



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

Autumn 1998

Vol. 28, No. 3

Thoughts from the Chairman	3
End of the Honeymoon	4
The Deadweight State	9
Frozen Desire	11
The Breakdown of Europe	13
Diversification	14
(Application Form – The Deadweight State)	15
(Cartels of the Mind)	17

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THOUGHTS FROM THE CHAIRMAN

In the Summer Edition a year ago we welcomed a new Government with its new personalities and ideas. We have now become accustomed to the personalities and the ideas are not quite so new. The promised re-structuring of social services and education is proving to be “easier said than done” but there appears to be very little opposition, as predicted, to what has been proposed so far.

What has been implemented but was not advertised in the manifesto is a very considerable curtailment of civil liberties and a draconian increase in the powers of the authorities in almost all areas of government. Along with considerable tax increases mostly by raiding people's pensions.

We have not as yet heard much on the constitutional front but the issues will become more topical as we move towards elections in Scotland. We roll towards monetary union almost without debate as the Government and believers do everything possible to avoid discussion. Within the economies of Europe, in spite of much heralded convergence, there is a growing divergence of growth, prosperity and employment.

The chaos in Russia and the lack of movement by Europe to bring the west-looking East European states into the market is likely to add to the economic turmoil on Germany's borders over the next year or so.

Governments are quick to take the credit for economic success but reluctant to accept the blame when things go wrong. As the world moves into dangerous economic waters we see the phenomenon of Japan's political machine locked in policies and practices that were set up over thirty years ago and unable to change, while the rest of Asia goes through wrenching economic and political change. One can see the potential for recovery in many of the Asian countries but the process is being dampened by the dead-weight of the Japanese bureaucracy.

The collapse of Russia has interesting lessons as it demonstrates once again that you cannot have a free country without a legal system that can enforce contract. The rule of law is a prerequisite for freedom of the individual and freedom of commerce – hardly a new observation but one that predicted the economic collapse of Russia.

China on the other hand with its embryo democracy at local and State level, and a generally enforceable system of contract, is surviving the world economic turbulence much better than its neighbours and is reasonably likely to continue doing so.

America cannot be immune to a world economic slow-down and there is likely to be many scares in the stock and currency markets before the excesses

of the last few years unwind.

This brings us full circle to the great question of Europe, probably the biggest and most dangerous experiment in politics and economics ever undertaken. Can the embryo Central Bank and the unelected Tribunes of Brussels develop policies to deal with the current economic uncertainties or will the dissatisfied populations of Europe take to the streets and compound the economic dislocation as it appears? – uncomfortable imponderables.

Running through the present economic upheavals are the technologies of the Silicon Chip which unwittingly contribute to the economic problems that we are facing. Because of their ability to enhance productivity they are adding to the over capacity in products and services at a faster rate than conventional bankers and economists foresaw, causing a widespread increase in the forces of deflation. With the exception of the Federal Reserve Chairman, Greenspan, these forces seem to be going almost unnoticed in the public discussions of the IMF and the rest of the world's central bankers, causing them to exacerbate the economic crises in Asia and the deflationary crises we are entering in the West.

Damon de Laszlo

14 September 1998

END OF THE HONEYMOON

A talk given by Michael Fallon MP, Shadow Treasury Minister, to members of the Economic Research Council on Wednesday 3rd June 1998

I would like to take the opportunity to talk with you firstly about the economy; then about the impact of this Government on business, and lastly on taxation and Parliament. I think it was Enoch Powell who said, referring to Chamberlain, that all political careers end in failure. I always say that all Governments fail; they all fail in the end; and I go on to say that the seeds of their failure are usually sown right at the very beginning. It's the things you do, or fail to do, in your very first weeks that set the tone and come back to haunt you.

Four crucial policy decisions

On the economy, as you know, this Government has done four things almost straight away which I think will come back and haunt them for the rest of this Parliament

They gave monetary policy over to the Bank. They allowed interest rates to rise almost immediately. They attacked Pensions and Savings and of course they collaborated in the launch of a soft Euro.

I don't think it is unfair now, a year and more on, to start to judge the effect of those four decisions and to look at the picture that has emerged. They thought by giving 'monetary policy' to the Bank that we were going to get more certainty and more stability. That actually has led to the opposite of course. We've had this kind of monthly lottery, monthly menopause. Everybody has to sort of wait and see which way the committee is going to go. We've had actually more focus on the personalities involved in the 'monetary policy committee' than we ever had on the "Ken & Eddie Show" and we haven't had the kind of certainty that the City and Business thought they were going to get. With the "Ken & Eddie Show", there was disagreement of course, but there was a policy, because the Chancellor made his policy clear, and people could see the direction in which he wanted things to go. Now we lurch from month to month and we see too, the disadvantage of handing monetary policy to the Bank of England while retaining fiscal policy with the Chancellor of the Exchequer. And I don't think it's unfair to say that thirteen months on when we have twelve months figures in, the inflation target, the very test of this new policy, has been missed **eleven** months out of twelve. Because inflation is not soaring that's a very difficult political point to make, but it should be made – eleven out of twelve months the inflation target under this brand new allseeing, dancing monetary policy, has been missed. So that's Monetary Policy.

Secondly, they put Interest Rates up. We think that putting up Interest Rates as they did throughout last year has actually hardened the landing, roughened the landing that the economy had to suffer. Certainly it's made the position of the manufacturing industry much more difficult at exactly the same time as it had to cope with a high exchange rate and businesses and home owners are paying far more than is necessary, as a result. Kenneth Clarke continues to make it clear that he would not have sanctioned the five increases that we've had in interest rates and we still don't definitely know whether there won't be others. So I think on that policy too we can see that the burden has been unnecessary.

On Pensions and Savings we think the Government's policy was almost exactly wrong. Just as the economy was decelerating they chose to attack not consumption, but investment. They attacked the Pension Funds through the

change on dividends, ACT and so on, and of course their tax havens. They withdrew retrospectively their intention to call back the savings from those who invested in PEP's and TESSA's. It undermined public confidence in savings and we are now beginning to see some of the results. Company Pension Schemes are becoming a thing of the past. Growing medium-sized companies are not setting up Pension Schemes any more. People are rather wary of what Government might now do to Pension Funds in the future and we see this kind of nationalised ISA, so that everybody is going to have to invest in a poor performing Government-backed savings scheme. So instead of actually trying to decelerate consumption they attack savings and investment, and that I think was a fundamental error last July which will come back to haunt them.

Fourthly of course they presided over the launch of a fudged Euro. It was this Government that chaired the fatal meetings that brought the Lira into the Euro and brought of course the Drachma into the ERM. It was this Government that fudged the criteria – and that isn't an academic point. These criteria were put into the Maastricht Treaty by us. Maastricht was much criticised, but it was the British Government, the Conservative Government, that fought long and hard to put in serious economic criteria, each of which had to be met. It wasn't a case as the Chancellor and Prime Minister keep saying of looking at the various criteria and seeing whether each particular member state meets enough of them. **All** had to be met under the Treaty, and in turn, each of them, in respect of the dodgier member states has been fudged. I suspect that the row we saw over the Chairmanship of the Bank, was just the start of a whole series of political rows over the implications of that softer Euro, and the Public Expenditure flows that are going to be needed in the future to sustain it. So we saw four rapid and wholly mistaken economic decisions taken in the early months of this Government that I think will come back to haunt them.

Legislation to hit corporate Britain

I now want to turn if I may to Business, because probably none of us can remember a Government that was so warmly applauded by business. We Conservatives were at fault here, because we had almost precisionbombed our business supporters, kicked them out, hammered them, small businesses, large businesses, new businesses whatever. Our record was pretty appalling the way we alienated businesses. This Government came into power on a wave of business enthusiasm. But we are now beginning to see the burden on business increase, in the way that those who have been to the parties at No. 10 had never quite envisaged. There has been the burden of additional taxation, Corporation Tax, Stamp Duty, Capital Gains Tax and all the rest of it. In

addition, coming now and particularly next year, is the burden of additional compliance. People go on about 1999 being the year of Millennium compliance. Let me just emphasise to you that 1999 is the year of Government Compliance. Businesses will have the minimum wage, they will have Union recognition, they will have the late payment legislation. They will have all the administrative costs of the working families tax credit – to be done by their Personnel Department. They will have the first of ten Social Chapter measures and Paternity leave to cope with. A whole raft of legislation, that is going through Parliament at the moment, most of which starts to bite from April 1999.

Business is going to be overwhelmed by a wave of legislation, the like of which we haven't seen since the midnineteen seventies when we had the Trade Unions Labour Relations Act and all the rest of it. We are going to have a wave of legislation that is hitting corporate Britain and hitting it hard.

Parliament is losing control of taxation

The final area I wanted to discuss with you is Taxation. I could go through the detail of the Finance Bill clause by clause. You may have points you wish to make on it or indeed the draft clauses in the Financial Services Bill. But I want to make, if I may, two bigger points about taxation – on the same theme. That theme is simple and it is I think rather worrying and something you may share my concern about. Parliament is losing control over taxation! I think that ought to worry all of us who are democrats. First of all in domestic taxation, this Government is now introducing Finance Legislation that delegates to Ministers the right to make its major taxation provisions via secondary legislation. There are at least twenty-five major provisions in the Finance Bill where there is simply a 'paving clause' and it's all going to be done by order. Corporation Tax; Capital Gains Tax; Personal Portfolio Bonds, and the rest of it. That means that the scrutiny that Parliament demands when extra taxes are raised will be absent. It means that the whole of Corporation Tax, or the whole of Capital Gains Tax, will receive a one and a half-hour debate, instead of being scrutinised line by line. And that the regulations of secondary legislation will not be able to be amended and it will not be properly considered by organisations outside the House. Indeed some of the powers that have been given under this Current Finance Bill of twenty-five sections that are simply farmed out to regulation actually enable the Treasury to define the area that they are attacking in the regulation, rather than in the primary legislation itself.

Now this process is not entirely new, all Governments will make light when they can. They like to deal with things by secondary legislation and so on. But this year's Finance Bill has taken this process to extremes, and we have now

these major changes to Corporation Tax, Capital Gains Tax etc. that are not being scrutinised by Parliament, but will simply be voted through as Regulations in the autumn – long after the Finance Bill itself has reached the Statute Book. In other words we have, so to speak, a ‘virtual bill’ that is impossible to scrutinise in detail.

The second and I think slightly more sinister development, in Parliament’s loss of control over taxation, is the rapidly escalating programme of European Union Tax harmonisation. You may think this is rather recondite arcane stuff and for years, of course, the European Union has dreamt of taking greater control over taxation. They know they can’t get into direct tax. But they’ve long been involved in indirect taxation through VAT. Now they are proposing new directives on the taxation of business, on the taxation of savings and the taxation of pensions. They did propose such things before, but the big difference now is that this Government has said it is willing to entertain legislation in this area. Indeed the current Financial Secretary is now in charge of a Business Tax Harmonisation Group – which the French, the Germans and the Italians have long wanted to see established so they could see the various tax advantages that are enjoyed by British Companies eaten away by harmonisation, levelled up, to ensure that they’re not put at a competitive disadvantage.

There are then proposals, after that, to deal with the harmonisation of Savings taxes; taxes on withholding and so on. And following thirdly on that, the tax treatment of Pensions.

Now I put it to you that this is a very worrying development. It means that taxation, which is after all at the root of Parliament, is going to be moving outside Parliament. First by the arrogance of this Government which doesn’t want the detail of its Finance Bill to have to be scrutinised, justified line by line. But secondly, because this Government is willing to surrender to Brussels, this Sovereignty over taxation for which we have long fought to ensure Parliamentary accountability. So there we have it. I think accountability is all the more important when you have a Government with a massive parliamentary majority that is hard at work with major constitutional changes. It is all the more important that we cling on to the various checks and balances that are involved. And as the economy and economic forces become more global I think it is more important, not less important, to keep the accountability that we have. It has been squandered over the last year. Monetary policy has gone to the Bank. Fiscal policy at home to the officials, and Fiscal Policy within the European Union over to Brussels. I think those are very worrying developments.

THE DEADWEIGHT STATE

By Russell Lewis, ERC 1998, price £10

At Cambridge I had a copy of the 1848 *Communist Manifesto*. Out of affection, and certainly not conviction, I still have it in the study of my Shropshire home. It is a reminder of the age when economic judgements began to dominate the political debate, and national institutions and loyalties were under challenge. In the words of the *Manifesto*, 'A spectre is haunting Europe – the spectre of Communism.'

Of course, it is mischievous to place *The Deadweight State* by Russell Lewis, a good-natured Welshman and an effective pamphleteer, in the same debate as Karl Marx and Frederick Engels. They have the role as relentless pioneers of world communism, but there is a helpful link. Lewis in his impish way is challenging the economic basis of western society no less than did the Marxists. If his radical analysis is proved correct he will have anticipated great social and economic upheaval, as did the Marxists earlier in this century.

The Deadweight State is essentially an attack upon the growth and the cost of the Leviathan state represented by fashionable public welfare and economic regulation. The book has a generous introduction by Lord Ezra, who tolerates Lewis's Euro-scepticism with courtesy. The main gist of Lewis's argument is that we are over-regulated, subject to burdensome public spending and are thus over-taxed. Ultimately this threatens freedom itself and the moral values it represents. A variety of factors have led to this situation, including the public spending consequences of Marxist and Keynesian economics. Lewis cheerfully takes on all comers, including the growing number who seek to establish greater physical controls to protect the environment and, with seatbelts and no smoking, to provide rules to save us from ourselves. It is a challenging liberal manifesto, but Lewis first has to persuade us that his radical programme is politically correct.

The book is made topical by British political experience in recent years. The Thatcher years from 1979–90 certainly demonstrated that the Tories could carry through a liberal economic programme that was eventually endorsed by its opponents. On the other hand, there is little evidence to support the view that the British public welcomed the disciplines of monetary control. The Conservative political dominance certainly derived from the deep divisions which paralysed Labour. Lewis can probably take most comfort for his libertarian arguments in the remarkable success of Margaret Thatcher in driving through a policy of privatisation. Institutions seeming impervious to change, such as the telephone, gas and water utilities, were transferred to private

ownership, and the Labour Party accepted that, politically, nationalisation was brain-dead.

Lewis is realistic enough to realise that the future is not necessarily on his side. For example, it is perfectly possible to place economic controls on the utilities that will provide regulation over prices, investments, executive pay and purchasing policies. The triumph of private ownership would then be shown to have been hollow, and the deadweight State would have become more burdensome. No one can doubt this possibility in today's Westminster world.

A second area where Lewis will have an uphill struggle is the Welfare State, particularly in respect of health. The runaway costs are evident enough, reflecting a growing age profile, and improved medical techniques and costs. These are factors that should be manageable by the methods of insurance, but there is a further and seemingly intractable problem. The bonds of marriage and social cohesion that underpinned society in the ages of Bevan and Beveridge are collapsing. Britain, with European records of extra-marital relationships and single parenthood, provides an awesome challenge to those who want to see a reduction in the burdens of state welfare. It is a challenge that will strain the radicalism and crusading skill of Russell Lewis. I wish him success.

Finally, there is the whole issue of the Social Chapter and minimum wage to which Britain is now linked on account of membership of the European Union. Here there is a deep irony. In the late 1950s to mid-1960s when Britain was seeking European membership, Germany was held aloft as a natural freetrade ally. It was argued that her achievements would be an inspiration as we struggled with the lacklustre, controlled economy of our post-war era. Russell Lewis, even then, felt that the European Community balance sheet was not unmixed in its advantages. In 1971 he wrote a pamphlet, *Rome or Brussels*, in which he contrasted the open markets sought by the Rome Treaty with the growing intervention and regulation sought by the institutions at Brussels.

Today matters have moved much further. The Social Chapter, extolled by the former President of the Commission, Jacques Delors, is now strongly supported by Germany. It is a touchstone of her domestic policy and is crucial to her support for free trade. Inevitably, the uncomfortable question arises whether Britain can avoid the dynamic of welfare and social spending on her present terms of European Union membership. It is a fundamental question. I suspect Russell Lewis would enjoy answering that. The bigger the windmill the greater the rubble.

It is a virtue of *The Deadweight State* that it does not understate the challenge presented by the current degree of state ownership and control. This review has considered only a handful of issues: the entrenched welfare bureaucracies, the belief that the state has a superior morality and competence to markets,

and the instinct, notwithstanding communist experience, that size is bound to triumph.

I am a shameless partisan; I want Russell Lewis to win and the bureaucrats peacefully to retire. So *The Deadweight State* will now sit on my shelves alongside the 1848 *Communist Manifesto*. It is ironic that I have to pay £10 for the Lewis wisdom, but the 1848 *Manifesto* – reprinted in the 1930s – cost less than 2p. I guess you pay for quality.

This John Biffen review was published in The Spectator 22/8/98 under the title "Assaulting the Bureaucrats"

FROZEN DESIRE **An Inquiry into the Meaning of Money**

By James Buchan
Published 1997 by Picador, price £17.99

"Frozen Desire" could be a Mills & Boon romance set in the high Arctic, although the sub-title tells us much more about the author's purpose. James Buchan, novelist and former *Financial Times* journalist, has set himself a monumental task which he proceeds to attack with a remarkable weight of research. The narrative has an easy, colloquial style which is far removed from the dry, heavy going of most writers on economics. However, this cleverly emphasises the wonderfully incisive sentences which are thrown almost casually into the text at fairly regular intervals:

But as a war progresses in duration and violence, the liabilities created in money – which have no earning counterpart, as we have said, for they are life and wealth destroyed, not made – become intolerable and must be extinguished: by war reparations from the enemy, if victorious, and by default or by inflation, if defeated or otherwise unsuccessful. (p.249)

The reviewer recalls ploughing through over 200 pages of Keynes' *The Economic Consequences of the Peace* to reach broadly the same conclusion. In less sombre vein, James Buchan considers faith in credit:

The charm of insurance and lotteries is that you collect your premiums and sell your tickets before you have to pay out on a claim or prize, so you can start up without money, and disappear without trace. The first permanent life office had to wait till 1762, with the foundation of the Equitable Life Assurance Society and the invention, in its deed of

settlement, of that strange and barbaric individual (usually Scots): the actuary. (p.114)

It comes as no surprise that the first reference in the copious notes, is to Adam Smith's great work *An Inquiry into the Nature and Causes of the Wealth of Nations* which clearly has been a major influence on his fellow Scot's thinking. Like Smith, James Buchan draws evidence from the earliest barter economies to his own, present day, experience; time spent working in Saudi Arabia at the height of her oil wealth, is detailed as the catalyst to the undertaking of the *Inquiry*. The author ranges across history, considering Homeric and Biblical mentions of money, then brings us to present times by way of double-entry book-keeping, John Law and the South Sea bubble, the French Revolution and Karl Marx. Not to mention the seventeen-century Japanese brothels (entrepreneurs and merchants were apparently encouraged to patronise these, to prevent them from amassing fortunes which could otherwise be spent on the pursuit of political power). The Spanish exploitation of the gold and silver of the Americas, leading to domestic inflation – ballooning money supply without a commensurate increase in the production of goods – is similarly dissected for its lessons about currency, wealth and value, the meaning of money then and now.

Another brilliant chapter gives us the story of the author's great, great grandfather, a country solicitor who acting solely as the executor of an estate, held City of Glasgow Bank stock. The directors' fraudulent accounting led to the Bank's failure and stock-holders were called upon to make good the deficit. Old Mr Buchan was reduced from upper middle class affluence to poverty, because there was no limited liability to protect the Bank's stock-holders. The author believes that the memory of this episode drove his own grandfather, the novelist John Buchan, to write prodigiously throughout his lifetime, even after the success of his works had more than safe-guarded his financial future.

Colonial North America and war-time Europe are visited before the – reaches its conclusion. Keynes receives little more than a passing mention; the verdict upon his economics seems to be: "A good try, but ...". This review will not divulge the end-product of James Buchan's distillation of all the research which went into his book; not to avoid spoiling the story but because the reviewer is himself in some doubt as to the full meaning of this conclusion. However, it is beyond doubt that "Frozen Desire" represents a courageous attempt to tackle an immense topic and to start again from first principles. I hope that Economic Research Council members will read this book without bias towards any orthodoxy – even better, that Mr Buchan could be invited to speak to us.

A.B.P.

THE BREAKDOWN OF EUROPE

Sir Richard Body

New European Publications 1998, price £9.95

Oh help! I felt annoyed whilst reading this book which spoiled my enjoyment of an excellent text.

But the author I count a friend, and it is a duty both to him and myself to account for my feelings.

First let us take note of the content. Body begins by arguing that many claims of the EU cannot stand up to close scrutiny. There is, he shows, little that is worth having in aggregations of political and economic power, no justification in the claim that a Big Market will make us rich, no substance in the idea that the EU has brought or will likely bring peace rather than war. He goes on to show how dangerous the megalomania of “Europe” is for creativity and democracy and how outofdate the very idea is in the face of modern technological and political developments. He sees hope in other models – the political processes of Switzerland and of the USA; the aspirations of regional communities.

In truth the book’s deceptively common sense, conversational style masks, for the layman, the immense range of wisdom, philosophy, experience and understanding brought into focus on “project Europe”. The reasoning is convincing and the conclusion (given by the title) entirely justified. The more academic approaches of specialised lengthy tomes (read only by a tiny minority) are lucidly and brilliantly juxtaposed into a short indictment accessible to all. And to make this point sharply one need only quote a couple of chapter ending sentences. Think, for a moment about “All megastates are diseased because their peoples cannot be at ease within them” (page 43) or “... it (the EU) will not prove to be a community of Europeans, only a continent full of stateless persons” (page 62).

My annoyance most certainly did not arise from the polemic or drift (though I have perhaps a greater enthusiasm for cosmopolitanism than Body appears to support) and my inability to enjoy it hardly stemmed from any lack of facts, analysis, perspective or entertaining, if alarming, speculation. It is compelling, convincing and highly recommended.

But recommended for whom? As an observer who, over 30 years now, has (or claims to have) kept abreast of the Euro debate (I have bookshelves of journals, pamphlets and books as well as countless newspaper cuttings and speeches plus lecture notes of my own efforts to explain developments to students and public meetings) I am, I think, annoyed at reading so much “yet

again” and at the realisation that those who need to read it, those whose conscience should compel them to read it, have not the slightest intention of doing so. The vested interests, the Eurofanatics, the placemen and the career bureaucrats and politicians driving ever onwards this most dangerous of adventures financed by forces that are anything-but democratic will ignore this and every other call to listen to reason based on experience, constitutional achievements, community values and economic welfare.

Britain’s own fragile but serviceable democratic mechanisms were dealt a mortal blow in 1972 and 1975 and are degenerating into a spin-doctoring farce. In such a mad hatter’s world it is hard to enjoy things when someone turns the light on.

But other observers who are younger, who have read less and who can face the challenge of what has happened and what will happen are in a different position. They should not delay, they should read this book. I believe that they will enjoy it.

J. B.

DIVERSIFICATION – NOVEL ERC STYLE, FROM MR BRIAN LEWIS

Dear Sir,

As an old member of the Economic Research Council, and at the risk of referring to a topic of little interest to the Council, could I mention that under my second name of “Allison” I have just published my first play entitled “Sibylla” on the years before the first crusade (1097).*

No doubt the play springs from spending too many years in the Arabian desert with not much else to do!

Thank you for the Summer 98 edition of “Britain & Overseas” just arrived, always of interest to me here.

Brian Lewis
PO Box 5101
Riyadh 11422
Saudi Arabia

* Available, price £3.99 from Unity Distribution, 1A South Folds Road, Corby, NN18 9EU. Tel 01536-742430

Research Study No. 15 1998

The Deadweight State by Russell Lewis

Specific recommendations for downsizing the still growing influence of the state over our lives are given in Russell Lewis' latest forward-looking contribution to political debate.

Following the foreword by Lord Ezra, President of the Economic Research Council, this 65 page booklet contains:

Executive Summary – Freedom Day Comes Late – Big Brother Flops – Command Without Control – Nannying Nonsense – Welfare Ills – The Reason Why – Shrinking the Megastate

The Author has been a leader and feature writer for the Daily Mail and the Daily and Sunday Telegraphs. He has been Chairman of the Bow Group, President of the Selsdon Group, Director of the Conservative Political Centre, the European Commission Press Office in London, the Institute of Economic Affairs, the Maastricht Referendum Campaign, the European Foundation and FOREST.

He has written a number of books, including the first biography of Margaret Thatcher, which reached number seven on the best seller list.

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

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