BRITAIN & OVERSEAS

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

Autumn 1997 Vol. 27, No. 3

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Published quarterly by

The Economic Research Council

239 Shaftesbury Avenue, London WC2H 8PJ

Price: U.K. £12 Australia $25 Canada $25 New Zealand $35 U.S.A. $25 Japan ¥4,000

ISNN 0045-2866

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BRITAIN'S ECONOMY – PROBLEMS AND SOLUTIONS

The 24th September meeting was, as an experiment, devoted to post-dinner discussion based on John Mills' pre-circulated paper *'Britain's Economy: Problems and Solutions'*.

Introducing the Paper, John explained his contention that Britain's postwar economic problems stem in large measure from the widespread belief that strong Sterling means a strong Britain: that a high exchange rate has been traditionally taken as a sign of economic health and propped up, whenever necessary, with high interest rates no matter what the economic cost of so doing. In fact, expensive Sterling and high interest rates had put British industry at a chronic and heavy disadvantage. By reversing the priority, he argued that the British economy could be restored to high growth. A rebirth of its manufacturing base would foster the growth in prosperity which comes only from enterprises capable of sustaining rapid increases in productivity.

As the discussion progressed, it emerged that a minority present considered Britain was doing quite well as matters stood. The nation's economic performance was said to be the envy of other countries: falling unemployment, low inflation and strong growth. This view was criticised on the basis that Britain only looked good by the standards prevailing elsewhere in the European Union – no great comparison. (In fact Britain's inflation and interest rates are both higher than in its major European neighbours). One advocate of *slow* growth believed that the impact on the environment of greater economic activity was to be deplored.

For the main part, however, those present agreed that a higher rate of growth was desirable, in part to generate the economic dynamism needed to meet such demands as tackling environmental fall-out. Growth was also important because of the unemployment problem, particularly in the light of efforts by politicians to conceal its true extent. The advent of computers had further accelerated the process by which jobs disappeared; again, only faster growth could plug the gap. Another major and growing concern was the ageing of the population. The economically active age-groups had to create a larger cake if those in retirement were to enjoy the prosperity to which, politically, they felt entitled.

Given those underlying needs, discussion next turned to Britain's relative decline. Various alternative influences were discussed - such as the differing proclivities to work of the world's national and ethnic groups; to the supposedly rigid class structure of Britain; and even to the economic cycler's argument that a period of manufacturing expansion comes around one decade in six no matter what governments do.

Many of these contrarian points were soon set aside. The basic contention of the evening focused on interest rates and their effect on the economy. Many present agreed with John Mills in rejecting the received wisdom that lowering interest rates would make inflation worse, arguing that there was neither empirical evidence nor worthy economic logic to warrant the orthodox Treasury-Bank of England assumption.

The point was raised that liberalised international capital flows now mean that it is impossible for any one country to sustain lower or higher real interest rates because money will simply flow away or towards that economy, thus frustrating the policy aim. John Mills responded by arguing that governments still have a substantial measure of control over interest rates – at least in the short term, and in any case a more prosperous economy would mean more equity investment opportunities so that flows of equity investment would more than offset any loss of fixed capital investment on this account.

At least one contributor argued against the conventional belief that lower interest rates would boost consumer borrowing. The belief missed a vital point about the banking system. Both history and logic showed that when interest rates are low, the banks grow only slowly and do not then have the resources to increase lending in large amounts to anyone. In contrast, the banks grow very rapidly when interest rates are high and therefore seek new lending outlets – such as credit cards or house mortgages.

Taking things to a more basic level, one member pointed out that prosperity must depend on people's willingness to work hard. There are great differences in prosperity between countries, which reflect attitudes to work. Thus countries in South America are less prosperous than Germany or Japan. John Mills responded by pointing out that some of the South American economies are now amongst the faster growing economies in the world and, in any case, he was urging policies which would provide the maximum possible opportunity for creating work. Britain, he asserted, still has untapped potential for effort given the extent of unemployment, "hidden" unemployment and part-time working.

Taking the "people" theme further, a member (from Canada) pointed out that Britain's class system is a real difficulty because it fails to sustain a culture conducive to the efforts of entrepreneurs. John Mills accepted this point but felt that there were many shades involved, there being both advantages and disadvantages in Britain's social make-up. The private school system does, after all, produce what are arguably the best results of any schools in the world. People are often motivated by the desire to rise in social position – and work hard towards this. Often those with money are able to provide financial backing for enterprises initiated by those known personally – enterprises which anonymous bankers might well not back.

A final interesting point was raised concerning taxation effects. Surely, it was argued, there is far more that the tax system can do to support, rather than, discourage, entrepreneurship. This point was then extended to look at government expenditure where disproportionate amounts of government expenditure go to Wales and Scotland in such areas as social security, education and transport, thus starving English regions of a stronger infrastructure base …. At this point the discussion seemed to be moving towards the devolution debate ….

and the Chairman, noting that it was 10.00, called the meeting to an end.

C.M. and **J.B.**

A FALSE ECONOMY

A reaction to the discussion – Britain's Economy, Problems and Solutions
by Participant Mr Richard Hadfield

The message of John Mill's address was that a self re-enforcing cycle of business confidence and output growth could be achieved by an expansionist monetary policy, lower interest rates and currency depreciation. While conceding that such a policy would produce some increase in inflation (2% or so), he argued that this was a minor consideration compared with the potential for setting the economy on a 4–6% growth path.

In support of the feasibility of such a policy, John Mills cited historical evidence which he said showed that prosperity was closely associated in the past with periods of monetary expansion and, as contemporary evidence, he pointed to the explosive growth in new economies of the far east where monetary expansion has been extremely rapid.

His historical evidence was somewhat selective, in that it did not mention the Barber and Lawson booms and several similar dashes for growth, export led or otherwise, all of which ended in spiralling inflation and devaluation, followed by retrenchment and deep recession. Presumably he would argue that it was the retrenchment that was the mistake.

There are many factors that can equally well or better explain the higher growth rates of the 'Tiger' economies, compared with the steady 2–2.5% rates of the mature European ones. Two obvious ones are the low base from which the former started and the fact that they were able to draw on a large, low or non waged, peasant population for their initial impetus.

A less obvious difference, i.e. the novelty and dynamism of any industrial revolution which has no accretion of sclerotic practices to overcome. This phenomenon is not merely to be observed in the Eastern Tiger economies. After losing two major wars, the German economy put on remarkable spurts of growth, each time, despite? or because? much of its industrial base had been destroyed.

Another major issue not addressed was what might be called the ‘addiction effect’ of small doses of inflation. At first, everyone seems to win, but eventually the much despised rentier class notices that its capital is being eroded by inflation. Keynes argued for the ‘euthanasia of the rentier’ – printing money to keep interest rates down – a practice followed by Labour and Conservative post war governments. The problem was that governments and businesses need to borrow, and for that they need willing lenders. Keynes argued that there was a chronic tendency to under-consumption and that the idle deposits of the rentier class would be available at low or zero rates of interest. But this assumption is undermined as soon as inflation takes hold. Those with funds available, seeing the erosion of their savings, prefer to invest in houses and old masters unless the rates on offer yield a return, after tax, 2–3% above inflation plus an additional risk premium if the inflation rate is seen to be unstable. In the 70s this meant that medium term finance for industry became extremely expensive and could only be accommodated if a compliant chancellor could be persuaded to give another twist to monetary expansion.

So, far from achieving lower interest rates by using the printing press to drive them down, we ended up with much higher ones. This is precisely, and forseeably, what happened to the UK economy until, in 1981, Geofrey Howe and Margaret Thatcher put a stop to it. At the peak of the inflationary spiral, bank finance was costing 19%. With inflation at over 25%, this might have been considered cheap had it not been for the fact that, whatever the nominal term at the loan, it was virtually repayable within the first 3 or 4 years. After that, if the business survived, payments were effectively negligible in real terms. A prescription guaranteed to entrench short-termism in the business psyche! – For which there is still evidence in the short pay back periods demanded by company accountants to justify investment projects.

Worse than that, demand management economists found that even a pause in the rate of money supply growth was deflationary. Hence stagflation – massive inflation and stagnant growth. There is really no such thing as a tolerable, low rate of inflation any more than there is a tolerable low fix of heroin. The market discounts a low rate in advance, depriving it of its stimulative effect; only an accelerating rate produces a buzz!

Despite all the foregoing criticism of simple expansionism, it is still true that under-employed resources are wasteful and that unemployment is a personal tragedy for many. John Mills' eloquent presentation of his case was, at least, an effective reminder of this and a stimulus to the search for alternative social and market solutions.

WILL SHEIKH-SPHERE, OR MILLS AND BOOM?
The Choice Between Cheaper Capital and Cheaper Labour

A reaction to the discussion – Britain's Economy, Problems and Solutions, by Participant, Mr Alan Shipman

John Mills' talk on June 24 and the follow-up discussion on September 24 gave an interesting counterpoint to Will Hutton's 1994 presentation, which later reappeared as part of his improbably successful *The State We're In.* Hutton argues that UK growth has been held back by lack of a reliable, cheap source of long-term capital for industrial investment. Mills argues that investment is constrained less by high capital costs than by the high relative cost of labour, and the goods it produces, caused by an overvalued currency. In the short run the two arguments are complementary, since with internationally mobile capital, lower short-term interest rates and lower exchange rates go together. On this basis Mills advocates a relaxed monetary policy to accompany his competitive exchange-rate regime, with tight fiscal discipline to counter any inflationary pressure and prevent the "crowding-out" of private investment by public expenditure. Mills' main disagreement with Hutton would seem to be over which is more powerful in accelerating growth – the lower exchange-rate, or the lower interest rate that brings it about.

I'd like to suggest that, in the long run, the Mills and Hutton arguments are not compatible, since it isn't possible to maintain permanently low exchange rates (i.e. undervaluation on some tradable-sector PPP measure) alongside permanently low real interest rates (relative to the international average). In fact, a low exchange-rate regime may require relatively high long-term capital costs, so that the appropriate macroeconomic stance involves tight monetary discipline and relatively relaxed fiscal policy.

Why should devaluation, even if it's one-off, lead to higher long-term interest rates? With internationally mobile capital, a popular answer is that, with the current account in deficit (as in the UK), even a solitary devaluation raises portfolio investors' perceptions of future exchange risk and inflation risk, so requiring higher long-term interest rates to maintain the capital inflows that offset the current account. But even if the devaluation is regarded as non-inflationary, and as boosting net exports sufficiently to close the current account gap, stabilising the interest rate implies volatility of the exchange rate, and vice versa. To keep capital cheap (the Hutton approach), we may at times have to let exchange rates fall sharply (e.g. if other nations' interest rates rise, when they are near the top of their cycle) or rise sharply (if this is needed to defuse capital markets' inflation expectations when we're at the top of ours). To keep the currency cheap (the Mills approach), we may at times have to let interest rates fall sharply (e.g. if other nations cut theirs near the trough of their cycle) or rise sharply (to stop expectations of the devaluation being inflationary if we're near the top of ours).

The point was well made at the September meeting that inflation-free devaluation depends very much on our stage in the cycle. Mr Lamont in 1992 could let sterling and interest rates fall together without igniting inflation because there was a recession at the time (though fiscal policy was tightened not long after.) Mr Jenkins in 1967, devaluing on a background of full employment, had to tighten fiscal policy immediately. (Monetary contraction, an effective constraining measure in Jenkins' day, is likely to be counter-productive now: the relatively higher domestic interest rate will attract capital inflows, renewing upward pressure on the exchange rate and expanding the money supply). Devaluation on its own is fine for correcting a trade imbalance and/or raising aggregate demand, but has to be offset by fiscal contraction if the aim is only to correct a trade imbalance. It's noticeable that while Japan achieved cheap currency alongside cheap capital through the 60s and 70s, it eventually had to let the Yen take off in the 80s and 90s. The UK was able to reduce interest rates when it left the ERM and devalued, but it had also been able to reduce interest rates on entering the ERM because – even at the absurd DM2.95/£1 level – the devaluation risk was seen as having been reduced.

Devaluation works, in reducing relative unit costs and letting exporters (and import-substituters) reduce prices or raise profit margins, provided it's a "real" devaluation, i.e. not offset by proportionally higher domestic prices. Mills makes a strong case that this needn't happen when the economy is below full employment. Real wages may rise to compensate the effect of higher import prices (or even over-compensate if lower unemployment improves bargaining power) but this could easily be offset by the scale economies from higher demand and production, and imports are in any case only a proportion of the CPI. Devaluation in the downcycle is therefore a way of reducing comparative UK labour costs without lowering domestic real wages in a way that might provoke retaliation. Why were there inflationary consequences to the 1976 sterling drop and not that of 1992? Partly, perhaps, because Mrs Thatcher had dismantled trade union power in the interim, but mainly because we were still close enough to full employment in '76 for the export led demand boost to pull up costs from the demand side.

So in current conditions, Mills' proposal for making UK labour relatively cheaper (without necessarily reducing domestic living standards, even in the short run) is a powerful alternative to Hutton's proposal for making UK capital relatively cheaper. History also seems to have swung against Hutton. He revives Keynes' vision of "euthanasia of the rentier" at a time when Britain's rentiers are making unprecedented profits in the Square Mile (albeit largely under US and Japanese investment-bank tutelage). And the model economies he cites, Germany and Japan, have recently rescued the rentiers from their self-destruction through financial deregulation, allowing pension and insurance funds, which once had to save at negligible real interest rates or invest in domestic companies that never paid a dividend, to move into Mexican Eurobonds or Russian GDRs with strongly positive rates of return.

It is tempting to conclude that the opening of international capital markets, far from destroying the case for devaluation (by forcing interest-rates up to offset the perceived exchange risk) has actually re-created it. If we opt for cheaper capital, it moves abroad, so the entrepreneurs who benefit will be competing against the UK rather than for it. If we opt for cheaper labour, it has to stay put, and seek compensating benefits some other way. Under Japan's cheap-capital regime, the "captive" investors weren't entirely ripped off because the economy grew, profits expanded, share prices rose and the capital gains made good the sacrifice of income. Under a cheap labour regime, "captive" workers might similarly benefit in the long term if they can now regain and retain employment long enough to realise human capital gains through rising experience, skills and seniority – or even quit the corporation to start their own business.

To make capital cheap again by trapping savings within the UK would, in any case, mean reimposing capital controls which were scrapped because they'd become impossible to enforce in the days of invisible (suitcase or semi-conductor) capital transfer. It would deprive our pension funds of the higher returns they might depend on to fund the retirement of an ageing population. And it would deprive lower-income economies of the long-term capital inflow with which they can invest for growth without hitting external payments constraints. Mills makes the case that relatively costly capital needn't constrain growth if real returns on investment can be raised, and that where comparatively cheap capital accompanies comparatively higher growth it is as effect (of higher incomes and the attraction and retention of footloose investment) rather than as cause.

If my argument is correct, and devaluation becomes associated with higher interest rates in the long run, how do we stop the beneficial effects on demand and investment being neutralised? Those like me who were taught the Keynesian priority of fiscal policy over monetary policy have little problem. A rise in capital costs needn't depress aggregate investment if accompanied by expansion of demand, which raises the expected return on fixed investment projects so that more can be profitably undertaken. Private investment can often sustain such a demand expansion, but in depression conditions it may require fiscal activism to get it started (and at the height of the boom, fiscal restriction to rein it in). As regards other ways to encourage investment without reducing capital costs, the UK version of "supply side economics" places great weight on flexible labour markets, deregulation and privatisation, but some interesting social and historical explanations were also given at the September meeting.

It is hardly surprising that devaluationism is unfashionable. The concept of fiscal expansion appears as dead as if Keynes had turned the *General Theory* into an Arts Theatre playscript, even though the UK's recent boom-bust experience can easily be explained in Keynesian terms. Much of the recent growth in international capital mobility has depended on standing Mills' approach on its head: fixing nominal exchange rates, and defending them – with extremely tight monetary policy if necessary – so that risks of real depreciation give way to expectations of real appreciation as the capital flows in. But it may not take too many Mexico/Thailand style crises to remind foreign investors that the only truly fixed currency is a single currency. Even currency boards, whose reputation has survived thanks mainly to Argentina's valiant refusal to match Mexico's devaluation, can be abandoned when the going gets too tough.

Mills' strategy, by openly identifying the pound as a candidate for devaluation and promising lower domestic interest rates into the bargain, does seem to invite a Mitterrand-style capital flight, and deter foreign capital from flowing in. So one reason it will be hard to get Mills' thesis officially discussed is that the mere mention of devaluation in government circles could put the UK on "devaluation watch", imposing a steeper interest-rate premium to calm the speculators. But suppose we were to stage a Mills-type devaluation, and then immediately subsume the pound within the "Euro" at the new rate? All the benefits of real devaluation plus real interest rates locked in at German levels. I suspect this is the bait that will be dangled before us when Mr Brown announces his conversion to EMU early in 1998.

"DEATH IN ARCADIA"
POVERTY IN THE INDUSTRIALISED WORLD

by Miss Noriko Hama, Resident Economist and Chief representative, London Liaison Office of The Mitsubishi Research Institute, who gave a talk to members of the Economic Research Council on Tuesday 11th March 1997

This writer was once invited to speak at a meeting of a local council in the northern outskirts of London. The occasion was a gathering of its anti-poverty select committee. The theme given to the writer was "Economic Transition and the Labour Market – The Asian Experience".

It came as something of a rude awakening, that poverty should be a serious issue of policy debate in a local community not at all distant from the heart of the City. Britain is, after all, an affluent nation. Less so than some perhaps, but clearly not poor in the way that the less developed economies of Africa and indeed Asia are poor. And yet here was a group of serious-minded citizens involved in heated debate over how poverty may be overcome in their midst. Moreover, they wished to learn from the Asian experience! There seemed to be something distinctly topsy-turvy in all this.

But then again, it cannot be denied that homelessness is a fact of everyday life in this country. In tube stations, out on the streets, what George Orwell would have called vagrants lie huddled in dark corners. Some beg, some appear simply too fatigued to call out for the spare change they seek. Some are old, many are young, some of the young are mothers clutching babies.

Admittedly, some lack authenticity. Some are reading books that nestle in their laps as they stretch out their palms for the odd coin or two. Are these starving bohemians who nonetheless refuse to let go of their scholarly pursuits, or are they miscreants out for free lunches, dinners and even breakfasts? It is never easy to tell. This notwithstanding, the phenomenon of poverty manifesting itself in public places is one very real aspect of living in Britain, as well as elsewhere across the industrialized world.

Poverty amidst affluence. This is symptomatic of the malaise that maturing industrialized economies are forced to encounter. Yet on the other hand, poverty can become the breeding ground for the energy that is needed to reach affluence. That is the springboard that provides so much energy and resilience to late comers in a playing field seemingly reserved for the established and the sophisticated.

The problem for today's global economy, and more specifically for the industrialized economies, is that the centres of wealth have become decoupled from the centres of growth. This is why the European Union has degenerated into a mutual aid society of the weak, instead of becoming the borderless single market of mutually enhancing competitive power that it claimed to become. Competitive power can only grow where there is healthy competition, and where the survival of the fittest is the rule of the game. Affluence can only beget poverty in a world where everyone is sitting on their withering laurels.

Is it possible to make the centres of affluence and the centres of growth converge once more? It would seem to this writer that this can come about for the industrialized world, only if it can rediscover the beauty of being small. How creative were the city states of Renaissance Italy. How competitive they were in their quest for excellence. How original they were in their desire to prosper. Monolithically unified entities lack the creativity that leads to new gateways toward growth. Japan in its postwar uniformity is only just awakening to this reality; and the process is proving to be a painful one indeed. It is high time Europe became aware of the anachronistic self-impoverishing nature of the mutual aid society of the weak.

"How can we ensure employment for all, without reducing our basic standards of living?" asked a participant at the aforementioned anti-poverty select committee. This is the dilemma that lies at the heart of affluent societies that have become decoupled from the competitive environment that generates growth. This is the dilemma that the European Union should be addressing at this turn of the century moment. An EMU with no ability to take flight cannot provide the solution.

Et in Arcadia ergo. How to interpret these words? "Even in Arcadia, there am I", is one reading. "I, too, was born in Arcadia" is another. The former are Death's stark words of warning. The latter is the utterance of the unknown occupant of a tomb which was thought to have no place in Arcadia. Even in affluence lie hidden the roots of poverty. Even the poor have the right to cry out that they were born in Arcadia. Is Europe, and is Japan, becoming but a dying ember of a lost Golden Age? Can the industrialized economies regain the youthful vigour that can make Arcadia come alive once more? To the extent that they seek a perpetuation of their postwar dreams, it can surely not be. New dreams need to be dreamt in this post-postwar age. Dreams in which a renewed multiplication of cells becomes possible, dream landscapes in which small, self-contained and yet flexible universes compete, challenge and collaborate, and learn from each other. An Arcadia of constant youthfulness may just become reachable in the realization of such dreams.

THE EDWARD HOLLOWAY COLLECTION REVIEW

Gold, Credit and Employment – Four Essays for Laymen by G.D.H. Cole

Published by George Allen & Unwin, July 1930, second impression, February 1931

It is utterly fascinating to read – 67 years on – this popular and influential book written by a leading academic (some would add socialist) who, at the time, was hardly less well known than John Maynard Keynes. Here is a real and vivid insight into the problems and solutions as seen at that time, made all the more relevant today by the constant references to unemployment in recent times being at levels "not seen since the 1930s".

The title of the book is the title of the first of the four essays published. Whilst totally dismissive of the practice of using gold as the basis for domestic-use money and credit creation, Cole, rather surprisingly, supports the continued use of gold as the basis of settling international transactions. He points out that exchange rate fluctuations introduce "an element of gambling" into all overseas transactions, including both trade and the payment of dividends on overseas investments. He believed that London's continued role as a world financial centre depended on the preservation of a fixed relation between our currency and those of other countries. In particular this enabled Britain to remain the "banker of Europe". But the *internal* supply of money and credit should be based, he says, not on gold holdings but on the needs of production and employment subject to the maintenance of internal price stability. The point is carefully argued through, looking at time-lags, a possible bout of inflation, and the extent and consequences of any "loss" of gold.

The second essay THE GOLD QUESTION considers the relationship of gold holdings to domestic money supply in greater depth. The question raised is the current one – is money supply to be controlled by the government (in line with political aims) or by the Bank of England (in line with technical guidelines)? In 1930 that meant "who controls the fiduciary issue?". Cole points out that to exceed the £260m fiduciary issue the Bank must ask the Government for permission, not the Government ask the Bank. Under Act of Parliament then, the Government was powerless to initiate such an increase – a policy position to which Gordon Brown has now returned.

Cole would therefore expect the Bank of England to vary the issue of notes and coins according to internal needs, and likewise would expect the joint stock banks to vary credit according to internal needs. But he argues that "cheap money" alone is not enough to bring prosperity. First, bank credit must be *channelled* into productive investment – not speculation, and secondly, the Government must itself borrow to spend in order to create an increase in demand to match increased production. "No mere policy of credit manipulation will remedy unemployment!" he thunders. There needs to be set up a "Commission of Financial Control" and "(indicative) national planning of productive effort."

The third essay THE GOVERNMENT AND THE UNEMPLOYED is both a scathing attack on the policies of the day and a set of concrete proposals. The Government, he says, holds that jobs cannot be found for the great majority of the unemployed except as a result of the revival of industry, but "I hold, on the contrary, that jobs can and must be found for most of the unemployed *before* we can expect industry to revive". So instead of aiming at increased industrial efficiency and hoping for a revival in exports during which time it would be futile to look for any great expansion in the home market, the issue of employing the unemployed should be confronted "here and now". Unemployment is an evil and long dole queues are a drain on the incomes of the rest of the community.

Money must be raised in part by borrowing and in part by raising taxes. Specifically he would raise taxes on higher income earners, from the taxation of land values and "above all" through inheritance taxes. Then the State should make "a definite offer of useful work to every unemployed worker, or at least to every man who has been long out of employment and has little chance of early re-engagement in his own trade. Unemployment is a national misfortune; but it is also a national opportunity. There is so much useful work crying out to be done – so much work that private capitalism neither has done nor is ever likely to do of its own accord." Then comes an interesting list of specific instances of such work – slum clearance (how do we feel about that today when Labour Councils decry "Gentrification" of old housing areas?), school building (how do we feel about that today when the private school system is booming as never before?), water supply works (how do we feel about that as now that such works supply fat cat salaries to those expanding highly profitable water supply companies?), land development – draining, reclamation etc to enable more food to be produced (how do we feel about that in an age of 'set-aside'?), restoring canals and ports (would that have been wise with the advent of leisure use for canals and new container ships?), social amenities – to give Britain a thorough spring-cleaning – clear away the refuse and paint the houses (well that is always a good idea!), road building, railway electrification, afforestation, coastal defences (well yes, but private enterprise is hardly uninterested) and building the Channel Tunnel (a good use of public funds just before the 1939–45 war?). This list, which would mostly employ building workers of one sort and another, is both fascinating and fascinatingly dated. Discussion follows of pay rates and training schemes and of the necessary quangos. So why, we should ask ourselves, was "Thatcherism" untried, and not even thought of, at this time? Did no one have that much imagination?

The last essay CHEAPER MONEY, RATIONALISATION AND EMPLOYMENT is concerned chiefly with the policies and practices of the banks. He says, "On the whole, the effect of banking amalgamations undoubtedly was to make the banks lend less on personal and more on collateral security, and therefore to make them less concerned with the purpose for which credit was needed than with the security offered for its repayment." "This was especially true of small and middle-sized transactions". As a footnote for those interested in today's financial crisis in Japan this review will quote further:

> It is more than possible that this attitude contributed in some degree to the situation in which the banks found themselves on the coming of the great depression of 1921 and the following years. They had lent freely to rich clients; and now they found that their clients could not pay them back, and that any attempt to force liquidation of their credits would be likely to bring widespread bankruptcies in its train. Instead of calling in their outstanding credits, they found themselves in many case impelled to go on lending more money in order to keep struggling firms in being.

With banks so blinkered and so unable to promote and back new investment opportunity, some change was called for. Sixt-seven years on we can see an answer in greater competition between the sources of credit but in 1930 (and Germany is cited with some approval as a model) the answer for G.D.H. Cole was for the banks to use their powers more wisely and more forcefully. They should have, he says, "experts at their command with a real understanding of industrial conditions" and "keep a constant watch over the enterprises which they foster, probably by the method of direct representation on the boards of the companies concerned." And credit should not only be provided for firms undertaking expansion and reorganisation but also *denied* to those who refuse to take part in this exercise. The banks, of course, will need guidance in providing for the "rationalisation" of industry. If they refuse to accept such guidance then what, he asks, is the alternative to the "rationalisation" (i.e. nationalisation of lending services if not day-to-day over the counter services) of the banks?

Wow!

J.B.

OBITUARY: LAWRENCE LINEHAN

Lawrence Linehan, a member of the Economic Research Council since November 1986, died of cancer on 23rd May 1997, aged 68.

After a public school education Lawrence obtained a B.Sc. degree in Economics at the London School of Economics. The subject remained a life-time interest, laced with scepticism about economic orthodoxy. He joined the British branch of the International Union for Land Value Taxation and mentioned it on political platform and doorstep when he stood as a Liberal Candidate for parliament in a North London constituency.

The same scepticism brought him into the Economic Research Council on the suggestion of fellow member, John Hatherley. They had met when both were standing for Parliament as Liberals, both propagating Land Value Taxation.

Although widely travelled, he was something of a "loner", though very loyal to his few personal friends. He was honest and forthright in expressing his opinions. He was divorced twice, and left three children from his first marriage.

A MISCELLANY ON MONEY – SOME RECENT LETTERS

Unilateral and Bilateral Monetary Theory.
A further contribution from Mr T.B. Haran

Sir,

I note that contentions of mine have rated a mention in the two book reviews by G.W.G. in the Spring 1997 edition.

My findings take me daily further and further from accepted theory, which is based on the definition of money as anything which acts as a medium of exchange, a unit of account or a store of value.

As you know, I regard this definition as inadequate and unsound, so I seek to replace it with my own version.

People trade solely in services, productive or otherwise. They are either service creditors (savers) or service debtors (borrowers). Moreover, goods are simply a by-product of the system of trading in services.

There are, therefore, in effect, two forms of money, (1) basic money (credits and debts in services) and (2) nominal money (media of exchange and bank deposits).

Basic money can be defined as a credit in services of one party and a debt in services of another, measured in a unit of account. It is *bilateral* and subject to continuous creation and destruction. Thus, it is created when a service creditor performs for a service debtor, and is destroyed when the statuses are reversed. Yet the process of destruction does not appear in textbooks! Total service credits (savings) always equal total service debts (borrowings).

I would apologise for going over this ground again, but it is necessary to demonstrate the gulf which appears when monetary theory is based on two very different definitions of money. To distinguish, I shall refer to the traditional teaching as *unilateral* monetary theory and to my version as *bilateral* monetary theory. In short, the first becomes UMT and the second BMT.

In April 1993, I wrote to the Bank of England pointing out that, if Britain became a cashless society, savers would increase their deposits and borrowers would reduce their advances. Thus, if the money supply is taken as cash plus deposits, part of it would disappear! How then can a monetary authority remain content to base its policies on such a farcical situation?

Under UMT it is believed that inflation is a monetary phenomenon and that demand has to be curbed to keep it under control.

In my letter in the Summer 1996 edition, I proved that inflation (and deflation) predate money. Thus, the introduction of a unit of account merely allowed the percentage rates to be calculated.

We are taught that trade is beneficial to both parties, but that does not mean that barter was always fair. If so, there would have been no rich and no poor. Actually the strong have always preyed upon the weak and inflation is the extent to which they use their strength. In modern times, that is the extent to which service creditors are being exploited. Accordingly, under BMT, I define inflation as a varying bias in the terms of trade favouring service debtors and, similarly, deflation is such a bias favouring service creditors.

In disregard of the facts, the Bank of England uses an unsound definition of money on which to base its policy for defeating inflation; yet the problem is not, in nature, monetary. It is of little consolation that the other central banks are equally guilty.

Demand is the healthy part of the economy and, together with need, should always be accommodated. In the first place, therefore, it is a mistake to curb it and in the second, consideration should be given to the damaging results of such action.

The Bank cannot curb the demand of the rich and the comfortable. Thus, putting up interest rates raises the cost of living, cuts the purchasing power of the poor and the hard-pressed, destroys weak business and creates unemployment. Knowing the facts, only a sadist would recommend the practice. The Bank should allow interest rates to perform their proper function, which is to hold the ring between the demand for borrowing and the funds available for lending. It should abandon monetary policies and concentrate on measures which affect the terms of trade, i.e. pay and prices.

UMT maintains that banks create credit, and hence money, by lending. In truth, basic (real) money is created (and destroyed) by trade *outside* the banking system. Thus, deposits are titles to service credits. Banks simply lend them in the same way public libraries lend books. Nothing is created by lending of any kind. It is wrong to count total deposits as part of the money supply, since the banks have allowed most of them to leave their possession.

Under UMT, cash and deposits are regarded as purchasing power. In fact, this factor is very much smaller; it consists of that part of cash and deposits which savers intend to spend, plus the part which borrowers have obtained for the same purpose.

UMT would have us believe that there is merit in increasing the ratio of savings to gross domestic product (GDP). Hence, the introduction of the ill-conceived Peps and Tessa schemes. Now that BMT has proved that savings always equal borrowings, these schemes should be cancelled. In the main, savers have simply moved part of their existing financial assets into the schemes at the expense of the state. In the light of the facts, it is criminal to continue them.

If there were merit in increasing the savings ratio, the correct way to do it would be to cut pay and prices. Savings would increase in value, while the cost of GDP would fall.

In my letter in the Winter 1996 edition, I set out an accounting formula showing the service credits on one side and the service debts on the other. The totals of the two sides are always equal and I believe that it is impossible to devise a transaction or refer to an event which would change that situation. For convenience, the formula is repeated.

Service Credits	*£billion*	*Service Debts*		*£billion*
Cash	60	Gross Indebtedness		2,220
Deposits	990	*less* Cash	40	
Investments	1,020	Deposits	80	
	2,070	Investments	100	220
less Debts	70			
	2,000			2,000

The figures are for demonstration purposes only. Foreign currency holdings are excluded, as they relate to the basic money supply of other nations, but sterling balances owned by foreigners are part of Deposits. Perhaps I should mention that the National Debt is included in Gross Indebtedness.

As can be checked from the formula, dealings in stocks and shares have no effect on the totals. Thus, no money was created when the Government sold the utilities to the public. It is a mistake, therefore, to believe that there is a pool of money lying around to tax. A windfall tax would, in consequence, have the same adverse effects on the economy as any other. The logic of the proposed spending is also questionable. Education is the business of government, training that of employers.

Honed over the years, the monetary and banking systems are in excellent shape, but they cannot protect the value of money. That value has to come into line *always* with the value dictated by the current level of pay and prices, i.e. the terms of trade.

Because the strong prey upon the weak, this issue cannot be left to the market forces. It is the function of government, not business and industry, to determine the value of money.

The plain fact is that to cure our economic problems, policies must affect the terms of trade. Thus, at present, it is necessary to cut pay and prices, not at the bottom, but progressively thereafter, and to insist on the savings in costs being deducted from prices. UMT takes from the weak, BMT from the strong.

The proposed cuts are not an attack on living standards; they are a necessary adjustment to bring pay and prices to the level the economy can best support; moreover, they increase the purchasing power of the pound and the value of savings.

I arranged for 'The Monetary Analysis' to be published in 1990 with the object of starting a debate on these issues. It has not sold enough copies to achieve that end and has been ignored by the economics profession.

Now I have written a second book, 'Bilateral Monetary Theory', for which I am seeking a publisher capable of promoting it both at home and abroad. The object is to replace unilateral monetary theory – entirely.

In addition to writing to the Bank of England, I have sent several letters to universities and the Treasury, with little satisfaction. I find it incredible that when someone tells the establishment that they are wrong, they do not even consider the possibility.

I believe that the twentieth century will go down in economic history as the age of monetary folly. Until, however, the establishment changes its attitude, that age will not come to an end.

It is some consolation to know that business and industries run economies and not monetary authorities. Their mistakes cause recessions and their successes raise the standard of living of most of us. No-one, however, is protecting the poor or ensuring that they receive their share of the benefits of scientific and technological advances. These alone should cause prices to fall.

UMT is full of misconceptions and anomalies. BMT has none of these; moreover, it is not only proved by argument, but is supported also by the accounting formula. So far, no-one has claimed to be able to disturb its equilibrium.

Hopefully, I am making some converts among our fellow members. I would trust then that they will press for the introduction of bilateral monetary theory or, at least, demand that it should be considered. The benefits to be obtained from adopting it would be enormous; they include full employment and falling prices.

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The Social Credit Monetary Theory – A further contribution from Mr Eric de Maré

Sir,

Why do the pundits, including all the professional economists and now intelligent beings like Damon de Laszlo and George Soros (as in your last number) never discuss fundamental realities: first, the prevailing world-wide power of the commercial banks to control all production and distribution of real wealth and therefore all governments even when they are regarded as being democratic, and, secondly, the mathematical certainty, which should be obvious to everyone and could be readily and precisely proved by computerised calculation that the entire human race is being kept chronically short of purchasing power? Costs, and therefore prices, are always higher than purchasing power, and increasingly so, owing to the fraudulent debt system of the credit monopolists.

The cause of the shortage is provided by the A plus B analysis of the late Major C.H. Douglas, the costing engineer. Even the famous Lord Keynes finally admitted that Douglas was right.

We are facing not just a technical and mathematical matter, but one of moral philosophy. Is the purpose of an economic system to provide everyone with work, or is it to produce and distribute wealth for the benefit of the individual? Surely the aim of mechanisation, now including the revolutionary micro-chip and automation, is to provide universal and growing leisure in a true economic democracy of civilising liberty?

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Deuteronomous Monetary Enslavement, a further contribution from Mr Lee Cheney

Sir,

There's an old adage that there's no such thing as a free lunch. But that's not true because if you are a money printing banker you print your own money scot free and if you are an "investor", or what *The Capitalist Manifesto,* by Louis Kelso and Mortimer Adler, calls a "primitive capitalist" (a "speculative-pariah-capitalist" in the words of Max Weber in his book *The Protestant Ethic and the Spirit of Capitalism)* income is unearned, free money (as opposed to earned investment from the legitimate ownership of the second factor of production). The whole point of this primitive capitalism is to use interest, debt, taxes, and the speculative stock market to transfer the ownership of wealth from those who produce it to pariah-speculators and finance capitalists, which is free money and wealth for this evil breed of the rich and super-rich right out of the pockets of legitimate business and labour.

Mr. T.B. Haran (B&O, p. 21, Winter 1996) argues eloquently that banks do not print money by lending, but Mr. Haran is flat wrong. To rest my case, I simply repeat once again what the Federal Reserve Bank of Chicago says in its publication *Modern Money Mechanics* (which is a detailed accounting analysis of how banks print money): "THE ACTUAL PROCESS OF MONEY

CREATION TAKES PLACE IN THE BANKS". Mr. Haran is simply wrong when he argues that banks do not create money by lending. Even the Economic Research Council publication, *Government Debt and Credit Creation* (Research Report No. 9, December 1981), says on p. 49, "For a long time the banks pretended that they did not actually create new money …. In everyday language 'deposits' means 'real' money".

In real life, *money* and *credit* are synonymous terms. What are not synonymous terms are *money* and *debt.* In real life, fractional reserve bankers not only print the money they loan, the entire international fractional reserve banking system, in collusion with the transnational corporations, is designed for one, and only one, purpose and that is to transfer the ownership of wealth from the producer to the primitive capitalist – the speculative-pariah-investor and finance capitalist. This massive transfer of wealth from the producers of goods and services to the finance capitalists could not occur if, as Mr. Haran contends and as *Government Debt and Credit Creation* says, on p. 49, "when the original customer repays his loan the equivalent amount of money is destroyed". In fact, this is a fallacy, an illusion, that never occurs in real life. The reason it is an illusion is simple: the idea that an equivalent amount of money is destroyed with the repayment of the original debt does not happen in real life because what actually happens in real life finance is that the original debt is repaid with *new money,* i.e. cash paid to the banker out of the pockets of the original debtor which the banker uses to replace his debt asset with 'real' (cash) money which is now *cash (free money) in the pocket of the finance capitalist* which, when multiplied millions of times over by the *deposit expansion* process detailed in *Modern Money Mechanics,* is the bottom line reason for the astronomical monopoly of capital by the slaves yoke of finance capital, whether national or international.

Money is not destroyed by the repayment of debt. The repayment of debt to the money printing bankers is the very process by which the perpetually expanding slave's yoke of finance capital enslaves the world to interest, debt and taxes and to the perpetually expanding transfer of wealth from the poor to the rich and super-rich.

Given the reality of both national and international speculative investment and finance capital, what is most striking is Mr. Alan Shipman's argument (B&O, p. 27, Spring 1997) that it is Britain's £1,400bn of overseas assets that keeps Britain afloat (as opposed to creating a vibrant, full production economy based on the principles of *The Universal Private Property Society).* Mr. Shipman's candid comment that "[Britain is] very lucky to own so much of the rest of the world" is most interesting in view of his question, "How else could we finance the perpetual trade deficit and still export more capital?". Very simply, Mr. Shipman, with a vibrant, full production debt-free and tax-free economy devoid of the monopoly of capital there would be no need for a trade deficit or speculative-pariah-capitalism.

The irony is that “Britain’s” ownership of so much of the rest of the world is not ownership by the British people at all. Instead, it is ownership by the Crown, and the Al Fayeds of the world, the transnational corporations, and the rest of the top 2% rich and super-rich.

D. Chapman’s comment (B&O, p. 25, Spring 1997) is worth much more than mere passing interest. He said, “the way forward to Britain’s prosperity and freedom is the same as it always has been, to build ships and sail the seas trading freely with all the world’s nations”, in other words, creating a vibrant, full production economy (as opposed to the existing finance capital economy that keeps 98% of the people enslaved to interest, debt, taxes, and propertylessness). Mr. Chapman’s vision is also true for the whole world, not just Britain, but surely Mr. Chapman is talking about “fair trade” in goods and services and the fair and equitable sharing of the ownership of capital and wealth, which is profoundly different to the monopoly of capital, speculative stock market trading, and the frenzy of finance capital.

Jesus was not just speaking out of the side of his mouth when he said that it is harder for the rich to enter the kingdom of heaven than for a camel to pass through the eye of a needle. There are millions upon millions of people and businesses that strongly object to being exploited by monopoly capitalists, pariah-speculators, and finance capitalists, but most proposed solutions are not solutions at all. It is the debt/tax slavery financial system itself that is the root cause of the monopoly of capital problems facing not only Britain and the EMU but the entire world, and it is the rich and super-rich pariahs of the world who perpetuate both the national and the international debt/tax slavery money system, which takes its toll on both the national front as well as the international front of every nation enslaved to an interest, debt, tax money system.

If Mr. Shipman’s number of £1,400bn can be used reliably, and assuming that there are 50 million Brits, it doesn’t take a lot of head work to figure out that if that £1,400bn was divided up per capita instead of fed to the rich and super-rich, each and every Brit would own a debt free and tax free portfolio of £28,000 (£112,000 for a family of 4), which would be a far cry from the propertyless, debt/tax slavery scenario facing 98% of the people as the world turns today. The Social Credit “national dividend” check, if you will, could easily become a reality in a *Universal Private Property Society*. But you can’t keep feeding speculative and finance capital and wealth to the Crown and to the Al Fayeds of the world, to the transnational corporations, and to the rest of richest top 2% of the population without sucking the life blood out of the other 98% of the population. That is one of the central themes of Werner Sombart. Even Louis Kelso (co-author of *The Capitalist Manifesto),* and Russia's Aleksandr Solzhenitsyn (author of *Rebuilding Russia)* make it crystal clear that there must be firm upper limits on individual wealth holdings and that no monopolies should be allowed to exist.

The really great pity about both the national and international debt/tax slavery money system is that the existing vast exploitation of business and labour would never occur in the first place if there were no interest, debt, and taxes and a reasonable wealth cap. With a reasonable wealth cap and an economy without interest, debt, and taxes, the money earned by business and labour would never be sucked into the pockets of the monopoly capitalists, pariah-speculators, and finance capitalists in the first place. Very simply, fair trade cannot survive in a debt/tax slavery money system, nor can freedom survive when 98% of the population is excluded from me interest free, debt free, and tax free ownership of land, capital, and other wealth. If there is to be an EMU, surely the first prerequisite must be to abolish the monopoly of capital and the financial exploitation of business and labour.

Mr. Chapman's comment (B&O. p. 25, Spring 1997) that "the United States is the greatest enemy Great Britain has ever had and has been since 1766" is most interesting considering that America is now the sole remaining super power keeping the push to expand NATO and the IMF/World Bank debt/tax slavery financial system into Eastern Europe and the Balkans in order to keep speculative-pariah-capitalism and the slave's yoke of finance capital alive and well. Mr. Chapman might find my new book *Freedom From Bible Slave Law* very interesting reading, especially the part that discusses Jerry Falwell, one of America's most powerful religious leaders, who claims that America has only two purposes for its existence, the first of which is to protect Israel (without which the IMF/World Bank debt/tax slavery money system rooted in Deuteronomy 15:6 would collapse), and the second of which is to evangelize the world to believe that the Old Testament Bible (hence the Deuteronomy 15:6 scenario) is the Word of God.

My new book *Freedom From Bible Slave Law,* supports those who believe that banks must be stopped from printing money by requiring 100% reserve banking, but rejects government ownership and control of the money supply by providing the people with the interest-free, debt-free, and tax-free per capita issue of the money supply (free money for the people instead of free money for pariah-speculators and bankers or the government), which is the first step necessary in order to solve the monopoly of capital problems being caused by our existing debt/tax slavery money system, the transnational corporations, and uncontrolled greed.

For many years, under the leadership of Edward Holloway and The Monetary Reform Club (the forerunner of what is now the Economic Research Council), the central discussion and focus among members was MONETARY REFORM. It seems to me it is time for the ERC to return to its roots and to bring the monetary reform debate on to the front burner and to start dealing head-on-with the problem of the monopoly ownership of capital and wealth.

Lee Cheney
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More Money – before you go
A contribution from Mr P.P.L. Wells,
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Sir,

The birth of the euro in 1999 will bring attendant semantic problems.

Some countries, for various reasons, will fail to meet the criteria and consequently be unable to euronate. They will be diagnosed, one presumes, as suffering from NSE, or non-specific eurothritis, a disabling complaint, but not irreversible.

What concerns me more is the threat to the British use of philology to disguise the fact that they are not exempt from the need to exercise their bodily functions. "Spending a penny" for example, has an impeccable record for saving English-speakers from embarrassment.

It should be abundantly clear to the European Commissioners that "spending a euro" cannot possibly serve this end, since the word resembles too closely the very function it is intended to conceal.

On this ground alone I feel we should be fully justified in exercising our right to secede from the contemplated union.

15 Sunnyside Road
Worcester.

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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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