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THE LESSONS FOR BRITAIN FROM THE SUCCESS OF GERMAN COUNTER-INFLATION POLICY

A talk by Dr Walter Eltis, Emeritus Fellow of Exeter College, Oxford to members of the Economic Research Council on Tuesday 24th October 1995

In 1945 there was no reason to expect Germany to produce a sound counter-inflation policy. This had been catastrophic in the inter-war years when the hyper-inflation of the 1920s was followed by mass unemployment and the collapse of orthodox financial policies in the 1930s.

How Germany learned to control inflation

Herbert Giersch, the first Chairman of the German Committee of Economic Experts, 'The Five Wise Men', made a crucial contribution to the establishment of post-war German economic policy on a sound basis and he has provided an account of how he developed an approach to monetary policy which established the D Mark as a far stronger currency than the pound or the dollar.

He served in U Boats in the Second World War, and in his words 'the journey with the Navy, at the end of the war on a submarine boat, ended in a prisoner of war camp in England.'[1] He continues, 'reading Adam Smith's *Wealth of Nations*, one of the few books of the camp library, was to become crucial for my view of the world.' He then found Keynes' *General Theory* in another prisoner of war camp (are British prison libraries still like this?) but this impressed him far less.

On his return to Germany he became a Lecturer in Economics at the University of Münster where he heard British and United States economists who came to tell the Germans how to rebuild their economy. He was disappointed to hear Joan Robinson of Cambridge University, one of Keynes' greatest collaborators, 'expound a vulgar Keynesianism ... like Hamlet without the Prince of Denmark: a theory and a policy of full employment without wages.' Leading American visitors 'recommended expansionist policies, erroneously assuming that we had Keynesian unemployment rather than the classical kind arising from the influx of refugees and the physical destruction of the capital stock.'

Giersch went on to evolve a view of the world which was very different from Anglo-American Keynesianism and it had three characteristics which have since become orthodox in the leading OECD economies. He came to believe first, after his disillusionment with the economics of leading British and American Keynesians, that inflation depended upon the growth of the money supply. In the early 1950s few economists in Britain or the United States believed this and none who were influential. The second element in Giersch's new view of the world was that employment

1. The passages by Herbert Giersch which are quoted are taken from his personal memoir, 'Economics as a Public Good' which he published in the *Banca Nazionale del Lavoro Quarterly Review* in Number 158, September 1986.

depended upon the real wage, and that if this was too high unemployment would result. Keynes had pushed this explanation of unemployment out of English language textbooks which universally attributed unemployment to an inadequacy of effective demand which could always be corrected by increasing public expenditure. Giersch's third new broad principle was that the object of government budgetary policy should be to strengthen the supply side of the economy by not absorbing private saving into public expenditure and budget deficits, while the tax system should be used to create incentives to foster long-term growth.

This was the opposite of British economic orthodoxy at that time. Government investment was more than one-half of total investment, and even Conservative Governments failed to reduce the top rate of taxation below 75 per cent. Keynes believed that the families which mainly ran British industry (through nepotism and inheritance) were too short-sighted to get investment decisions right, he spoke of the 'stupidity of fourth generation men', and it was generally believed by Keynes' followers that governments would take far better investment decisions than the private sector. Sufficient net of tax profits to finance investment therefore had a low priority in Britain. As for saving, Keynes had declared that throughout most of human history, saving had been too high. These fallacies formed the background for the economic policies which contributed to Britain's relative economic decline in comparison with Germany in the 1950s and the 1960s.[2]

After a series of distinguished appointments in Germany, at OECD in Paris and at Yale, Ehrhardt appointed Giersch to be the first Chairman of the German Council of Economic Experts in 1964, and the new Committee faced a crucial problem. Since Bretton Woods, exchange rates between the world's leading currencies and the dollar had been largely fixed, and this meant that the rest of the world automatically imported United States inflation. If much of the developed world was in effect a dollar zone, and prices rose at 4 per cent per annum in the United States, they would also rise at around 4 per cent in Britain, France and Germany and indeed in every country with an exchange rate tied to the dollar. Hong Kong's currency is tied to the dollar today so Hong Kong's interest rates and its inflation rate are largely determined by decisions taken in New York and Washington.

The Americans had all read Keynes (the great MIT Nobel Prize-winning economist Paul Samuelson has remarked that he didn't mind who determined economic policy so long as he got to write the text-books) and their impact on policy was inflationary, so if the D Mark continued to maintain a fixed exchange rate with the dollar, United States inflation would automatically be transferred to Germany.

Giersch's startling advice was that the D Mark should be detached from the dollar. This outraged the business community who believed that upward revaluations of the D Mark would destroy their export profitability. Ehrhardt who had become Federal Chancellor remarked, that the Wise Men 'were offering the public stones in place of bread'. By an extraordinary process of political persuasion, Giersch achieved the

2. I have discussed these in detail in 'The Failure of the Keynesian Conventional Wisdom', *Lloyds Bank Review*, October 1976.

vital step that separated the D Mark from the dollar in 1968, which made it possible in due course to establish the D Mark as one of the world's strongest currencies.

Since the D Mark's first revaluation in 1968 it has risen 175 per cent in relation to the dollar, or at an average rate of 3½ per cent per annum. The dollar was worth 4.0 D Marks in 1968 and it is worth less than 1.45 in December 1995. Since 1968 the D Mark has risen 339 per cent in relation to the pound, or at an average rate of 5½ per cent per annum. The pound was worth 9.65 D Marks in 1968 and 2.20 in December 1995 so sterling has lost 77 per cent of its relative value.

Despite the relentless rise of the D Mark in relation to both the dollar and the pound, Germany's share of world trade in manufactures has risen considerably since 1968 while the export shares of the United States and the United Kingdom have fallen. There has been continual apprehension from the German business community, not least in 1995, that the rising D Mark would price German manufactures out of world markets, but this has not occurred. German exports have been so well made that they have continued to grow strongly, and in the last twelve months for which data is available, the volume of German exports has risen 11 per cent despite the supposed 'overvaluation' of the D Mark, while the volume of United Kingdom exports has also risen 11 per cent, despite the so-called 'undervaluation' of the pound.

The prime importance of Germany's 1968 decision is that without it the Bundesbank would have been all but irrelevant to inflation in Germany. If the D Mark had continued to be tied to the dollar the United States Fed would have continued to take the monetary decisions that mattered to Germany, and the Bundesbank would have had little more influence on German inflation than Hong Kong's Financial Secretary has on current inflation in Hong Kong. The independent influence of the Bundesbank has followed entirely from the decision to detach the D Mark from the Dollar.

The rest is history. Because, since 1968, the D Mark has risen 3½ per cent per annum in relation to the dollar, average German inflation has been about 3½ per cent less than United States inflation. Because the D Mark has risen 5½ per cent per annum in relation to the pound, average German inflation has averaged about 5½ per cent less than United Kingdom inflation.

The benefits to German industry from lower inflation

One of the most beneficial consequences for Germany from its lower inflation rate has been a generally lower level of interest rates. Portfolio holders including the world's banks and insurance companies and international fund managers can choose the country in which they will invest their assets. Countries with faster inflation and falling exchange rates like the United States and the United Kingdom must pay higher interest rates to compensate for the fall in the value of their currrencies which the world comes to predict as it sees it happening time after time. Because the pound has fallen more than 5 per cent per annum in the last 30 years, United Kingdom interest rates have had to be about 5 per cent higher than Germany's. The gap has narrowed in 1995 now that United Kingdom inflation is only 1 to 1½ per cent above Germany's, and the interest rate on ten year government bonds is 6 per cent in Germany and 7.4 per cent in the United Kingdom, an interest rate advantage to German borrowers of just 1.4 percentage points.

In addition to the benefits to the German business community from lower interest rates, there have been further benefits because the far lower German inflation rate has required less correction over the decades. German businesses have been far less inconvenienced by the need to deflate in order to balance the macroeconomy.

When I was Director General of the National Economic Development Office from 1988 to 1992 we produced a paper addressed to the Council chaired by the Chancellor of the Exchequer written by the 15 Chairmen of our industrial sector groups who included senior industrialists, David Barnes, Sir John Cuckney, Sir Ivor Cohen, Ian Gibson, Sir Ronald Halstead, and the senior trade unionists, Bill Jordan and Eric Hammond. They agreed that a principal difference between British and Japanese and German industry was that the Japanese and the Germans could concentrate on production. They had more predictable macroeconomies and lower interest rates so they could concentrate on engineering, product design, research and development and marketing. They did not all the time need to divert attention to finance. In contrast, many of those who ran leading British companies were preoccupied with questions involving finance, the need to keep their companies financially viable and questions of which companies to take over or detach themselves from. Because of this fundamental difference, British companies were far more often led by accountants, while German and Japanese companies were far more often led by those with particular expertise in production who had obtained science and engineering PhDs at the start of their careers.[3]

Because of the United Kingdom's comparatively unstable macroeconomic environment and far higher interest rates, business leaders with expertise in accountancy and finance have often had to veto far reaching proposals to expand and develop new product ranges. The arrangement of finance was a low ranking routine task in Germany's climate of comparatively low interest rates and financial stability.

Another far reaching advantage to business from low interest rates which German manufacturers have benefited from is most easily illustrated from the housing market. Britain and Germany have had average inflation rates of 8 and 3 per cent over the last twenty years so home owners have paid average interest rates of perhaps 11 per cent in Britain and 6 per cent in Germany. If you have to pay an 11 per cent rate of interest in Britain, and house prices are four times an employee's earnings, the general average over the last 20 years, then when an employee buys a house, 44 per cent of his income will initially be needed to pay interest. If the employee has an income of £50,000, buys a £200,000 house and pays an 11 per cent interest rate, £22,000

3. A re-edited version of the paper the NEDC Chairmen presented to the National Economic Development Council in July 1991 is published in February 1992 in the *National Westminster Bank Quarterly Review* ('The Lessons for Britain from the Superior Economic Performance of Germany and Japan', by Walter Eltis, Douglas Fraser and Martin Ricketts).

interest a year will need to be found from his £50,000 income. Husbands and wives can do that together, but if either loses their job or falls ill the house is likely to be repossessed. The situation of companies will be similar. If they are paying 11 per cent nominal interest rates and they cannot pay the interest on the first two or three years of a large investment financed through borrowing, the company will be repossessed in the same way as a family home.

Consider in contrast the situation in Germany with 3 per cent inflation and a 6 per cent rate of interest. The family buying a £200,000 house and paying 6 per cent interest will only need to find £12,000 interest a year from an income of £50,000, so only one earner is needed to pay the interest and either of two earners in a family can lose their jobs and the family will still be able to find £12,000 a year. Therefore their home will not be repossessed during recessions in the economic cycle. The condition of businesses with equivalent large loans will be equally robust so there will be far fewer bankruptcies. It has been found in Britain that each 1 percentage point addition to the inflation rate has added 6 per cent to the number of bankruptcies.[4]

German industrialists have therefore enjoyed great advantages throughout the period in which German nominal interest rates have been lower because of lower German inflation. Why has Britain failed to obtain these advantages?

Why Britain has failed to control inflation

British governments and economists have had the unreal belief that they could control the economic cycle, so after unemployment began to rise, British ministers' and economists' almost immediate response has generally been, 'this is intolerable – Why do we have this unemployment? Shouldn't we lower interest rates!, Shouldn't we cut taxes!, Shouldn't we expand spending!'.

Hence Britain has rarely been prepared to pay the price required to bring inflation down, and there is no way inflation can be brought down without reductions in demand and spending. The pace of wage increases cannot be reduced without an increase in unemployment, and price increases cannot be reduced without a weakening of business markets. The political pressure to end recessions early has repeatedly led to government reflationary policies long before inflation had truly come down.

This can be contrasted with how Germany handled the re-unification crisis. German inflation was comfortably settled at 2 per cent until 1990 when it increased to more than 4½ per cent. The Germans had to pay a reunification tax which produced sharp rises in German prices. The Bundesbank's response was to raise interest rates to 10 per cent, unemployment soared, Germans protested vehemently (and not only Germans because other countries' currencies were tied to the D Mark so their interest rates had to rise with Germany's) but within two years of the Bundesbank's imposition of 10 per cent interest rates, German inflation came back

4. See S.B. Wadhwani, 'Inflation, Bankruptcy, Default Premia and the Stockmarket', Discussion Paper no. 194, Centre for Labour Economics, London School of Economics, 1985.

from 4½ per cent to 2 per cent. By paying that price Germany did not allow inflation to rise permanently from 2 to 4½ per cent. During the oil shocks of the 1970s when British inflation was allowed to rise to 25 per cent, German inflation peaked at 8 per cent and the Bundesbank pulled it down again.

The Bundesbank became the institution which Germany used to control inflation once Ehrhardt and Giersch had freed the D Mark from the inflationary dollar. Its President and Directors are bankers and its sole task is to control inflation. It is not subject to political pressures, and it has shown that it can resist unpopularity. Therefore if some shock such as the rise in oil prices in the 1970s or the consequences of reunification sends German inflation upwards, the Bundesbank is entirely able to bring it down again.

In Britain in contrast, the tendency in the 1960s and the 1970s was to allow inflation to continue because the Chancellors who determined British interest rates were unwilling to pay the price of pulling it down again.

The British situation has been very different since 1989 when high interest rates were imposed which brought inflation down rapidly from 9½ per cent in 1990 to an underlying rate of little more than 2½ per cent in 1995. The political sacrifices John Major and his Chancellors have made to bring inflation down have been great, and this has been the first true occasion since 1968 when a British government has imposed a German interest rate policy which attached overwhelming priority to the control of inflation. After 1979 a German policy was followed for a few years, but it was not persevered with, and inflation which was reduced to 3½ per cent in 1986 was allowed to rise again to an unacceptable 9½ per cent.

Since 1990 when both Britain and Germany imposed interest rates calculated to bring inflation down, the pain in Britain has been far greater than in Germany because British inflation had to be reduced from 9½ to 2½ per cent, while in Germany it only needed to be brought down from a peak of 4½ per cent. Because we lost control of inflation in the 1980s, we have had to pay a far higher price in the 1990s. That illustrates how British reluctance to control inflation and the postponement of counter-inflationary decisions until the need to raise interest rates became overwhelming has accentuated the extent of economic fluctuations, and therefore made business conditions far more difficult for British companies.

Because raising interest rates in Germany is a technical matter outside the political process, the Bundesbank is free to judge the right moment to raise them which prevents inflation from running away in the manner it so frequently has in Britain.

Germany's lesson for Britain

The comparison between counter-inflation policy in Britain and Germany offers a strong case for moving to make the Bank of England independent. Germany has evolved an institution for the determination of interest rates which has proved extremely effective and conferred substantial benefits on German industry and commerce. If we observe an institution which works against all the odds, because in

1945 no one expected the Germans to acquire such an efficient way of running macroeconomic policy, the lesson for Britain is to seek to achieve something similar. If electorates became accustomed to the idea that interest rate decisions were taken by an independent central bank, ministers might cease to be blamed for decisions to raise interest rates in the manner that they now are. It would gradually be appreciated that if these were raised, this was because bankers were doing their job to control inflation, and whether bankers did this well or badly would be judged by how well they controlled inflation. The economic evidence is overwhelming that, in the language of economics, the Phillips curve is vertical, which means that demand reductions which raise unemployment in the short term do not raise it in the long term. Bringing inflation down does not damage long term growth as the experience of Germany shows. It damages employment in the short term, but if we developed a way of running our monetary affairs which focussed on keeping inflation low, any short term losses in output would be recovered. Indeed if a more effective counter-inflation policy reduced the degree of fluctuations in the economy, because inflationary hiccups were rapidly controlled, our businesses would gain the advantages from more predictable markets. They would then be less preoccupied with financial vicissitudes, and, because the countries in the world which have the lowest inflation are those which have the lowest interest rates, our businesses would gain the advantages of lower interest rates.

A central bank which shares many of the characteristics of the Bundesbank therefore appears to offer an opportunity to take the control of inflation out of politics, and to offer the best prospect of stable and favourable macroeconomic conditions for industry and commerce. That is the lesson Germany offers Britain. Whether Germany itself has learned that lesson, or whether it will now replace the Bundesbank with a European Central Bank which will be far more subject to political pressures, is now the most interesting question in European politics.

THE POSITION OF EDUCATION AND TRAINING IN WEALTH CREATION

By David Fifield

The aim of this essay is to provide a model linking the contributing interests needing to be satisfied if long-term wealth creation is to be achieved. Within the model the position and nature of education and training will be explored from both the current and an historical position.

Over the last ten years there has been a developing appreciation and interest in what is often referred to as the stakeholder model. A consensus holds that the three key stakeholders are the owners, employees and the customers. The model was given a symbolic focus in 1993 by Furnham and Pendleton in a Financial Times article which as its conclusion suggested, "For 2000 years the Christian church has been teaching the difficult concept that God is a trinity – three in one. If there is a God of business, he or she also has three manifestations: the shareholders, the customers and the staff. They are different but equal and all demand similar attention. Those who emphasise the worship of any one over the others are today's false prophets."

In the above model there are three points that need to be considered. With a cohesive and shared interest driving corporate strategy, ownership at the final count must hold the dominant position. Another train of thought has sought to include additional interests in the form of community and the environment. Protection of the environment as well as social accountability can only be safeguarded through a legal framework, plus codes of practice, applied independently and fairly to all. This leaves businesses with the basic model free to direct their energies along Darwinian lines. Lastly some believers in the basic model like to include suppliers as a separate interest. With businesses trading along a chain of activities through extraction, processing, manufacturing, wholesaling to retailing means one company's customer is another's supplier and vice versa through the chain. This is then reinforced by the fact that contracts between organizations require matching conditions of sale and purchase.

During the 80s I produced a series of essays that anticipated and explored the evolving interest in the various aspects of stakeholder makeup. A selected collection of these essays was then republished in 1990. The precis that follows considers the key interests from a behavioural and survival point of view, plus the proximity of ownership to the management process.

Owner managers are most often found in small businesses such as farming, retailing, subcontracting, engineering etc. With this type of ownership, protection and development of the assets is a primary concern. The assets used by the business are expected to provide a living now and well into the future for the owner and his/her family. In addition to the development of the assets the next most important aspect is the maintenance of a positive cash flow. Profit maximisation and a return on capital then follows. The proximity and permanence of the funding is close to the management and long-term, all the time expectations exist for the business. With

business growth debt may be taken on. Here an outside source in return for agreed terms covering security, duration and return provides funds leaving management close to the business and still thinking long-term. However with a possible lien on some or all of the assets ownership can be thought to have partly moved outside an organization. In the third form, traded equity, ownership can be considered to have moved outside, with management having authority delegated to it. In this situation owners are more likely to be interested in a competitive rate of return via capital growth and income. The future is judged according to the quality of the management and products. As protection, ownership, through the right to leave a situation it does not trust, retains a mobility option. As a performance measure return on capital is important. With ownership mobile and separated from management the risk of short-termism creeping in is an on-going risk.

Employees form the bridge between the owners and customers of a business. With both owners and customers having unique expectations the employees have to form a compatible bridge between these expectations if both are to be satisfied. The establishment and maintenance of the bridge provides each business with its unique corporate character.

The corporate character can be conceived as having three elements. The first is the social organization which is derived and defined by management and employees so as to create order and channels of communication for those seeking to meet agreed objectives. It provides a definition of structure according to a hierarchy of identified tasks and roles. These tasks and roles carry titles such as general manager, chief accountant, sales engineer, etc. Management through its direction has an important say in the establishment of the social organization. Matching employees into the hierarchy is more complex than just recognising a need for certain skills and training. Individuals are more "complete" having acquired through a combination of inheritance, learning and cultural formation, a range of qualities such as experience, preferences, interests and abilities. The right match that is needed if an individual's selected place in a hierarchy is to be effective is a demanding exercise needing great management care in the interest of long-term corporate success. The third aspect, the corporate culture, derives the bulk of its characteristics from the market place as opposed to management/ownership expectations. These manifest themselves through the speed of money turnover, which in turn is controlled by the method of production, the form and type of assets used, technical knowledge and methods of distribution. This "financial dynamic" then induces a similarity in management style for those companies competing with each other. Conformity is demonstrated through like customs, habits and discipline. The corporate character as established through the interplay between organization, people match and corporate culture needs to remain flexible responding to changes in the market place, to technology as well as ownership demands.

Market opportunities are provided through a series of windows with each window established through a competitive price and technical benefit. In the case of price this is set by custom and the competition, be they suppliers of like or alternative products/services. Technical benefits are supplied through a combination of factors such as the use to which the product will be put, its design and aesthetic appeal together with presentation and mode of distribution. Over time, businesses, consciously or otherwise, identify windows that meet their interests and capabilities, while providing the revenue needed to meet the future and current ownership expectations. What is often overlooked in this scenario are the changes demanded in takeover situations compared with evolutionary development.

By reference to the model, the contribution education is expected to make can be identified. This can then be linked to influences coming from the past and for what the future is likely to hold. What also needs to be recognised is the fact education and training forms only a part of what employees offer business organizations. Equally important are powers of mental reasoning, experience and personality. Personality, including characteristics such as extraversion/introversion, linear/lateral thinking, objectivity, a preference or otherwise for structure etc., tend to be overlooked, while being crucial for success according to the roles needing to be filed in an organization's hierarchy.

The windows provided by market opportunities establish a set of roles. Roles take two forms. A sales force generating organizational income by taking products or services to potential customers. Marketing, assisted by senior management, then takes care of the future by seeking to satisfy new opportunities. Both roles require an adequate technical understanding of what an organization can supply, as well as a customer's needs. The more technical a product, the more sophisticated the understanding needed. A key difference between the two roles lies in personality. Selling benefits from a sequential approach, while marketing relies on powers of lateral thought.

With employees forming the bridge between ownership expectations and marketplace opportunities, another set of roles are established. The bridge defined earlier as the corporate character, is made up of social organization, people match and corporate dynamic. The social organization forms the promotional framework. With the people match the pattern of skills, training, abilities etc, are recognized. These are established initially through recruitment and then updated according to evolutionary developments in the market place, plus changes in ownership expectations. The corporate dynamic is largely established through the speed of goods and money turnover and by the nature of the assets employed. Where the emphasis is on money and goods turnover, commercial skills will always be in demand, in contrast to capital intensive activities where technical and production expertise and a longer time horizon are critical. Within this combination of applied skills is the need for additional expertise, such as general management abilities, accountancy, administration, legal and possibly engineering and scientific training. The whole is then helped by the orchestrating skills of the personnel function.

It is clear education and training play a crucial role in the evolving success of any organization. What also has to be considered is the cultural climate in which success is achieved. As suggested earlier ownership at the final count controls events. In material terms ownership manifests itself through its financial commitment as represented by the expected returns set against a perceived time horizon. On these

counts the UK differs from other EU members.

A number of writers have highlighted parallel historic trends for both capital investment and education. Cain and Hopkins in "British Imperialism innovation and expansion 1688–1914" picked 1870 when they suggested major stock banks preferred the liquidity brought by increasing contact with the London market to long-term involvement with industry. The major banking and financial institutions did not as a consequence develop as a part of the emerging financial capitalism in the style of the USA or Germany, there being no welding of the joint stock banks, money markets and stock exchange with provincial manufacturing. Kennedy "Industrial Structure, Capital Markets and the Origins of British Economic Decline", found banks with a primary interest in long-term industrial investment did appear late in the 1860–70s, but their lives were brief. A point had been reached where the whole system had to be reorganized to withstand the greater risks of emerging industrial requirements or the system had to withdraw from long-term industrial involvement. The system withdrew. Lee "The British Economy Since 1700", brought the preceding views together by stating Britain in effect had two economies, an element of self sustaining growth in the SE based on the accumulated wealth of trade and finance, and a low income relatively less significant industrial and manufacturing economy in the North. Rubinstein "Capitalism Culture and Decline in Britain", on a more optimistic note records Britain's financial performance has been outstanding with the continuing centrality of the City as a major financial centre over the last 30 years.

As with financial evolution a unique pattern was also developing in education during the second half of the last century. Professor Lyon Playfair in 1853 published a pamphlet, "Industrial Education on the Continent", in which he pointed out the superiority of technical instruction in Germany. According to Sir Robert Ensor, "England 1870–1914", before the 1870s neither schools nor universities in England provided facilities for the study of those sciences from which the industrial revolution had sprung and which were needed for every step of its progress. Instead contributions were coming from abroad. At this stage Britain had a time delay in adopting other nations' technology. However, following the Paris Exhibition, the loss of ground was recognised. Some years too late in 1889 the Technical Instructions Act was passed.

In 1995 Coopers and Lybrand, "Investment and the cost of capital: an international comparison", Economic Outlook, implied not a lot had changed . On the subject of education, the UK was found to have one of the lowest proportions of spending as a proportion of GDP among OECD countries. Japan and Germany, two countries with well respected education systems, came even lower in this league table. On corporate funding, the UK's higher cost of capital was put down to a lower debt/equity ratio. This is attributed to relative low levels of long-term debt finance being available to middle-sized companies. By comparison German and Japanese companies sustain higher levels of gearing without pushing up unduly the equity risk premium. This has resulted from a close relationship between middle-sized companies and the banks.

With a central role held by the City in UK business finance, the following points need to be noted. Unlike German and Japanese companies, UK companies are bought and sold on a much larger scale. This process over time has encouraged the formation of some large groups, where funding can be thought of as almost permanent. Share trading activity has also encouraged a two level pricing system, a steady state price and a take-over price.

In conclusion, if it is accepted that over the last forty years education has moved from a process of academic achievement to one of utility, so linking it with training, present and future needs become clearer. Within the trinity of interests, ownership exerts a significant influence. This is particularly so within the UK . With more traded ownership the future can be considered to be less predictable than in say Germany. This is brought about by a preference for products and services that offer an early return, using delegated management, plus the risks from takeovers. By comparison, Germany's closely integrated ownership and management, with takeovers rare, offers a longer time horizon. As a consequence Germany tends to have a stronger interest in manufacturing and its need for technical and craft education, whereas the UK is moving away from the incremental and towards modular learning. The growth in business studies and MBA programmes demonstrates the UK's direction. Here is a market-driven learning process providing a portfolio of subjects with a commercial foundation, a flexible mode of presentation, i.e. full time, part time, distant taught, that can be undertaken at the start of or later in a career. As a form of learning it integrates market opportunities with an understanding of ownership expectations, while providing greater employment protection. Another UK career, offering similar benefits and with a longer history, is accountancy with its transferable skills and the policing role it offers ownership.

With a modular approach meeting the bulk of the UK's indigenous needs, the growth in UK manufacturing brought about by capital investments coming from the EU and elsewhere will guarantee a continuing, but small, demand for scientists, engineers and hopefully economists.

STAKEHOLDERS IN SOCIETY

By John P. C. Dunlop

I would like to draw attention to the most important fact that stares us in the face and that colours all our political beliefs and prejudices:-

The fact that the larger part of our fellow countrymen have no real stake in the productive enterprises of our country nor under present dispensations ever will. This is the power house that generates all the ill will and political violence that underlies our industrial relations.

Everyone in our country now has not only the inalienable right but the duty to receive educational instruction. Yet year after year our youth are turned out of school into the labour market with no guarantee of a job. No duty, no inalienable right to work, no inalienable right to a home, throughout their lives those who have experience of the scrap heap of unemployment will have no certainty other than the ever present threat of poverty and so no feeling of a secure basis to their lives. They will never have the certainty of owning anything other than the clothes they stand up in, or of experiencing a comfortable and protected old age. This will not apply to all who are born into the working class but it is certain that a very large proportion of them will have cause to fear the future .

Any government that tackles this problem and puts into effective operation measures that will successfully dispel the basis of these fears without at the same time bringing on violent economic and political upheavals can be sure of a permanent majority at any election, yet no party at present, whether Labour, Conservative or Liberal, has a plank in its political platform that will ensure this. Nationalisation is no answer because industries have been nationalised and denationalised, and in any case nationalisation gives no right of employment. Witness the coal mines where the labour force has been progressively reduced in the past years.

The problem of the right to work is a very difficult one to solve but the question of a right to share in the economic output of the country, and eventually through this to homes of their own for everyone born and resident in Britain, is a much simpler proposition, and astonishingly simple to provide. In fact the answer is so simple that one wonders why no one has thought of it before as other more primitive societies have solved the problem centuries ago in their own simple ways. Basically these recognised the principle that every member of the community has a right to share in the common product of the group.

If we wish to develop a stable and productive community we have to forget doctrinaire theories of politics and economics and accept that everyone born into our society is also entitled to a share in its product, and then adopt a practical plan to make this possible with the minimum upheaval to existing institutions.

A way to do this is by creating a national investment fund or community chest, to borrow the terminology of a well known board game. The simple way to establish this was demonstrated a few years ago by the imposition of the Selective Employment

Tax, a tax lauded by some and execrated by many others and which was later abolished. The important lesson afforded by this tax exercise is the ease of extracting from industry a large sum of money based on the numbers of employed persons in production at any time.

If in place of S.E.T. a levy of £1 per head per week is exacted from employers for every person employed in their business an 'Instant Community Chest' can be created within a week: after 52 weeks the fund would amount to some £1,000 million.

The money collected would be used primarily to provide loans for installing more productive equipment to private business at commercial rates which at present are about 12% per annum. The community chest would have to be managed by commercial managers who would be not only thoroughly experienced but ready to be personally responsible for the safety of the investments they have made and be remunerated on the basis of not more than 2% of the loans advanced, which would have to include the cost of distribution as well as collection of the income. The balance of income of the fund would then be initially distributed to the oldest age groups in the country, say all persons over 75, on a basis of equal shares per person irrespective of sex.

Each year as the fund grows, the entitlement to a share in its income would be given to the people in a group born later than the youngest participants; i.e. in the second year 70 year olds would participate, in the third year 65 year olds, and so on until in the final year and yearly thereafter, the newly born would become shareholders in the community chest. Thus after a period of years the whole population would become in fact property owners, and the ideal of a property-owning democracy would have become a political reality.

Individuals would only be entitled to participate:

(1) If they were born in Britain.

(2) They remained resident in Britain.

(3) During their lifetime only; i.e. their heirs would not be entitled to succeed to their share of the community chest, with the possible exception of spouses of the elderly, or infirm dependants of the deceased. They at least should be entitled to the small additional comfort that their joint income would afford the survivor for his or her few remaining years.

It should be emphasised that the income from the community chest should be entirely excluded from a person's computation of Income for Tax purposes and additional to present pension rights.

Every year the fund would continue to grow larger but as long as the levy remained the same, each year until the final year the amount available to each individual participant would vary slightly as their numbers fluctuate according to the difference between the number of participants dying and the numbers in the age group coming into participation. But after the final year the actual amount available to every man woman and child will increase year by year.

From the outset the community chest will assume a continually increasing

importance in the economic affairs of the country. Managed by professional merchant bankers and run on strict commercial lines the community chest will provide a regular flow of investment available to businesses and to private individuals for their personal house purchases. Eventually the fund should be able to provide the down payment for young couples buying a home of their own. If they used up the whole of their entitlement from the fund, their income from the fund would cease until it was repaid, but if they required only part of their entitlement then they would lose only the appropriate proportion of their fund income.

The great social importance of the creation of the community chest is that the old people will get not only a considerable increase in their income, but such a feeling of security as they have never had before. Young people will be able to look forward to having homes of their own and every person in Britain will have the knowledge that they eventually will participate in the prosperity of the country. The feeling of security thus engendered is bound to have important and beneficial effects on the social relationships in the country as a whole, and provide an atmosphere in which other economic problems will be more easy of solution and especially that of the wage price spiral.

Another important point to note about the creation of the fund is that although it increases costs of production and so is inflationary to that extent, it is creating a fund for new investment which should help to reduce production costs by a much greater extent and also in its initial years is automatically and regularly increasing the income of the elderly who have up till now been the most severely hit by inflation.

It should also be pointed out that there is no obvious reason why the only method of providing contributions to the fund should be by the method above described, there could also be a levy of one or two per cent on profits of all concerns above a certain size and provision for public spirited persons to leave donations to the fund in their wills.

SOVEREIGN BRITAIN

By Norman Lamont
13 Speeches on Britain and the European Union
Published by Duckworth 1995 price £8.95 (paperback)

When considering the European Union what really is the use of books composed of compilations of politicians' speeches? Speeches are, at least sometimes, fascinating, stimulating and inspiring. But this is of the moment and to willing audiences. Summaries, reports, or perhaps mere extracts are often printed in the newspapers and elsewhere but the purpose has then changed to a matter of record and information.

Books are a different matter. Some, such as Bill Jamieson's "Beyond Europe", Sir Richard Body's "A Europe of Many Circles" or Bernard Connolly's "The Rotten Heart of Europe" offer a reference point, a dissertation in depth on a specific aspect. They are contributions which go beyond anything that could be a subject of a speech.

So this reviewer's attitude is not one of great enthusiasm for "Sovereign Britain" though he would have very much enjoyed the opportunity to have been present when the speeches were originally delivered. But it is a duty to report the titles offered. They are: Part 1. *Europe* "The advantages and disadvantages", "The ERM", "EMU and a single currency", "France and Germany first", "We joined for the wrong reasons", "Should we be members at all?", "Britain outside EMU", "Do we need a European Parliament?", "The Mounting Cost", and "The case for a referendum". Part 2, headed *The Nation State* contains "Sovereign Britain", "Europe's threat to democracy", "Ulster and Britain", and the author's resignation speech made in 1993.

But we must not confuse the book with the man nor the policies for which he stands. Clearly Lamont has lived his political life as an impressive education. He has believed and been disillusioned, has advocated and been betrayed, has struggled and failed and has found anger where at first there was mere surprise. Perhaps he is not the first to have trodden this path over "Europe" but he is way ahead of the majority of M.P.s and perhaps years ahead of the rest of us. The maturity of view and the grasp of issues is impressive even if each chapter is too short to do justice to the topic chosen. Interestingly, Lamont displays a clearmindedness and a broadmindedness but not a bitter mindedness.

At the end one is left with the message that Lamont has realised that the EU is about the achievement of a union of executives and not of polities. It is to be a union based on coercion, not on the affection, loyalty and consent of member peoples. Meaningful democracy both within member states and at "the top" must degenerate into a charade. Bismarck established such an entity and it is only now, over 100 years later, that Germany has returned to being politically "normal". The EU has a rough road ahead and Lamont is absolutely right to point out that it is all so very unnecessary.

To further his cause so well portrayed, for a liberal, and kindly-minded Europe that is in spirit democratic, in trade open and free, in society able to find a way

towards wider, far wider, share and capital ownership, what can this author do next? He might yet join that interesting and indeed impressive new political party, the "UK Independence Party". He might foolishly support Sir James Goldsmith's "Referendum Campaign" – an enormous banana skin for any true opponent of EU collectivism. Most likely he will remain a Conservative M.P., acknowledge the work of long standing groups such as the "Campaign for an Independent Britain", lend support to John Redwood, and perhaps fairly soon, regain centre stage.

J. B.

A REFERENDUM ON EUROPE?

The following letter was published in The Times on September 25th; to which two responses have been received – from Mr Ivor R. Johns and Mrs Anne McCosker

From Mr. James Bourlet

Sir, A national referendum on future changes in Europe is under consideration by John Major, has been called for by Lord Tonypandy (letter, September 20) and is demanded by a variety of politically active groups.

Beware! Prior to the 1975 referendum public Opinion stood 2 to I **against** membership and returned to that ratio a year later. But for the event the "pro" side spent some 14 times more (and that is a cautious estimate) than their opponents – and won. Opinion, even British public opinion, can be bought.

If we are to have another referendum on Europe a clear commitment must be made at the outset to somehow fund each side with something approaching parity – or the result will be worthless.

Yours faithfully,
James Bourlet
(Hon Secretary)
Economic Research Council
239 Shaftesbury Avenue, WC2

Dear Mr Bourlet,

I agree entirely with your letter in The Times regarding a referendum.

One has to consider also, the general 'presentation' of a campaign. In 1975, I remember only too well the impression conveyed of the 'extremist' nature of many of the politicians on the 'no' side in contrast to the more 'moderate' and 'reasonable' personalities on the 'yes' side. Undoubtedly this made quite an impression and whilst, in those days, most 'extremists' tended to be 'Left Wing', today either 'Left Wing' or 'Right Wing' charges are likely to be used.

The presence on the 'no' side of former Cabinet Ministers who, in some cases ended their Ministerial careers amidst some unpopularity with the public on other grounds, would also doubtless be picked on. One can foresee it all – 'has beens' who

ended up 'over the top' or 'embittered' in contrast to the 'sane' and 'reliable' leaders on the 'yes' side.

Another factor in 1975 was the misleading and broken promise on the part of the Wilson Government. 'Fundamental renegotiations' were not carried out and the farce was followed by a 'Yes' recommendation instead of the promised 'No' recommendation which should have been made in that event. Should there be another complicated formula surrounding any new referendum politicians would need watching like hawks – the potential for deviousness, I imagine, is no less present today than in 1975.

In my opinion, 1975 set this country back years; we would have been better off without it. I do not want a repetition (and at an even more vital stage).

Yours sincerely,
Ivor R Johns
153 Heanor Road
SMALLEY
Derbyshire
DE7 6DY

Dear Mr Bourlet,

I was delighted to read your letter in The Times.

The trouble is there are very few of us around who actually took an active part in the 1975 campaign. So many either did nothing, or were on the other side. They have no idea about what actually happened 'on the ground'. Unless one saw as I did, and you obviously did, the way the people were manipulated they would not believe what happened.

Yours sincerely,
Anne McCosker
1 Coniston Road,
Ringwood,
Hampshire. BH24 IPF

NEW MEMBERS

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

Members may propose persons for membership at any time. The only requirement is that applicants should be sympathetic with the objects of the Council.

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i) To promote education in the science of economics with particular reference to monetary practice.

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

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

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

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

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

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

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

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NAME OF ORGANISATION ....
(if corporate)

ADDRESS ....

....

....

PROFESSION OR BUSINESS ....

REMITTANCE HEREWITH ....

SIGNATURE OF APPLICANT ....

NAME OF PROPOSER *(in block letters)* ....

AND SIGNATURE OF PROPOSER ....