in 41 out of the 62 seats it holds while the LDP faces re-election in just 32 out of the 93 seats it holds.

Consequently, if the LDP could increase its majority at the expense of the SDP in the Upper House (irrespective of whether or not Mr Murayama stays on as Prime Minister) we should have a cabinet reshuffle in September 95 with the LDP increasing its influence. It could thus exert its will more easily on its partners and introduce the kind of policies deemed necessary to tackle Japan's problems. The alternative the LDP would then have would be the option to call a general election if its partners did not support it – which would put a question mark over their future.

The current unwillingness of the government to pursue policies which may not be taken kindly by the electorate and which would need passing by Diet approval is compounded by the problem that Japan's respected bureaucrats can not be expected to cooperate aggressively with a government that is in a terminal state. We have seen the dismissal of the Vice Minister of Finance who aggressively cooperated with Mr Ozawa in the previous government. The Ministry of Finance (MOF) itself without a strong government is unlikely to agree to a spending programme or tax cuts unless it is first shown that it is working with a government which will commit to alternative measures to make up for any depletion of its resources. Inevitably, a point would come where they would have no alternative but to agree. In addition Japan's current political problems are causing, it is rumoured, infighting between ministries while many urgent matters being discussed by special committees have been put on hold until after the Upper House election. All of these pressures came at a time when the Diet have gone into summer recess 95. Thus one was thrown back on monetary policy and on the Bank of Japan (BOJ) to keep things going when monetary policy is not seen to be really working.

This has tied the hands of the government on the fiscal policy side until the Diet is again in session. The situation seems serious enough to call a special session of the Diet for the 7th August when the Upper House elections are out of the way – probably to discuss a supplementary budget.

The outlook for the stock market could depend on what measures are included for discussion in the supplementary budget. If they contain real estate or land tax cuts that should be seen as good for the banks in terms of helping to get the real estate market moving again and thus good for the stock market.

The Solutions?

1. The Japanese authorities could try and put a base under the real estate market and get it moving again. This is extremely important as Japan is a land based economy and putting a base under the real estate market would be very helpful for the banks. Once some solution to help the banks is in place the domestic investors have said they would come back into the market. The banks account for 25% of the market and to help them would be a major factor in pushing the stock market up.

   This could be done in a number of ways. One, as mentioned, would be to reduce holding tax on real estate to zero. A second would be to cut real estate trading tax. These two changes could not take place before April 96.

   A more aggressive approach would be to launch bonds to raise funds from both the public and private sector to the tune of some ¥20 trillion. The funds raised would be used to depreciate some of the bad debts, giving investor confidence that purchasers exist for real estate. This could drastically change sentiment. There is a precedent for this strategy with the bailing out of the SxL's in the US in 1990 and for the Japanese stock market in 1964 and 1965 when two entities were set up, the first financed by the private sector in 1964 and the second in 1965 by the public sector. At today's value the money put in though those two companies would equate to ¥5–6 trillion and ¥8 trillion respectively i.e. in total ¥13–14 trillion. Note, also at that time most financial institutions were relatively healthy. Action is most likely to come for the Housing Loan Associations. Problems here could come to a head in July/September and the amounts of money involved are so large that the problem may not be able to be solved by the private sector and may require the use of public funds.
2. The next problem to be addressed is how to get consumption growing again. This could be done by cutting income and corporate taxes with a commitment to raise consumption tax in 3 to 4 years down the road. Currently consumption tax is only 3% in Japan. This approach would give a window of opportunity to citizens to purchase goods before the sales taxes are increased which should stimulate consumption. Even when the increased sales taxes are imposed, any increase in prices should be offset by the downward pressure on prices due to deregulation.

   A further support for consumption would be raise access to mortgages i.e. up to 95% as against the current 80% and to reduced interest rates. Many positive changes are currently being introduced.
3. On the problem of the strong Yen, deregulation to help suck in more imports is going to be a slow and painful process, as is hollowing out. We are currently running out of engines of growth as the worlds leading economies slow down. Japanese institutions should be encouraged to invest overseas as part of the hollowing out process and in order to weaken the yen. It no longer seems to be in anybody's interest to manipulate the Yen upwards against the dollar.

   To this end, Japan's basic balance in FY 94 saw money moving from Japan to overseas. It was in deficit to the tune of US$ 3.688 billion, the first deficit in the last 5 years. The April–May deficit on the basic balance was US$ 5.69 billion, so the position continues to improve. However, the long-term capital balance is in deficit because Japan's domestic financial investors have been buying Euroyen bonds by foreign borrowers in the Euroyen market. They have been investing in Euroyen bonds due to a lack of attractive investments at home as the Japanese authorities try to help the Euroyen market. This buying of Euroyen bonds has not however helped the dollar and what we need to see is domestic Japanese investors buying US Treasury bonds.
4. Other less important but nevertheless significant support would come from a further fiscal stimulus to the tune of ¥10 trillion which is now expected and supporting factors for the stock market such as cutting sales taxes on securities.

Conclusion

The key to Japan's recovery seems to be the stock market. If the market can be maintained at a level of 16–17,000, banks can go on writing off their non performing loans against profits from selling securities. In addition, this would improve sentiment which in time should help rebuild confidence. Industrialists could also feel that if the stock market has bottomed with the low interest rates that should make plant and equipment investment attractive. If consumption recovers, imports are expected to increase sharply which should help the yen against the US dollar.

On Friday 7th July, we had some kind coordinated action by the Fed and BOJ on reducing interest rates in the US and Japan. In Japan the call rate was brought down from 1.24% on Thursday 6th July to 0.75% on Friday 7th July. This was intended later to be followed by a cut in the official discount rate from the current 1%.

On the same day there was also coordinated action taken to support the dollar against the yen. This is a huge reversal of strategy by the US towards Japan and can be taken as an indication of the concern that they felt for the situation in Japan.

This joint action with the US may have had something to do with Mr Kashiwabara joining in the middle of June (in a very senior capacity) the International Finance Department of the Ministry of Finance. He is reported to have been a classmate of Mr Cantor when he studied in the US.

These two actions were perceived as very appropriate by the market which over the following 4 business days jumped over 1200 points. This lessened concern that some of the Japanese banks may not be able to meet their Bank of International Settlements (BIS) ratios and would thus have to stop doing international business.

The pushing up of the market in this way has been engineered by suggesting, it is rumoured, to some of the domestic financial institutions that perhaps it would be wise to hold off selling stock, and why do they not consider buying US Treasury bonds as the Yen may weaken to the ¥90 = US$1 level? This action panicked investors who were short into short covering which squeezed up the market with the help of some foreign investors buying high tech Japanese issues, some of which were at that point said to be more attractive than US high tech issues. It is foreign investors who are again currently supporting the Japanese market (as they have been doing for most of the last 5 years). They had the support of security houses dealers who as a result of some dealing rule changes by the Ministry of Finance on Monday 3rd July 95, became able to deal in the last 15 minutes of business and also to deal outside the high and low price of the year. The Ministry of Finance has also been doing its bit in showing that they are very serious about the stock market and are trying to help. However, the attitude of the Ministry of Finance should be reconfirmed and if it is positive it should help the sentiment in the market to change dramatically. The domestic investor nevertheless is only expected to come back in an aggressive way when some solution is in place for the financial system.

If Japanese domestic institutions were to again start investing overseas and help with recycling Japan's surplus this should also help weaken the yen which in turn could support the profitability of Japanese companies and in this way help to get the economy moving again. The BOJ is also seen to be keeping up its support as on Thursday 13th July 95 it lowered the amount of collateral required for City Banks to borrow funds. Under the change, the banks will be able to save up to 40% of collateral required for borrowing. This could be a policy to support money supply growth.

The next problem to be addressed is how to achieve a strong Conservative government. This looks as if it could be achieved through a positive result for the LDP in the Upper House elections on the 23rd July 95. However, Mr Murayama is expected to stay on for the time being as Prime Minister as the next election for the head of the LDP is in September 95. This issue may have to be settled first before the LDP makes its move. A good result should however, strengthen their hand and allow them either as part of a coalition government or by calling a general election to put in place the type of policies necessary to address Japan's structural problems. The first of these to be addressed will possibly be the seven Housing Loan companies in September 95 which are expected to see the writing off of ¥5 trillion. A plan is said to be already in place with the bureaucrats who are just waiting for approval from the government.

Something has changed for Japan since the beginning of July 95 as reflected in the stock market which is a barometer of sentiment. It has changed not because things have been getting better but seemingly because they have been getting worse. The local government survey of short term land prices due out around the 10th August is

expected to show that land prices continue to fall increasing the pressure on the banks. It was thus vital that the authorities took action. They did the only thing they could do quickly with the political paralysis they find themselves in.

The Bank of Japan used up some of the remains of its monetary policy but this time, with the US on their side, they have gained a breathing space. However, it is still very early to say that we are now seeing the start of a bull market as much of the volume is being accounted for by trading. A lot of the improvement in the market is still artificial. The sentiment is changing but very slowly. We need to see what happens after the Upper House elections on the 23rd July 95. Many of the other measures that need to be taken will involve fiscal policy which *will take much time*. It will be interesting to see what is included in the supplementary budget for discussion in the Diet on 7th July. Let's hope they contain measures that will continue to support the market which in turn will support confidence that the worst is over. Then some day it will be disclosed how near Japan has come to a serious financial crisis which could have had major adverse consequences for the rest of the world. However, while some solutions are emerging little has changed as yet.

A SIMPLETON'S GUIDE TO THE SINGLE CURRENCY DEBATE

By Paul Goulder

Should the EU have a single currency, a 'Euro-Pound' – or 'Euro-Mark' or whatever – ever?

The arguments for Britain are not so complex but they do fall into four categories, a) Micro-economic, b) Macro economic, c) Micro-political and d) Macro-political.

The 'Micro-economic' arguments are about the reduced costs of transactions, the convenience of a single currency, the ease of banking. Clearly these *favour* one money.

The 'Macro-economic' arguments are about regional economics, about the impossibility of maintaining full employment and prosperity in one part of a vast superstate in the face of financial flows which through savings, taxation and sales can drain money towards faster growing regions. The scale of tax based subsidies to counter this effect would be politically impossible – as would be the scale of migration needed. Imagine the USA and Japan locked into a single America-Japanese currency at an equivalent exchange rate of ¥300 = $1 for the past 20 years. There would be no industry left in America at all by now! Clearly the macro-economic arguments stand *against* a single currency.

The 'Micro-political' arguments are about British politics, about how far our responsive democracy would be diminished by handing over important economic powers to continental executive bodies. They are about our constitution, our confidence in making our own decisions and about the dangers of risking our hard won political freedoms in the face of continental corporatism. No one can seriously doubt that the balance of the debate here is *against* a single currency.

The 'Macro-political' arguments are about the European Vision, the desire to build an entity that can face any superstate on an equal basis. They are also about the fear of a resurgent nationalist Germany and so it is felt that, at whatever cost we should build a political federation that locks in Germany as merely a constituent province. This line of thinking may lead one to *favour* a single currency.

So that is it – shown here in a diagram. Choose your boxes and take sides!

	Economic	*Political*
Micro	For	Against
Macro	Against	For

EMU AND THE NEWSPAPERS, 9TH JUNE 1995

The decision on whether or not Britain abandons the pound and joins in a single Euro-currency in a few years time hinges – if past form on Euro issues is followed – on the tide of public opinion and not on objective assessment. In this the stance taken by the newspapers is crucial to the management of public perceptions.

On 8th June a perfect opportunity to observe the bias of newspapers and their editors occurred with the publication of the pro-ECU 'Kingsdown' report and the pro-pound Institute of Directors report spiced with some choice comments from the Prime Minister.

The newspapers the following morning were perused and subjected to one simple question. Would reading the reports, editorial and comment given lead one to shift one's opinion in the pro-ECU or the pro-pound direction? Taking into account direct reporting and instruction, innuendo and the absence of points as well as the quality of analysis and depth of perception – in other words an enlightened but subjective impression, this is the result:

----- *pro-ECU* -----			----- *pro-pound* -----		
Extreme	*Moderate*	*Marginal*	*Marginal*	*Moderate*	*Extreme*
Independent		Daily Star	Express	The Times	Telegraph
	Guardian	Daily Mirror			Daily Mail
	Financial Times	Today			Sun

The 1st prize for best individual commentary goes to Anatole Kaletsky writing in The Times. The prize for coverage designed most effectively to keep their readers uninformed must be shared between the Daily Star, the Daily Mirror and Today.

THE THROW THAT FAILED

*By Lionel Bell. Published by New European Publications 1995. Price £25**

What a comprehensive, valuable and disappointing record this book so ably presents! Subtitled 'Britain's 1961 Application To Join The Common Market', this book, for the first time looks at the record of the discussions which took place within the government (now released under the 30 year rule) which lead Harold MacMillan to apply for British membership. This was the crucial decision when a genuine choice was available. All subsequent decisions – to re-apply, to accept humiliating terms, to confirm membership in the referendum, can now be seen as mere road blocks to be cleared by the bandwagon set in motion in 1961.

To appreciate the thoroughness of this account, try reading the contents in reverse – it is more interesting that way. A browse through the Appendices gives trade graphs, verbatim reports of MacMillan's conversations with de Gaulle, and reminds us of the 'Dramatis Personae' in the Cabinet. Otherwise the book has just three chapters.

Chapter 3 – 'The Results', is yet another much needed realistic assessment of the costs and benefits of membership. This is well done and will be an invaluable contribution to that audit of membership, called for by Bill Jamieson in his recent work 'Britain Beyond Europe', which the Government must surely soon undertake. Bell's conclusion on the claims openly made, is humiliating, 'What was to come to pass has not come; what was not to come to pass has come'.

Chapter 2 – 'An Intellectual Journey', contains the clue to the book's title. Noting that at the start of negotiations in 1961 the French put up numerous obstacles to British membership which were outwitted by Britain simply accepting every demand made thus forcing France to bluntly say 'no', Bell elaborates by saying 'This ... could be described as the French hooking their fish, playing it and bringing it to shore. The trouble was that they never really wanted it; when it refused to wriggle away de Gaulle had publicly to throw it back into the water and put up with any consequent difficulties with his partners'. De Gaulle's throw failed; we insisted on being caught. This chapter then sets out the hopes and fears, the reasoning and the shallowness of reasoning, the facts, distortions and frailties that lead to spurious conclusions and misplaced expectations. A sad but very worthwhile account.

Chapter 1 – 'In Their Own Words', is the boring bit. But this is the truly valuable research contribution which should place this book in every library. Just who said

*Available to ERC members at f15.00

what: What *did* they think they were doing? This reviewer can only leave it to the reader to reach his own conclusions.

The book is disappointing because one has always imagined that this momentous decision must surely have been made for some unspoken but overwhelming reason. Given the banality of the party political arguments one's very faith in leadership demands such a reason. At last, this Euro-sceptic reviewer hoped, the basis of his 'mistake' would be revealed and be convincing. Bell comes close, saying, (page 110) 'The reason (for deciding to apply for membership) that dared not speak its name and could not therefore be openly analysed, was to nullify the risk of a politically hostile Western Europe.' In other words we joined, despite economic costs and damage to our interests in the Commonwealth and elsewhere, simply out of fear of Germany once more becoming fascist, militaristic and menacing. The very suggestion would have looked insulting and might even have encouraged such developments. It could not therefore be publicly discussed and openly assessed. Was this astute statesmanship or was it flawed reasoning? That may in the end be the only question we need to answer. But it was disappointing not to learn of some happy gain to be reaped in exchange for the hardships membership has caused.

J. B.

LETTERS

Responses to 'Pay as You Spend Instead of Pay as You Earn by Tony Baron from Mr John P. C. Dunlop, Mr Peter Griffith and Mr Eric de Mare.

Sir,

I did not see the article by William Rees-Mogg in *The Times* 5 January 1995 commented on by Tony Baron, in which it was suggested that income tax should be abolished but I did listen to a discussion on taxation in Colin Bell's Radio Scotland programme *A Tax to Grind* on 16 November 1994 with Alistair Darling MP, David Jenkins CA of Pannell Kerr Forster CA, and John Brown, the lecturer in taxation at Glasgow University.

This was a most illuminating discussion covering income tax and national insurance. What emerged from it was that income tax regulations now occupy 10,700 pages of the statute books, 750 of these having been added last year. Alongside of which is the almost as complicated social security legislation. The whole system, to use Colin Bell's words, is 'one of Byzantine complexity' and one in which scope for avoidance and fraud is wide spread.

The arguments put forward by Rees-Mogg and Baron are cogent and reinforce other arguments for reform and when, on top of this, one realises that income tax and the other taxes on human effort (VAT and NIC) are levied on a base as shifting as the dunes of the Arabian desert or as unstable as the sands of the ocean floor, then the case for some kind of reform becomes still more credible and insistent.

The proposals put forward by Rees-Mogg and Baron for transforming Pay-as-you-

earn into Pay-as-you-spend certainly would appear to be workable but they would not get rid of much of the bureaucracy associated with PAYE and NIC, and many of the disadvantages associated with the old system would remain, in particular the yield would not be any more certain than at present.

The conclusions reached in the Radio 4 programme represent a mere tinkering with the engine of taxation whereas what is needed is a new engine.

Baron correctly states that we need also to recognise that income tax, as well as discriminating against savings, is a disincentive to work (viz. his remarks on the poverty trap).

To this should be added that we also need to recognise that unemployment neuters the productive capacity of millions of folk who are otherwise fit, able and willing to work. Any reform of taxation should therefore be one which provides the climate for these latest productive forces to become employed. As things stand at present the only way this can happen is by the nation going to war. This is the way it has been and that is the way it still is.

Rees-Mogg's or Baron's proposals would do nothing to get rid of that problem and if they were introduced it is doubtful whether they would be regarded by the public as anything other than another form of income tax.

When you add up all these considerations the sum of them provides an unanswerable argument for the complete abolition of all taxes on human effort, which include VAT as well as income tax and national insurance contributions, and it becomes clear that we need to replace the present system *in toto* with an even better form of taxation, one that is not only much cheaper to operate, one that is not susceptible to avoidance and evasion, one that will create an economic climate which puts no constraints on the constructive employment of the presently unemployed forces of labour, one that does not penalise savings, one that can fund necessary government expenditure without inflationary side effects, and one that can deliver the required revenue with absolute certainty.

The New Engine

Is it possible to design such a tax?

It is, and it has been done already. Like Rees-Mogg's proposal, it is a tax on consumption, but it is far simpler and much less bureaucratic than his proposals or those of Baron.

It has already been presented to the readers of *Britain & Overseas,* first of all in a review by the editor in the Winter 1990 edition and a booklet by this author published by The Resource Use Institute Ltd., and followed in the Spring 1991 edition by an article describing in more detail the operation of the tax which is called Unitax.

Since then much has been written and research undertaken by others on the advantages of Unitax. Eventually these efforts culminated in the formation of The Unitax Association on 16 October last year.

In March this year The Resource Use Institute Ltd published *The Resource Economics Proposition – A Pictorial Thesis* by Farel Bradbury, the originator of Unitax.

This proposition is a simple one – the **replacement** of all taxes on human effort by a single tax, an excise duty levied on the **energy** which is the only common constituent of all our activity. Energy has to be used in the production of all goods and services. It can be, and is, used to displace labour, which can save drudgery – or it can create unemployment.

As the energy we use can clearly be defined in standard units which are already exchanged for money, and as the primary sources of this energy are comparatively few in number when compared with the umpteen million tax points used in our present system or would be in Rees-Mogg's reformed system, it is easily apparent that here we have the ideal vehicle for a simplified system of taxation – the new engine.

The Resource Economics Proposition

The Resource Economics Proposition (REP) is that a duty (Unitax) is applied at the economic source of all primary energies (as defined by statute – coal, oil, natural gas, hydro and nuclear) and on the S.P.E.C. (Statutory Primary Energy Content) of all imports. Exporters will be able to claim a rebate on all exports against ordinary commercial documentation and with reference to a National Integrated Tariff for such goods.

The effect of this is that Unitax, being levied at the beginning of the productive process, trickles down (to use Lady Thatcher's immortal phrase) and spreads out through the price chain to every consumer, so the duty is a true consumption tax. Products in the chain closest to the Statutory Primary Energy input (e.g. electricity and petrol, affecting heating, lighting and transport for example) where the energy input cost is greater than the labour input cost, would bear more tax per unit cost than those where the reverse is the case, unless special regulations were introduced for special cases. But as we shall see, this would be unnecessary.

To do this would introduce unnecessary bureaucracy and we would be on the way back to the 10,000 pages of income tax legislation.

The procedure for levying Unitax is similar to but far simpler than that for VAT. Unitax would be levied only once, but VAT is deducted and recalculated at every transaction while less than 1% of traders presently processing VAT would be required to process Unitax.

This one universal physical characteristic of energy, that it can be measured to one standard in all forms, is available in no other resource on earth and because it comes into every economic transaction, its use as a measure of economic activity ought to be obvious. Studies indeed have been conducted on this aspect of energy at the Centre for Human Ecology at Edinburgh University by Malcolm Slesser.

Allowances and 'Traps'

The present system recognises that with income tax there should be tax free allowances below which level the incomes of individuals are in effect their basic spend (but on which no relief for consumption taxes, e.g. VAT, is granted). Also the introduction of these introduces 'traps' and inequities in both the tax and benefit systems. The Resource Economics Proposition goes one better than that.

It recognises that every citizen has basic needs for food, clothing, fuel and accommodation. Indeed it is a crucial aspect of the R.E.P. that a State Pension, or Basic Income is provided for every citizen. This would come into force when Unitax is substituted for Income Tax. To quote Bradbury:

> "Building on present 'social security' and 'welfare' systems, the R.E.P. extends the Basic Income and rolls in the full benefit entitlement as might be paid to the unemployed, pensions, child allowances etc. This is remarkably efficient and completely eliminates the 'traps' of present systems because the basic income does not have to be assessed in the light of other earnings. Indeed, in a labour free market, it is the other earnings that may be reduced and so passed on in lower competitive prices.
>
> "The Basic Income ensures that everyone has what the system would otherwise try to do by expensive 'targeting' and cruelly inefficient selectivity. Incidentally, while some privately funded 'luxury' pension and endowment schemes may continue, the B.I. is such a cost-free means of getting support to people that a whole plethora of complex – not to say devious – financial activities should atrophy ... If the intention is that everyone must be supported in their old age then they must receive by one means or another a given sum of money every week. Not to agree this is to suggest that a civilised society would let its elderly starve. But if we set up the expensive mechanisms of selective benefits we add costs and we all pay the costs. If people each make their own arrangements then we lose the economies of scale, introduce the borderlines and, of course, profits must be taken off. On the other hand if, by R.E.P., we simply hand the money out, it is virtually cost-free (so we are all better off). Such Basic Income is then circulated quickly in all consumption.

Savings

> "While pensions scheme may atrophy the same would not be true with savings and investment schemes. *Here the profitable return on investments would not (under R.E.P.) suffer any tax deduction.*
>
> "Tax avoidance schemes would give way to investments attractive in their own right."

Wages

Bradbury goes on to outline the effect on the work force and the relationship between them and their employers. Wages and conditions would be determined by market forces leading to a high wage economy with more attractive conditions of work and possible sharing of profits. The issue of the 'minimum wage' would be dissolved and the higher the Basic Income is set the lower would be the rate of unemployment.

Others (Roberts and Ephraim) using models of the economy have calculated that under the operation of the R.E.P. the periods of boom and slump which distinguish our economic system would be reduced and could disappear.

Costs of Production

The effect of present taxation on costs of production is easily seen with VAT. It is levied on the added value created by processing bought in materials or services. The major part of these costs is made up of wages of labour and taxes (Income Tax and National Insurance Contributions from both labour and its employer) on the wages of labour. Therefore VAT is a tax on a tax. It is a double tax on labour. It increases the additional labour costs created by these taxes by a factor of 17.5% as at present. The total of these costs is by far the greatest proportion of all costs of any enterprise.

Their abolition would bring down very considerably the costs of public services which are the most labour intensive of all enterprises. The same applies to industry so the transfer of tax onto energy would reduce the overall costs of production of industry.

Effect on the P.S.B.R.

One of the most important beneficial effects is that the revenue from tax would no longer be dependent on the variable levels of earnings, profits and sales as it is at the moment.

According to research at Bath University by Sandford, Godwin and Hardwick, profits from these sources in 1986-87 provided 81.7% of overall Central Government revenues of which the operating costs consumed nearly 5% of revenues collected. Excise duties consumed less than 0.5% of revenues collected. So these taxes, as well as being unpredictable in their yields, are also by far the most expensive to operate.

If the economy goes into recession the yield falls and the government is forced to borrow. This incurs increased costs from interest charges and forces the government to cut back on already budgeted expenditure.

Unitax, by contrast, need not be dependent on the vagaries of the economy because it can be designed to produce a regular flow of money to the Exchequer in a way which allows its rate of duty to be raised or lowered as frequently as is required. If the revenue falls below requirements then the rate of duty is increased to

provide for the shortfall. **In this manner the need for the PSBR would disappear**

As a result the government would become more independent of financial institutions, interest rates would be lower and restraints on necessary public spending would be lifted. Take education for an example, as Bradbury says – 'Print the money and Unitax it back. It is legitimate to print money against wealth. Education is a national wealth.'

Think of any other necessary public expenditure, the same applies. Without arguing about totals we can say truthfully that there are several million pairs of unproductive hands around the country that could be employed in useful occupations. The R.E.P. provides the way to get them to work.

The Way to Achieving a Sustainable Economy

Perhaps even more importantly and overriding all the previously mentioned considerations is the future of mankind on this planet. Practically all the economic activity of the industrialised nations is resulting in the swallowing up at a frantic rate of the non renewable resources of the earth. Nobody knows the total of the hidden resources in the earth's crust from which we obtain most of the energy we use, but it is certain that they are finite. They have taken millions of years to accumulate. They are being dissipated at a rate which is many times faster than the rate of their formation and one which is increasing exponentially every year. Their use liberates major pollutants into the earth's atmosphere. For example, Donella and Dennis Meadows with Jørgen Randers in *Beyond The Limits* have shown that '*current* atmospheric concentrations of carbon dioxide and methane are *far higher than they have been for 160,000 years*'.

Unitax being raised on energy values can be used to encourage economising the use of these fuels and the development of renewable sources with less pollutant effect.

No other system of taxation can deliver such advantages to both government and people and when you take into account the fact that the implementation of the R.E.P. would issue in an era of economic peace and sustainable development, the questions have to be posed – What are we waiting for? – Why are politicians and the media so unwilling even to examine these proposals and engage in public discussion about them?

John Dunlop
The Unitax Association
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Dear Sir,

I refer to Tony Baron's article in *Britain & Overseas* of Spring 1995 entitled 'Pay as you spend instead of Pay as you earn'.

Taxes need to be raised to finance firstly Government expenditure and secondly benefits for those on low incomes. In other words those with high incomes are expected to pay proportionately more tax and NI contributions than those with low incomes. This is usually referred to as a progressive system of taxation in contrast to a standard rate system or a regressive system such as poll tax. It is not administratively possible for all taxes to be progressive, but it is possible for taxation on income to be progressive. To avoid means testing it is also possible for taxation of benefits to be progressive.

The same principle should also apply to overseas aid for the relief of poverty. The recipient country should be able to show that it operates a progressive system of benefits and taxation. In this way aid should be received by those most in need.

William Rees-Mogg in his article in The Times of 5 January 1995 seems to think that a tax on expenditure will be progressive in its incidence and could for this reason replace income tax.

Even if one could envisage expenditure tax as being (after an initial allowance) a standard rate tax based on expenditure, this would be a standard rate tax not a progressive tax, necessitating high rates for high expenditure and low rates for low expenditure. A system of progressive taxation based on personal expenditure could mean that the high spending taxpayer would have no funds left to pay the tax, that is the tax would not be collectable. A progressive tax system based on income would be easier and quicker to collect than a progressive tax based on expenditure.

Tony Baron goes on to support the expenditure tax proposal on the grounds that a tax on income will tax additions to savings as well as expenditure. A clear definition of income is needed in this argument. Net income is usually computed after a deduction for depreciation of capital allowance. Theoretically, the allowance for capital replacement has already been given before arriving at the next income figure.

There was a time in the 1950s when because of inflation and the low productivity of capital, it was thought that this depreciation and capital allowance were insufficient to replace the capital asset. In the 1990s however there is hardly any inflation, and capital is highly productive, particular, computers. The depreciation and capital allowance these days shall be more than sufficient to replace the capital stock not just with the same capital asset but with a much more productive capital asset.

William Rees-Mogg and Tony Baron (second paragraph) emphasise the output expanding character of capital investment but overlook the fact that it can be input saving particularly at the expense of the employment of labour.

Peter L. Griffiths
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Sir

In your last and most interesting issue, Tony Baron's leader supports William Rees-Mogg's radical proposal printed in *The Times* of 5th January that income tax should be abolished and be replaced with a progressive expenditure system, the argument being that taxing gross incomes discourages savings and therefore investment in production.

That sounds like good sense but consideration reveals that Sir William doesn't fully understand how the money system works – or rather doesn't work. He seems to be assuming (i) that industry, in some deeply mysterious way that no one can quite grasp, creates the money by means of which its products can be distributed to consumers; (ii) that the main purpose of an economic system is to provide everyone with paid employment; (iii) that taxation of some sort must always be necessary.

These assumptions, so deeply embedded in our cultural and generally held without thought, do not accord with realities. First, industry creates no money of any sort; it borrows it, either from investors or, more likely, from the commercial banks who create loans out of nothing but ink and paper and charge large interest on the debts so created merely by making book entries.

Secondly, the old Labour Theory of Value is obsolete. Marx accepted it as firmly as did Adam Smith, and so does every M.P. in sight today. Yet it should by now be obvious to all that human labour is being ousted by machines and that hand-held hammers and sickles are no longer important tools of production. The purpose of a social economy today should no longer be Full Employment but Full Enjoyment; our civilised and civilising aim should be the liberation of the individual to develop his creative potentials without financial pressures from any quarter. That ideal has now become possible, thanks to ever-developing, labour-saving technology. The wage-salary system is, after all, a kind of slave system in which most people work not for pleasure but merely for money.

Thirdly, all taxation is robbery. There I and Mr. Lee Cheney, according to his letter in your previous issue, agree. As Plato pointed out, 'taxation is a form of governance'. It has become a tyranny which is forced on us by needless indebtedness, both public and private. A huge amount of our taxes goes to paying interest on national and local debts that have no right to exist. In the U.S.A. today the interest now due on the Federal Debt is more than half total incomes, and our National Debt is not far behind. When, one may ask, will interest due on the world's national debts equal the total of the world's incomes?

The fact that should be clear enough is that the entire human race is being kept chronically short of purchasing power. An ever-growing gap exists between incomes and prices (and therefore costs) of production. If that is not so, why the competitive and lethal struggles between nations for export markets that sooner or later lead to war?

Achieving a Favourable Balance of Trade must mean that we can only prosper in monetary terms by making ourselves poorer in the terms of real wealth – surely a purpose of insanity. Why house mortgages, hire purchase and plastic credit cards with their vast indebtedness? Why inflation which must indicate that money is not adequately representing real wealth and is being treated as though it is a commodity? Why mass advertising, our largest and most unproductive industry? Why, to take a single example, do people sleep in cardboard boxes when builders are going bankrupt and brickworks are closing down? Why, in short, poverty amidst plenty?

A huge, unearned increment of wealth exists that, for lack of enough purchasing power, is not being distributed to anyone. Investment of savings, as proposed by Rees-Mogg, merely pays for future production while reducing available purchasing power to buy the goods and services already on the market. Redistribution or reallocation of incomes in whatever form does not solve the problem of that GAP between incomes and prices. This is more than a political issue; it is one of higher mathematics in that time and flow come into the equation. So, indeed, does moral philosophy.

The only solution is to hand the power of credit creation over to the democratic state so that money can fully represent real wealth without all these spurious debts. The first job then would be to provide retailers with new debt-free and interest-free state credits so that they can sell their stuff below cost prices, so filling the Gap, increasing the public's purchasing power and eliminating inflation for good. National dividends, or Basic Incomes, can come later to usher in a new age of civilised leisure. By means of adequate state credits the social services, in particular Health and Education, can thrive. And, not an insignificant matter, daily commuting and its poison gases, can be rapidly reduced.

No need to liquidate the banks. They will always have their uses as places of safe deposit, accountancy and advice. But they have no right to rule the world without sanction and to the universal suffering of the *salis populi*. If allowed to continue the Debt System may, indeed, bring civilisation to a hideous end. After all, it was debts, taxes and inflation that destroyed the Roman Empire, and forced the world into the Dark Ages.

Note what Lord Acton, Chief Justice of England, declared more than a century ago: 'The issue which has swept down the centuries, and which will have to be fought sooner or later, is the People versus the Banks.' Many other great men (including Edmund Burke, Benjamin Franklin, Abraham Lincoln, Gladstone, Disraeli, Bismark) have told us the same thing in their own words. Who in authority today in any sphere has the honesty and courage to tell us the truth about money in their clear, bold way?

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A Response on 'Student Numbers' from Mr. David Fifield

Dear Sir,

I would like to provide a broadly based reply to the invitation, issued in the Spring Review, on the subject of student numbers.

A fall in standards formed the central theme to the correspondence in the Spring Digest. This I feel is a narrow approach, risking a sterile discussion on a topic with other ramifications. I therefore believe it more appropriate to look at education as an evolving product driven by socio-political forces.

Based on academic competition only 3% of the school population entered higher education in the 50s, compared with the present 30%. In parallel the percentage of top honours being awarded has increased. By the same token the GCE O level, designed for the most able 20%, equates to a 50% pass rate for the replacement GCSE. Accepting abilities for succeeding generations remain more or less constant, this suggests something else is happening. With education viewed as a product, a significant growth in consumption over the last forty years, alongside general consumption, was always to be expected. Its growth should be seen as an integral part of the process whereby individuals are helped to make choices in a steadily evolving society and expanding market place.

National cultures and their influences on wealth creation provide another route for examining the contribution made by education. Germany and Britain demonstrate some interesting differences. Germany for instance relies more heavily than Britain on manufacturing for its prosperity. This in the past I have suggested is based on committed ownership, which in turn has resulted in a greater reliance on retained earnings and involved bank lending. Evolutionary product design fits well with this approach, as does the use of engineers and scientists with their incremental learning. Britain, with its much greater reliance on traded ownership, centered on the stock market, is more interested in the short term measure of return on capital. This arrangement encourages money to seek an independent career, unlike the position in Germany, where money and people have interdependent careers. Britain's strength in retailing and financial services fits well with its approach to ownership, while being less demanding on technical support. Here the need is for flexible and commercially minded staff prepared by an education system using a modular approach to provide a portfolio of subjects.

What conclusions are to be drawn from the preceding thoughts? Apart from entry to a few select careers and places of learning, academic competition and attainment is no longer the main force driving British education. By comparison, the rest of Europe remains true to its longstanding philosophy, the achievement of technical understanding, witness the use of titles to demonstrate fields of competence. In France a licentiate is licensed to practice. An Anglo-German report published in 1994 found middle managers in Germany to be more technically orientated and task driven when compared with their UK counterparts. It would seem Britain has an education system based on improving consumption and citizenship, rather than forming a part of the wealth creating process.

Based on the above thoughts, what are the likely short/middle term consequences?

- Britain will fall back in relative prosperity compared with the main EU players.
- Students enjoying a benefit not linked to the wealth creating process will have to find more of their own funding.
- In order to maintain a balanced economy and reduce unemployment there will be a continuing need to import manufacturing expertise to make up for the indigenous shortfall.

Problems in assessing a nation's ability to take on cultural change makes predicting the long term difficult.

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A further comment from Mr John D. Allen following his address to the ERC

Dear Sir,
I regret that Stephen Hill [Letters, Spring '95] has misunderstood the broad thrust of my address to the Economic Research Council last October, published in your Winter '94 edition. Although it is true that Adam Smith demonstrated in his 'Wealth of Nations' the inflationary character of taxation levied on wages, by no means did I rely upon this exposition, authoritative as it is.

This question has been thoroughly investigated over the past year by our research team in the Economics Faculty of the School of Economic Science, and Mr. Hill may be aware of the work I did myself on this question in the 1970s and 80s in collaboration with Emile Woolf, who is one of this country's leading authorities on accountancy and audit practice.

From this work there is no doubt whatever about the inflationary nature of PAYE and national insurance contributions combined. Indeed, we have put forward the thesis that high taxation on earnings is one of the principal obstacles to fuller, if not full, employment.

As a matter of secondary interest, I would be glad if Mr. Hill could verify the source of his title line about Lions led by Donkeys – a reference to the calibre of the English soldiery during the 1914–18 War. Who said it and on what occasion?

Mr. Cheney has not unnaturally picked up my comments about taxation on labour and costs of supply. While it is true that one would like to see the weight of taxation shifted from industrial costs and earnings in the direction of unearned incomes, so that a better balance could be established in the distribution of wealth, this could not be done until a scientific basis for tax reform were found.

My suggestion was that we might follow David Ricardo in taking the net rather than the gross product as the basis of taxable revenues. He was most insistent and eloquent on this point in his Principles of Political Economy and Taxation. The shift from gross to net would of course exclude wages and supply costs from calculation of the product available for taxation; but again such a shift would not be possible until all its implications had been examined and an effective system of assessment and collection worked out.

Such a move would, however, be conducive to a big reduction in inflationary pressures and the costs of government administration which are everywhere inflated by notional payments of taxation on wages and salaries. I have never understood why civil servants and others who are paid out of taxation should have to pay tax. Anyone who understands the principles of set-off would realise that this is nonsense. That leads directly to application of the same principle to all forms of employment.

May I also assure your readership, and in particular Mr. Hill, that the proposals I put forward owe nothing to the so-called single-taxers. I quite agree with him that the ideas of the Liberal reformers of 1909-10 are now redundant. But the economic principles that lay behind them are not; what we need today is some lions to pick up this ancient trail and lead the economic donkeys out of the morass.

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Postscript

Stephen Hill comments: 'The answer Mr. Allen is seeking is, I believe, an exchange between General von Ludendorff and General Max Hoffmann of the German High Command during the retreat from Cambrai in 1916.

Ludendorff: 'These English fight like lions.'
Hoffmann: 'Yes, but don't we know that they are lions led by donkeys.'

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