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AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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WHAT HAS HAPPENED TO THE 'BALANCE OF PAYMENTS'?

Extracts from a talk given by Mr Martin Weale, Director of The National Institute of Economic and Social Research, to members of the Economic Research Council on Wednesday 19th March 2003.

The way we used to be …

If we think back forty or fifty years, to the times when we had such Prime Ministers as the pipe-smoking Harold Wilson and the matchstick-counting Alec Douglas-Home, the 'Balance of Payments' was a really big issue, perhaps the central issue in economics. As a result of this concern foreign holiday-makers had to take their passports to a bank to be stamped and have issued an annual quota, which in the 1960s was £50. Foreign currency was essentially something that was scarce and was, through various mechanisms, rationed. So if you wanted to invest in foreign shares you had to buy foreign currency from the 'pool' provided by others who happened to be selling foreign shares. Those buying such shares generally paid a premium and those selling received a premium so that, in essence, the exchange rate for the pound for investment was lower than the exchange rate for trade.

Other countries with more extreme Balance of Payments problems than Britain might have a range of parallel exchange rates and a black market in foreign exchange as well (normally operated by cheerful shop and stall keepers operating pretty normally on the streets). So, why were Balance of Payments issues such a concern, and where have they gone to?

The underlying structure

The spirit of the post-war economic environment, established at the Breton/Woods Conference in 1944, was that Capital movement would be controlled by governments. There was a feeling that in the 1930s the free movement of capital had been de-stabilising; that exchange rates had been all over the place and therefore doing something to stop that was going to lead to an improvement. If only you could stop these free movements of capital then you would have a more stable exchange rate which would promote the day-to-day business of trade through greater certainty, confidence and stability. And then there was the additional fact of a general dollar shortage as a result of the war. Many countries had run up large debts to the United States and needed to earn the dollars to repay those debts.

Why we were reluctant to adopt today's solutions

Nowadays we might say 'Why not let exchange rates float and, if you like, clear the foreign exchange market?' But, as I said, people felt that floating exchange rates really hadn't been a great success in the 1930s and so we had a fixed exchange rate system with exchange rates between the US and other countries where, in essence, dollars were too cheap and therefore there was a dollar shortage.

Another aspect was that because exchange rates were fixed the Bank of England or the Bank of France had to maintain the exchange rates against the dollar so that there was always the worry that you might run out of foreign exchange. Nowadays we might say 'If you need more foreign exchange, all you do is go and borrow it, or go and buy it.' But at that time, because capital mobility was believed to be a problem, there weren't deep capital markets in which it was easy to borrow. And so we had to keep foreign currency reserves as a sort of buffer – beyond which one had to rely on official sources of credit, such as the IMF.

All this meant that the newspapers were full of 'Balance of Payments crises' because Britain seemed to be perennially close to running out of foreign exchange and able only to pay for 'three months imports'.

We did consider floating the pound to find the market clearing price to alleviate the shortage in 1952/53 when Rab Butler was Chancellor of the Exchequer. It was called 'Operation Robot' but it was never implemented because we had debts as a consequence of the war to the colonial and sterling area countries which were denominated in sterling so that if the pound was depreciated against the dollar those people would, with reason, feel that they had been short-changed. In the process they would try to sell their sterling for dollars thus aggravating the problem.

The second world war and its aftermath could be reasonably described as a world gone completely mad in which shortages, rationing, control and crises are the perspective from which we can gain some understanding of why people felt, rightly or wrongly, that they couldn't immediately go for the sort of solutions that we would now see as obvious.

And deficits within the Balance of Payments come in a number of forms. Firstly there is the deficit of exports plus services over imports as a problem.

If this was balanced by long term capital inflows that was felt to be all right, but if it was financed by 'hot' money short term capital inflows that was a second problem because such capital might disappear as quickly as it had come. In contrast, I think that nowadays it would be a reasonable approximation to say that capital markets are rather efficient – the way in which you borrow might matter, but it's a second order issue and we no longer say that some forms of borrowing are quite safe whilst others are a problem. But back then we did.

How the system unravelled

The whole Breton/Woods system of fixed exchange rates with restricted capital movements began to be undermined when Britain devalued in 1967 (and remember that then sterling was the second reserve currency and so the sterling/dollar rate was the linchpin of the system) and France in 1969. By 1972, by which time the United States had removed its pin relative to gold (the price of gold was allowed to rise) the system had effectively unravelled.

Post 1972 – towards floating but with relapses

The consequence was that we began to sort of live with a system of floating exchange rates. I say 'sort of' live with, because it was not terribly long after floating started that the European countries tried to introduce exchange rate stability. We had the 'Snake', a system of managed cross exchange rates between some European countries (Britain survived in it for about 6 weeks), and this was followed by the 'Exchange Rate Mechanism' and that in turn has lead now to the 'European Monetary Union'.

Nevertheless, floating for Britain proved to be something that we could live with better than had been expected in the 1960s. The 1970s was also a period of the development of the 'foreign currency market'. I wouldn't like to say what was cause and what was effect, but at much the same time you find the eurodollar market developing and foreign exchange markets increasing greatly in turnover. And so we moved from a system in which foreign currency was inherently scarce to a system in which people who wanted foreign currency could just buy it in the market. After such a long period of restriction many of us found it a novelty and a surprise when, in November 1979, the new Conservative government lifted exchange controls and it became perfectly legal to open a bank account in Germany or wherever. Incidentally, lots of people then opened such accounts and promptly lost money as sterling continued to rise to its 1981 peak.

The same sort of process happened on the Continent, but more gradually. I think it was the early 1990s when the French and the Italians finally got rid of their foreign exchange controls. So until then the Italians hadn't been allowed to acquire the foreign currency they would have wanted. It's not clear in Italy that that was an obstacle, but nevertheless there was a legal obstacle and that was all gone. So we have now moved towards a world of freedom of capital. It is really a very different world.

Interpreting deficits today

Currently United States imports exceed exports by a substantial proportion of GDP whilst for Britain imports exceed exports (taking into account both services and goods) by getting on for 2% GDP. How are we to interpret this? Well, an excess of imports over exports is equivalent to saying that investment in Britain is exceeding saving, it represents foreigner's willingness to acquire British financial assets or, to put it another way, it is the supply of savings from the rest of the world to this country. So the key issue is the balance of foreign saving relative to domestic saving, and whether it matters if part of one's investment needs are being provided by foreigners. That in turn can expressed by the question 'Is Britain saving enough?'

Some nations have a savings surplus – and others a deficit

OECD figures for national savings in 2001 gross of depreciation show Britain on 15% – above Turkey on 12% and Portugal on 4% but below everybody else. Does this mean that we are not saving enough?

To explore this question we have to note that national savings rates are the sum of savings by three sectors – the household sector, the company sector and the government sector. In each, institutional mechanisms affect savings rates. In Japan company sector savings are high (to the frustration, no doubt, of shareholders), in Italy personal sector savings are high (perhaps because young people there find it difficult to borrow) whilst in Britain recent government current account surpluses represent government sector saving. Clearly, in Britain, domestic savings are low mainly because borrowing is easy – is that a good thing or a bad thing? I can see nothing alarming in the newspaper stories I read about how young people are borrowing quite a lot, or implicitly more than they used to or more than we could borrow at their age. If you have a reasonable expectation of a fairly rapidly rising income (we know earnings rise rapidly between 21 and 30) then borrowing makes a great deal of economic sense. Plainly it would be a mistake to judge savings too low on this basis.

So foreigners may own an increasing proportion of British wealth

One of Gordon Brown's estimates for national income growth is 2½% and if you work out the ratio of national wealth to national income you can work out how much saving you need for domestically owned wealth to grow in line with income. The answer, broadly speaking, is about 8% more saving than we actually do. In other words, instead of saving 15% of GDP we need to be saving something like 22/23% of GDP to maintain existing ownership levels of British wealth! That is the sort of savings rate that our neighbours on the continent manage to deliver but Britain and the United States signally fails to deliver.

Meanwhile, not only are we failing to save enough for existing investments, those investments often seem inadequate in terms of industrial investment, public infrastructure and low levels of housing starts.

So my present opinion (maybe one day I'll change my mind) is that Britain does have a problem of not saving enough.

The instructive case of the United States and Japan

Japan has an aging population where many, quite logically, are saving up for their retirement. This can be done via personal savings, company pension plans or government surpluses. Japan has relatively few outlets for domestic investment and so the only way out is to run a Balance of Payments surplus – some estimates suggest of 7 to 10% GDP. This needs to be balanced by somebody else's deficit.

The United States has a relatively young population, not yet doing a lot of saving for retirement, and the work force is growing. So for the next five or ten years the United States deficit should remain large. So the two positions can be complimentary reflecting structural and demographic differences.

National saving should start to feature in the government's macroeconomic policy agenda

So in contrast to being worried about Balance of Payments deficits we now need to persuade ourselves that compared with historical memory fairly large Balance of Payments deficits and surpluses are likely to be the norm rather than the exception. We should not ignore this but we should focus on the more important aggregate – the level of national savings. Are we saving enough? If we aren't saving enough what is it that is discouraging people from saving and what policy changes do we need for an adequate rate of national saving?

I wouldn't necessarily expect or want to see all sorts of micro-solutions here and there, and a particular savings target. But I want to see some recognition that the question of national saving is starting to feature in the government's macro-economic policy agenda and I want to see a movement away from the (what I call the pre-Keynsian) view that essentially the government has to look after its finances and what the rest of the country does is its own business and no concern to it.

NEVER MIND THE OIL – JUST HAND OVER YOUR KIDS

*By Peter Kruger**

Opinion is divided over why we went to war with Iraq. Perhaps it was all about oil, or then again, perhaps it was to find and destroy weapons of mass destruction. Neither of these reasons, together or alone, was compelling enough to spend billions of dollars toppling the regime in Baghdad. More likely what we are seeing, in the Middle East and throughout the developing world, is a rerun of the struggle that took place in Europe and the US during the late 1960s – the battle for the hearts and minds of the next generation of workers and consumers. This time the outcome could radically alter the economic world order. Losing the battle would create a problem that is either intriguing or frightening – depending on how much longer you expect to live.

The Middle East's most effective weapon of mass destruction is its population – 37.4% of Iranians are aged 15 or less while just 3.4% are over 65. Iran's death rate is 5 per thousand (a figure which would fall considerably if drivers took notice of traffic lights) while its birth rate is 22.1 per thousand. By contrast, in Germany, only 15.5% of the population is below 15 years while 16% are aged over 65. Despite its excellent health service Germany's death rate is 10.8 per thousand and its birth rate is just 8.2%. Deutsche Bank predicts that by the end of this century Germany's population will have fallen from 80 million to just 25 million.

While particularly steep, the projected decline of Germany's population is typical of the ageing and shrinkage of populations throughout the developed world. Amongst developed nations only the US is managing to maintain a reasonable demographic profile. Its most recent wave of immigrants are producing large families and will probably continue to do so until exposure to western materialism – which appears to be the world's most effective form of birth control – reduces their desire to reproduce.

Throughout Europe current population trends will have a significant economic and political impact. By the middle of this century Europe will have undergone a transformation similar to the one that followed the Black Death – which radically reduced the working population during the 14th

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* The author is a commentator on demographic trends and Senior Analyst with Wireless Healthcare, an ehealth and telemedicine consultancy based in Cambridge UK

century. In theory, Britain should be able to take these transformations in its stride as, historically, its relationship with the global economy has involved constant change. During the industrial revolution Britain's colonies provided a captive market for manufactured goods and a source of cheap raw materials. In the latter half of the twentieth century Britain's manufacturing base shrank as industrial production was transferred to developing countries. Service industries replaced manufacturing and the workers of Britain, along with those in most other developed countries, survived by taking in each other's washing. This should have given developing countries some economic leverage over the West but it did not.

The West had managed to switch from being a monopoly provider of manufactured goods to a monopoly consumer. The industrial base of a developing country is still heavily dependent on companies headquartered in the either Europe or the US where goods are sold and profits are realised. Any earnings re-invested in a developing country flow through either Wall Street or the City of London first. Even the prosperous owners of independent companies in developing countries discover that the best place to invest their wealth is in the consumer driven economies of the West.

However as demographics start to bite, and the next economic transformation gets underway, Britain and the rest of Europe may find it difficult to pull off the same trick twice. As we get older we consume less goods and, worst still, there are fewer of us to take in the washing. Following the Black Death workers were able to negotiate higher wages. Today, as the workforce shrinks, attempts to force up wages will send jobs, especially those that involve communications, to a developing country. India is already soaking up jobs from the UK's IT and financial services sector while companies in West Africa are processing insurance claims made by policyholders in the US.

It is not inconceivable that in twenty years from now Indian outsourcing companies will be running a significant part of the NHS. First to go would be NHS Direct, the National Health Service's telemedicine and medical help line service. This would be followed by the back office functions of NHS Trusts – appointment booking and human resources. Advances in communication technology will enable a number of clinical functions such as x-ray analysis and cancer screening to be carried out in developing countries. The model of telemedicine envisaged in the 1990s, where a doctor in Europe treats a patient in the developing world via a broadband communications link, could be turned on its head.

Indian-based outsourcing specialists are already sizing up the European healthcare sector and have won business from UK-based utility companies. The NHS is just one of the organisations on their hit list. As well, India is just one of the destinations for UK jobs: any country with a large number of underemployed and restless young people will see outsourcing as a means of providing work for idle hands. Outsourcing also helps developing countries stem the outflow of doctors and other professional workers.

India today is where Japan was when the West's electronics industry began moving east. There are already calls for the Indian government to use some of its rapidly growing reserves to develop infrastructure and stimulate economic growth. Hopefully it will be careful enough to avoid a Japanese-style crash when the European market for outsourced services flattens out four decades from now.

What will be the impact on Western economies themselves? In the short term older people will benefit from a reduction in the cost of healthcare and other services. In the long term, say 2060, we will all be dead. During the intervening years Europe will experience a steady haemorrhaging of wealth to developing countries. Europe could, by repatriating some of the revenue earned by outsourcing companies, retain control over its service industry. Along with the US it could become a monopoly consumer of services and even repatriate revenue that doctors in developing countries earned from treating local patients. However the anti-globalization lobby would find this about as acceptable as Naomi Klein pocketing an award for effective brand management.

A more likely scenario is that without a critical mass of young consumers Britain and the rest of Europe will, by the middle of this century, have experienced a significant reduction in wealth. Some of this wealth will have been extracted from small businesses, formerly owned by retired entrepreneurs, which fail as the consumer sector declines. However most of the wealth will have been wrung out of the property market. Houses that, in former years, came top of the list of assets when the solicitor read out a last will and testament will have been sold off, or re-mortgaged, to pay for healthcare and other services. As well, the fall in the number of people fit and able to live in their own homes during the two decades leading up to 2060 will depress house prices. They could sink to the level where a four-bedroom house costs little more than a luxury family car – assuming, that is, anyone still has a family in 2060.

Best placed to take advantage of the flow of wealth from Europe to the developing world is the US whose demographic structure guarantees it will remain both a dominant consumer and producer for next thirty years. As disposable incomes in developing countries increase US industry should be well positioned to provide these economies with goods and services. While the US also has a large number of elderly people it will benefit from both low cost, outsourced, healthcare services and tax revenues from a relatively young domestic workforce.

All this assumes developing countries remain politically stable. Unfortunately there is a strong correlation between a country's instability and its population's testosterone level. In 1968, as Europe's baby boomers came of age, some parts of the continent seemed on the brink of revolution. Terrorist groups assassinated politicians and bombed public buildings. In the Sixties the West accused the Soviet Union of stirring up discontent amongst the young. Today we blame Al-Qaeda for inflaming the youth of the developing world.

While we in the West claim there is no war with Islam there is a battle, with Islamic leaders, for the hearts and minds of the next generation of baby boomers. Here the parallels with the cold war end. The Soviet Union attempted to sell an alien philosophy, with limited appeal, to people who were busily getting to grips with consumerism. Within Islamic states Western-style materialism is the alien philosophy. As well, whereas the Soviet Union's interpretation of communism prevailed over all others, there are a number of conflicting variations of Islam – hardly the basis for stability.

Viewed in this light the recent shift in the relationship between the West and the developing world makes slightly more sense. After decades of neglect the West now understands foreign and economic policy in the twenty-first century is about more than oil – whose price can be kept low by ensuring producers are always at each others' throats. The West is belatedly, and somewhat clumsily, attempting to bring stability to the developing world. Motivated purely by self-interest it now realises getting the developing world's baby boomers on side is the only way to ensure Europe grows old gracefully and the US maintains its dominant economic position in the world.

DOES BRITAIN NEED MASS IMMIGRATION?

*Summary of a talk given by Mr Anthony Browne, Environment Editor of The Times Newspaper, to members of the Economic Research Council on Tuesday 3rd December 2002**

My views have recently been denounced by David Blunkett in the House of Commons as 'bordering on fascism'. Well, I do think that we should have zero net immigration and I want to tell you why, and in so doing, hopefully convince you that I am not actually a fascist.

Firstly we should note that there appears to have been an important recent policy change. Since 1971 Britain has had a policy of 'no primary immigration' (meaning that the only immigrants normally allowed were husbands, wives, genuine asylum seekers etc) but now the government has introduced a lot of different schemes to bring people over to Britain and has said that they want 150,000 people a year to come.

I am going to look at the impact of mass immigration and all the arguments that are put forward about it on three different levels – on the level of *individuals* on the level of *Britain as a whole* and on the level of *the world as a whole.*

Individuals

There are individuals who win and individuals who lose from immigration. Those who win are, apart from (most of) the immigrants themselves, those who employ immigrants – which is why large businesses are generally in favour; why the CBI is in favour of mass immigration; why plantation owners wanted slaves – they wanted labour and they wanted cheap labour. The people who lose out are the people who compete with immigrants, because the supply and demand on labour affects the price of labour. Mostly this affects unskilled labour but many skilled traditional trades are affected as well. Particularly hard hit are people who are more 'marginal' in the labour market, such as women whose employment requires family-friendly practices, crèches and so on, and the elderly who tend to be more expensive and often require re-training. Similarly, ethnic minorities compete

* It has been exceptionally difficult, from an editorial viewpoint, to summarise this detailed and extensive talk. Readers who wish to question any point should first request an original transcription.

directly with immigrants as is demonstrated by the effects of new immigration by Hispanics on African Americans amongst whom there has now developed a complete underclass of largely unemployable workers and a situation where there are more of them in prison than in university.

We may note here that ethnic group interests of all kinds often conflict with individual interests because they want to bring in more of their own countrymen.

Britain as a whole

On a national basis, mass immigration obviously has a very big impact and there has been a whole range of different arguments to justify this, all of which are totally bogus.

'We need immigration because of the decline in population' is bogus because we don't have a declining population – births exceeded deaths by 70,000 last year. Projecting a decline in 20 years' time ignores the effects of women delaying starting families, but even if it turns out to be true, the time to turn on the immigration tap is in 20 years – not now. In any case a slow population decline – say 0.25% a year would, given productivity increases of 2.25% a year, only slow the growth of the economy marginally and would have environmental benefits in the sense that people can live in larger houses and build on less farmland.

'We need immigration to support our aging society' is bogus because, although (three cheers) we *do* have an aging society, the arithmetic is nonsense over the longer term. One day the immigrants will retire, justifying yet more immigrants. Working on a 'dependency ratio' of 4:1 one can calculate Britain's population reaching about a quarter of a billion by 2100.

'Industries competing with low wage countries need immigrants' is bogus because, over time, this does not succeed, given the higher cost of living here. An example of this is the British textile industry which in the 1950s brought in a lot of people from South Asia. They inevitably folded, leaving communities from South Asia in poverty. The industry should have gone down the route of increasing productivity, increasing investment, value added, design and specialisation. We can't compete on low wages and we shouldn't encourage business to go down the low productivity route.

'Immigration brings cultural enrichment', whilst true up a point, assumes that this is what people actually want. But we do not find people in rural towns, in small market towns and in villages saying that they want a lot of people from India, Nigeria and North Africa to help enrich their culture.

Basically I think that *all* societies should be allowed to decide what sort of culture they want to live in – this is basically democratic and anti-fascist. Indeed, the more you impose mass immigration on societies, the more you fuel the rise of extremist parties like the BNP.

In contrast to Britain, the people of Australia and Canada want immigrants. Those countries have only 1% of the population density of Britain and need a sort of 'critical mass' of population to justify building roads and other infrastructure projects. So that is fine – but for countries that are densely populated there is no correlation between population density and economic growth.

The world as a whole

It is on this level that I am most worried because governments are always tempted to encourage the immigration of professional and skilled workers which can amount to taking away from poor countries their politically stabilizing and tax-paying middle class. A third of Ghana's graduates leave, as do half of the graduates of India's top medical schools. Sixteen African countries have begged Britain not to take all their nurses. 75% of Jamaican graduates are outside Jamaica. If the developed countries take these graduates – paid for by the taxpayers in poor countries – how are those countries going to develop their industries and gain political stability? One is tempted to think of this as a kind of colonial plundering of their natural resources.

The immigration lobby

The people who are demanding immigration are the immigrant lobby groups rather than the British people. There aren't people out there demonstrating and writing to their MPs saying 'We want immigration' but there are immigrant lobby groups, big industry and the CBI calling for it. Policy makers must strike a balance and not be swayed. No one is suggesting closing the doors completely but we should allow roughly as many in from the rest of the world as leave here, just as there are about equal numbers moving to and from other parts of the European Union. In the not too far distant future the rest of the world should (especially if we pursue helpful policies) become richer thus reducing economic imbalances which will slow down immigration dramatically. But we can't have open borders now whilst there are such big differentials in the world, even if (and this is my ultimate cynical thought) it suits the Labour Party because it seems that some 80% of recent immigrants vote Labour!

RETIRE WITH CARE – YOUR NATIONAL PENSION LEVEL IS AT STAKE

For those (ie most of us who have reached our 60s) who have paid in the necessary National Insurance contributions, the state retirement pension is currently £77.45 per week for a single person and £123.80 per week for a married couple. (Divorce, it seems is valued at £31.10 per week – but that is another subject.) As retirees, recipients may of course choose to spend their declining years anywhere in the world but there is a catch for the unwary: the pension will be increased in line with the UK retail price index (thus maintaining its UK purchasing power) for those living in the UK and for those living in some other countries, but not all other countries. Non-indexation can mean that after 10 or 20 years the pension is so reduced as to be effectively withdrawn.

So be careful about where to go. Information is not always easy to come by – how many property developers' brochures warn potential UK purchasers of sun-lit villas that their pensions will be reduced if a purchase is made? How many estate agents dealing in overseas properties even know the answers?

Prompted by an Economic Research Council member's query, enquiries were made of the Department for Work and Pensions. Full indexation applies only to retirees who move to:

EU countries + Norway + Iceland + Liechtenstein
Barbados
Bermuda
Cyprus
Israel
Jamaica
Jersey and Guernsey
Malta
Mauritius
Philippines
Switzerland
Turkey
USA
The former constituent Republics of Yugoslavia

How come? Each of these are the result of individual reciprocal arrangements, mostly made prior to EU entry in 1972. So it is a long story and one that is currently under legal challenge in the Annette Carson case. She has lived in South Africa for many years and has asked that her pension value be index-linked. So far she has lost her case in the British courts, but a House of Lords Committee is currently debating whether or not she may have the right of appeal to the Lords.

But in the meantime, and most probably for the foreseeable future because the government is determined to resist change, the list throws up some odd looking choices. Britain encourages one to retire to Israel but not to the Lebanon; to the USA but not to Canada; to the Philippines but not to New Zealand; to Jamaica but not to the Bahamas or the Turks and Caicos Islands. It's good news for those currently speculating on coastal property in Croatia but bad news for bargain hunters in Bulgaria. The north African coast is a no-no and you can forget Australia.

Well well! Of course maintaining the pension is hardly the sole criteria one may be concerned with. Income tax levels, cost of living, the quality of health-care, the cost of return visits to the UK, the costs of visits by relatives and friends from the UK, the reception given by the locals, language problems, the location of existing friends and much else comes into the equation. Further contributions to this debate are welcome. Where is the 'best buy'?

BRITISH POLITICS: A VERY SHORT INTRODUCTION

By Tony Wright, MP, published by Oxford University Press, 2003, ISBN 0-19-285459-3, £6.99

Tony Wright MP is a political scientist as well as a professional politician. In the United Kingdom, and England especially, this combination is quite rare. Perhaps this is because the traditional emphasis of British constitutional politics is empirical and piecemeal, and so uncongenial to academic theorists. Dr Wright's approach, however, manages to be distinctively academic and rigorous at one level, profoundly practical at another. He retains a post-Enlightenment intellectual's irritation with anything that is not clear and linear, including a constitution characterised by haphazard accumulation and frequent inconsistency, that historically has had 'no book of constitutional rules; no supreme court to guard the constitution against the politicians; no charter of citizens' rights that had to be complied with; no second chamber with power to rival the first; and no electoral system that enforced proportionality between votes cast and seats won'. He is impatient with 'settlements of a kind' rather than clear-cut reforms.

Dr Wright is therefore an intellectual radical, but temperamentally he is a pragmatic reformer who understands the value of moderation and compromise. Indeed his main criticism of the adversarial conduct of British politics is that it makes consensual change more difficult. And it is clear too that he approves of the British tradition of incremental reform, for he devotes a large part of this book to chronicling it. One of the problems faced by constitutional reformers from the left has been that they often ignore or set out to rubbish the past. As a result, their musings seem curiously deracinated, like the jottings of the minor *philosophes* whom Tocqueville excoriates in *The Ancien Regime and the Revolution*. Dr Wright gives the modern, centre-left message more teeth because he sets it in an historical context. Reading his book makes it easier to see the demand for proportional representation (for example) as the continuation of previous campaigns to widen the franchise and make the political system more transparent.

In this tightly argued, scholarly but highly readable little book, Dr Wright makes no secret of his political bias. Nonetheless, he is objective and refreshingly fair-minded about rival philosophies. He is himself a New Labour purist. Given recent events, and the cast of characters involved, this might seem like a contradiction in terms. It is not in this case, because

Dr Wright was 'New Labour' in his approach before the term even occurred to Mr Blair. Elected in 1992, he was part of a new intake of intelligent and open-minded Labour MPs who were tired of the far-left fundamentalism that had nobbled their party and kept Mrs Thatcher in power. In contrast to the far left, they held to the true Labour values of economic democracy and a just society. Unlike the traditional Labour right (or what remained of it by then), they were concerned with individual freedom, flexibility and choice, instead of the 'blanket' approach to state provision characteristic of Old Labour. They were also preoccupied with issues of civil liberties, constitutional reform and the protection of the environment, concerns they wished their party to embrace more fully.

When, in the mid-1990s, Tony Blair appeared to adopt this agenda, Dr Wright and his centreleft colleagues supported him enthusiastically and hoped for positive change. Dr Wright is therefore the original New Labourite. His approach is genuinely democratic and communitarian, and so bears no resemblance to the 'democratic centralism' of the Blair Project in practice. Most of the Blairite clique began their careers in the student left of the 1960s and early 70s. Although claiming to be modern, the Blairites retain the student left's fanaticism, its ruling class disdain for democracy and its emotional hang-ups about issues allegedly connected with 'race' or 'gender'. This brand of hysteria, known as identity politics, originated on the American New Left. It has been one of the motifs of Blairism in power, but has nothing to do with Dr Wright's interpretation of New Labour, which is about the betterment of the whole people and individual freedom rather than group rights. At the same time, Blairism in practice dumped unceremoniously any vestigial commitment to socialist economics, worshipping great wealth with an obsequiousness that would embarrass most Tories. Dr Wright's version of New Labour, by contrast, is a modernised form of social democracy: Fabianism with a human face.

In his analysis of twentieth century British politics, Dr Wright cites three 'revolutions' that punctuate an otherwise plodding progression. It was the Attlee revolution in 1945, that ushered in the post-war welfare state, with its assumptions of economic collectivism and universal social provision. In 1979, the Thatcher revolution overturned most of these assumptions which is why, as Tony Wright reminds us, Milton Friedman rightly described her as 'a nineteenth century liberal' and so not really a Tory at all (a view later echoed by Alan Clark). The Attlee revolution had not been much concerned with constitutional reform, and had relied on the (in theory) almost unbridled power of the executive to enact change. Mrs Thatcher's government relied even more on centralised power to enact its programme of privatisation and the 'dismantling of socialism'. As Dr Wright reminds us, Lord Hailsham described the 1970s Labour administration as an 'elective dictatorship', but this sobriquet applied far more to the Thatcher government in which he served. The Thatcher revolution was economically *laissez faire* but politically statist, or as Tony Wright put it, 'at once liberal in economics and uncompromisingly Tory in politics'.

The third revolution, inaugurated in 1997, is the Blair revolution. This is the most problematic of the three for two reasons. First, it is the hardest to define in clear terms. Secondly, it is hard to tell whether the Blair revolution is continuing, in which case the jury is out, or whether it has already lost its way or fizzled out. Certainly Dr Wright invested great hopes in Tony Blair. He hoped that the 'Project' would turn out to be a judicious blend of individual freedom and social responsibility. This has not transpired and so an atmosphere of thwarted expectation hangs over many parts of this book.

British Politics is a thoroughly researched, densely packed book, part of an excellent new series from the OUP. It has a human dimension, rich in amusing anecdotes and personal insights that make it an enjoyable read. There are, however, two flaws that spring immediately to mind. The first is that at times in the discussion there surface two perennial (and connected) defects in left-wing thought: the failure to acknowledge complexity and the resulting attachment to outmoded analyses. A good example is Dr Wright's description of the English. For he speaks of:

> [A] general tendency among the British not to know about, or care about, who they are. … The English have always been the worst offenders, feeling no need to look beyond the end of their comfortable noses at the nature of the multinational state of which they *are* the overwhelmingly dominant part. [*my emphasis*.]

The 'are' is telling. Although Dr Wright is aware of the seismic changes associated with Scottish and Welsh devolution, with their promise of further change, he overlooks the effects of this shift in the balance of power. The position of the English is no longer unequivocally one of dominance (if it ever was) and so the current quest for 'Englishness' is more about vulnerability and lack of confidence than national chauvinism or even football.

The second, closely related flaw is Dr Wright's uncritical approach towards the European Union and the increasing grip of its tentacles. He makes the mistake of equating the EU with 'Europe' and 'European civilisation', although what makes Europe attractive, and creative, is the variety that 'harmonisation' sweeps away. More curiously, he seems to include the Human Rights Act, and the Convention it incorporates, within the EU leviathan. In reality of course, the European Convention on Human Rights derives from the Council of Europe which, quite unlike the EU, respects cultural differences and is based on co-operation between nations, not their abolition and absorption. Dr Wright's blindness to the anti-democratic, topdown nature of the EU is also surprising, given that he is a genuine champion of decentralisation, open government and politics on a human scale. Perhaps it reflects another historic weakness of the left, a rush towards grandiose utopias that always turn out to be dangerous and corrupt. Dr Wright should turn his attention towards devising a positive, centre-left view of co-operation in Europe, between independent nation-states. That would be good, not only for Labour and Britain, but for the future of democratic Europe.

These small criticisms do not detract from a valuable book that is a must for anyone curious about British politics. The overwhelming impression of the book is of an humane vision of social and political reform, a 'One Nation' socialism rooted in British political culture. Once, Tony Blair was seen as the greatest hope for such politics, but now he is the greatest obstacle in its way.

A.R.

JAPANESE PHOENIX – THE LONG ROAD TO ECONOMIC REVIVAL

by Richard Katz, published by M.E.Sharp, 2003, $68.95

'In the former Soviet Union, a crisis of the system looked like droves of people waiting in line for hours only to find nothing on the shelves. In the United States, a crisis appeared as simultaneous 13% inflation, 20% interest rates, and 10% unemployment. In Japan, it's a bank debt crisis.' (p. 81) This remark, far more pertinent than a fixation with falling rates of economic growth, points to the heart of Japan's current malaise. Which part of an economic system takes the stress when things go adrift?

Richard Katz brings together the many strands which outsiders have identified in trying to understand Japan's economic woes. An outline of his chapter headings shows the overall picture. Divided into five parts, the first is headed 'A Tale of Two Problems: Supply and Demand'. The keys here are that Japan's consumers, rather than saving too much, have too little to spend. Pay is too low, returns to capital derisory, pensions are insecure, government social security inadequate – and high prices rob spending power from potential growth sectors. On the supply side Japan has two economies – an efficient export orientated sector and a protected inefficient domestically orientated sector. Growth potential is not in some new line of hi-tech widgets but rather in improving efficiency in more humble areas such as food processing and building materials.

Part Two is headed 'Macroeconomic Policy Debates'. The point here is that conventional stimulus programs – government deficits and trade surpluses have simply run out of steam and failed. The only solution that can work is competition-oriented reform, forcing private incomes to rise. The process will be painful for many – and it is to ease this transitional pain that further fiscal stimulus is needed – and has its only real rationale.

Part Three is headed 'Globalization: A Progress Report'. This reports a very mixed picture. Japan's share of the world's exports/imports has been falling and most of the recent increases in Japan's manufactured imports are 'captive' – which means that they are simply supplies back into Japan from Japanese firms that have relocated production offshore, importantly in China.

But foreign direct investment in Japan has, he says, experienced a 'sea change'. Toys 'R' Us is now Japan's largest toy retailer with 14% of the market. Foreign firms and executives control 'about every auto firm other than Toyota and Honda'. Foreigners have made inroads in telecommunications. To give just one other example, even Tesco has bought a chain of some eighty outlets. The last few years have seen an explosion in new cases which means that the total, whilst still tiny by international comparison, is impressive in comparison to 1990. Even though Japanese manufacturing abroad is five times foreign manufacturing in Japan, the trend is in the right direction and the authorities are starting to be supportive. And foreigners are taking an ever greater part in finance – in underwriting, brokerage, pension management – underlining the significance of the simple statistic of foreigners now owning 20% of the value of Japanese shares, up from only 10% a decade ago.

Part Four is on 'structural reform'. Employees, firms, government agencies, are being dragged kicking and screaming towards competitive pressures. Reactionary forces win many battles and are, for the most part, holding out, but time, says Katz, is on the reformist's side. One chapter heading sums it up smugly 'Competition Policy: Not Enough Competition. Even Less Policy'. (Ch. 16) And economic structural reform is having to go hand in hand with tax reform and with reform of the entire political system, ending Japan's one-party state. No one should underestimate the magnitude of the task. Those who do are likely to make losses on their Japanese investments!

Part Five rounds on American policies towards Japan. Simplistic 'Japan bashing' has been foolish. America should recognise the various actors within Japan avoiding measures that play into the hands of reactionaries and embracing policies that help the reformers. Meanwhile Japanese need to discard the reactionary propaganda claiming that reform means 'being like America' and recognise that good old fashioned Japanese virtues can be rekindled through reform. (Maybe someone should say this here in the UK too.)

Finally, Katz' last chapter – a two page peroration entitled 'The Phoenix Economy' notes Japan's remarkable bursts of economic success in the past, suggests that change will take time, but ends optimistically. Japan, he says is 'a great nation currently trapped in obsolete institutions' and 'does not have the feel of a failed state'. Reform 'is finally starting down the road'.

Well researched, littered with graphs, statistics, facts, references and quotations, Katz' style is nonetheless semi-journalistic despite his fine insight as an economist. It is quite simply the best and most important book analysing Japan's economic problems, yet written by a foreign observer.

But this last point, whilst making a compelling case for it to be read by every serious student of (and investor in) Japan, also suggests its possible shortcomings. It is all very well taking the western analytical toolbox to work mercilessly on the Japanese patient; to, in effect say ‘away with the mumbo-jumbo’, ‘take off the hazy spectacles’; to ‘paint up the reality’; and give a detailed ‘straight’ account. Yes, by all means do this (and Katz has done it brilliantly), but…, but…, is it right to ignore so much research and literature written over the last fifty years which has sought to understand Japan’s economy in terms of groupism, collectivism, coordination, cell-like productive structures? Structural reform will not change Japanese psychology, upbringing and loyalties. Business works within a context of civil institutions affecting legal processes, political structures and philosophical beliefs. Japan has much else to achieve besides Thatcher-Reaganite reforms of economic rigidities.

J.B.

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

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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.

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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.

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