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

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A CRITICAL HISTORY OF ECONOMICS

*Extracts from a talk given by Mr John Mills, member of the Executive Committee, to members of the Economic Research Council on Tuesday 28th September 2004**

Economics is an extraordinary subject – extraordinary in that throughout the two or three hundred years in which people have been studying it, it has never really been very clear what economics was trying to achieve. But I think that actually it is fairly clear what economics *should* be trying to achieve and I'll start by outlining what I think this is.

Economic objectives

Economics is a study of public policy making in respect of commonly shared public objectives – full employment, low inflation (or at least inflation that's at a manageable level), the avoidance of unacceptable levels of inequality (and there's a wide measure of disagreement about what level that is), and some sort of policy mix that enables us to have a sustainable future in which we can carry all this forward. I argue in my books on this that we should regard strong economic growth as both compatible with and a prerequisite of these aims.

But if you look at the history of economics and what nearly everybody involved in economics has said and written about, there really isn't very much there so 'why is this the case?', 'why hasn't economics addressed these questions more centrally than it has?'. I suggest that there are a number of reasons, each related to particular parts of economic history,

The baggage of the distant past

First, in the long history of economics, way before Adam Smith, economics had its roots in attitudes that were reflected in what economics has had to say. Ancient Greece with Aristotle and Plato for example, and the Church, which had a huge amount to say about usury and fair prices and all that sort of thing – an enormous amount of baggage when people, particularly Adam Smith, started to look at economics as a distinct subject. Most of

* This talk refers to 'A critical history of economics' by John Mills, published by Palgrave 2003 (see review, 'Britain and Overseas' Summer 2004.), and to 'Managing the world economy', also by John Mills, published by MacMillan 2000 (see review, 'Britain and Overseas' Autumn 2000).

these ‘old’ attitudes were concerned with ‘How do you deal with a world of unending scarcity where it simply isn’t possible to create sufficient resources to make everybody better off?’ It was about dividing up the cake which stayed pretty well the same size. But these attitudes became inappropriate once Pandora’s box was opened and the industrial revolution started. So I think that the long standing, pre-industrial attitudes, which are still reflected in a lot of economics, had a good deal to do with it.

19th century errors

Secondly, and despite Adam Smith who is one of my real heroes, it is interesting how wrong the early Victorian pre-eminent economists were. Three major errors stand out. The first was David Ricardo and the labour theory of value. This theory, or course, had a long history going right back to ancient Greece but Ricardo was the person who really held to it more or less all his life. Yes, he did wobble about a bit but he had this view that all the value of any goods produced pretty well depended on the amount of labour that went into it. The impact of this was to make it very much more difficult to develop theories about economics and economic growth which were likely to work. Next was Thomas Malthus and the ‘iron law of wages’. I am sure you recall his view that just about all the working population or at least the ‘working classes’ could never become better off because as soon as they did they would procreate more quickly (‘exponentially’ – though there is not a shred of evidence for this) whereas output from the land would only increase ‘arithmetically’ (again – no evidence for this), thus driving standards of living down. The notion that there is nothing one can do about poverty, that policies pursued by the government to try and alleviate this distress are bound to fail, very adversely affected the development of economic thought during the 19th century. The third major error I’ll mention is ‘Say’s Law’ which (despite usefully tackling new ideas) advanced the idea that all depressions were self-correcting so that all you could do was just to ride them out – the belief that all output creates its own demand so that there is no possibility of structural unemployment. Thus again you have the view that there is no role for the government in solving economic problems.

The radical challenge

The third major thing that I think went wrong was the radical challenge that held economics to be about how to divide up the fruits of the by then

greatly increased economic output. Karl Marx was the most preeminent of these although there were plenty of others who followed in his footsteps. In many ways Marx was right to criticise what was wrong with classical economics but in general his attack on it didn't take economics much further at all – though it did have a huge impact on sociology. What did come out of the radical challenge was a fear about the owners of capital, that unless they were more accommodating in terms of doing whatever they could to alleviate poverty there might be a revolution. In the sense that this did lead towards the welfare state, this attack from the left was effective. But in terms of looking at the major objectives of what economics should be about, Marx was no more successful in trying to pull together ways of running the world than had been the classical economists. In fact when you look at the history of the last century or so, he was worse.

The post 1870s retreat into micro economics

Next, we should look at the shift in economics from about 1870 away from being a practical subject to being much more of a theoretical one, one very largely concerned with what we nowadays call micro economics in contrast to macro economics. One of the most striking things is, when the depression hit at the end of the 1920s, how incredibly little mainstream economists had to say (in any part of the world) about what to do about it. In America, even Irving Fisher, the doyen of American economists, just said 'you've got to ride it out'. (Incidentally, in 1929 he invested a large fortune and lost his shirt as a result!) In this country you had people like Lionel Robbins (Lord Robbins, Director of the London School of Economics) saying much the same thing. The Austrian School of economics? – again Joseph Shumpeter played variations on the same theme. There simply wasn't any consensus anywhere in the economic establishments about what to do.

Keynesianism and Monetarism

Although, of course, there was John Maynard Keynes (who had a lot to do with prosperity in the 1940s and 1950s, but not much in the 1930s) but the real problem with Keynesianism is that it had a great deal to say about how to deal with unemployment, but not much about growth. Keynes himself was very sceptical about whether growth was going to continue, he thought that some kind of plateau would be achieved relatively soon. And perhaps the biggest failure of all in what Keynes' work covered was that he had

very little to say about inflation. If he had been alive when inflation began to be a problem as the 1950s and 1960s wore on and particularly in the 1970s, it may well be that he would have come up with insights, but he died in 1946 and wasn't there – and his successors really failed to do this. This is why, when the big inflation hit the world in the 1970s Keynesianism was swept aside with amazingly little difficulty by the monetarist consensus which took over.

The monetarists' consensus has been successful in some ways and has had quite a lot to do with the very low levels of inflation that we've got at the moment, though not necessarily all of it by any means. But whatever you can say about the monetarists' success in containing inflation, it has not had a successful record either in achieving economic growth (there is absolutely no doubt about the fact that the way the growth rate has gone down, particularly in the western world, over the last twenty-five years compared with the first twenty-five years after the war) or in dealing with issues of inequality.

So where now – from 2005?

Following the proposals that I have considered in a series of my recently published books I think that what we essentially need to do is to structure policies to increase living standards as fast as we possibly can do; to reduce unemployment and inequality and base all this on a 'sustainable context'.

Opponents to policies giving priority to growth might fear that inflation could reappear as a major problem. I have to say that I think there are a whole lot of reasons why this is fairly unlikely to happen. Whatever the merits may be about some aspects of globalisation, the fact is that there is massively more competition from everywhere in the world – for industrial goods in particular. This makes it very unlikely that we are going to see the leveraging-up of inflation that in the 1970s took place as a result of supply side pressures. And on the demand side I doubt if this will be allowed to run out of control such that there is 'too much money chasing too few goods' because on the whole economic management has become sophisticated enough to stop that happening. In any case, if you look at the balance of advantages of different policies – and take my view as to where we should be going – at least *some* risks with inflation are worth taking. And on this issue it is worth reminding ourselves that there is inevitably some increase in inflation alongside an increased growth rate because of the balancing out effect of productivity increases being greater in areas like

manufactures than is possible in services. Historically, high rates of economic growth have been accompanied by some inflation and I think that most people would think that an inflation rate of 3% or 4% alongside a growth rate of 5% or 6% was a better state of affairs than one where the growth rate is 1% or 2% and the inflation rate about the same. This is the choice being faced not just here, but in many parts of the world.

China is an interesting case in point. China has massive problems and enormous social pressures. Despite these disadvantages they are pursuing an extraordinarily successful economic growth policy which has lifted literally millions of Chinese people out of poverty over a relatively short period of time on the basis of very rapid industrialisation. Millions have the chance to work in factories, which brings problems of pollution and that kind of thing, but is far preferable to being grindingly poor and suffering from intermittent food shortages. China's economic policies are not far away from those advocated in my book and it is certainly interesting that a Chinese language version has been published there.

So why an economic growth priority?

I think there are three really very important reasons why we should go for high growth and the rest of my 'package'. The first is that I think this is what everybody wants. I think most people really *want* higher standards of living. The enormous amount of economic migration from poorer to richer parts of the world surely points to this conclusion.

One of the very interesting things about economic history is how many economists from the nineteenth century right through to the twentieth century would be very sceptical about whether economic growth either could go on or whether a satiation point would soon be reached. John Stuart Mill had this view and so did John Maynard Keynes, as did a whole lot of people. But there doesn't seem to be any evidence of this, any evidence that satiation creeps in at any level. Indeed, it seems to me that however well off people are, they are always quite happy to have a bit more. So if growth is what everybody wants I think that it is right that economics should try and respond to it.

The second reason is that we need growth if we are to achieve *sustainability*. If you look at the United Nations population projections you see that it's very likely that the world's population is going to go from about six billion, where it is at the moment, to somewhere around nine or ten billion by 2050 which is a very large increase. Now if you also look at

the history of the last 200 years or so, there has been a steady increase in living standards of somewhere about, well running up to about 2% per annum on average right across the world, and if that goes on for the next fifty years, and you get that increase in population, you are going to have a massive increase in world GDP of up to something like six times what it is at the moment. The question is whether all this is sustainable?

On the whole I take a fairly bullish view that it is sustainable but I think that the really key joker in the pack is what is going to happen to population. The United Nations projections actually range from a low estimate of around eight and a half billion by 2050, to a high estimate around thirteen billion – a big spread. The key is the poorest people because there is a very clear correlation between poverty and the number of children. Now there is a break point at about, in current money, three thousand US dollars per head. Once that point is reached, right across the world, across all cultures, the number of children that women choose to have plummets, and once that happens, after a bit of time, population stabilises. At present there are still very large numbers of people in the world whose standard of living is below three thousand US dollars a year – about a billion (if my memory serves me correctly) living on a dollar a day, and while this is so it is very very hard to stop population growing and continuing to grow exponentially because children are just an investment for the future. Since it is extremely hard to shift large amounts of aid from rich countries to poor countries the only real way in which we can raise the standards of living of poor countries is by giving them an opportunity to trade themselves out of the poverty that they are in at the moment. This means reducing protectionism (particularly on agriculture) in the western world – but to make all this possible you need a background of prosperity in the developed western world. So prosperity will enable us to stabilise population at a manageable level.

The third reason for an economic growth priority concerns *security*. There are enormous disparities between the richer and the poorer parts of the world, particularly between the western world and those countries where, for cultural, religious and other reasons, people have much more difficulty in bringing together the sort of rule of law and all the other things that make it possible to run an effective economic state. I think that the more clear examples there are of states being able to run expanding economies with full employment, with people at ease with themselves, with societies that are successful as models, the less likely it is that we're going to have more and more of the world fragmenting into sources of terrorism, which

would not only be very disadvantageous for themselves, but, as you see in Iraq, would produce a kind of downward spiral but not breaking up which is then very difficult to raise investment, very difficult to get the country on its feet, very difficult to get standards of living up, and therefore very difficult to deal with all the population problems which I have described.

Economics can be optimistic

In writing my book 'A Critical History of Economics' I found that economists have too often been gloomy and misguided. I really don't think that the prospects for the world economy now fit that frame of reference. I'm an optimist about what can be done if we can get the policies right, and I think that this view is justified if we look at the history of the way things have developed in the longer term. We need to see if we can develop better policies and improve the prospects for the whole of humanity, I think we can, and I would like to think that my book and the work of the ERC can play a modest part in achieving this.

FLAT TAXES – THE CASE FOR RADICAL TAX REFORM

Summary of a Pamphlet by John Chown published by the Policy Institute and commended by the Institute's Director and ERC member, Bill Jamieson*

Flat taxes have become the talk of Europe. The trigger for this is an economic revolution in Eastern Europe. The former communist countries have drastically liberalised their economies. They have been rewarded with high rates of economic growth that their Western counterparts can mostly only dream of.

As part of this transformation, many Eastern countries have introduced much simpler tax regimes, usually, if a little simplistically, known as flat taxes.

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* For a complete version of this document, please download from www.policyinstitute.info publications or call the institute on 0131 620 8587

Flat taxes have a logic that is both clear and compelling: why not charge income taxes at a single flat rate, so that everyone pays the same proportion of their income in tax?

The Benefits Of Flat Taxes

Flat tax regimes offer a number of important economic benefits. Above all, they *simplify* the tax system. They reduce distortions to normal economic behaviour caused by people trying to minimise their exposure to tax, especially higher earners. The economy thus works more efficiently.

A simplified tax system offers the prospect of higher tax revenues resulting from a more efficient economy, less tax avoidance and lower compliance costs. At the same time government collection costs would fall. This means that overall tax rates could be reduced to generate the same amount of revenue. This fall in taxation would itself contribute to higher economic growth, generating a virtuous circle of higher revenues and lower taxes.

The Social Security Problem

Simplified tax regimes have been consistent with high growth in Eastern Europe. However, the problem there is that they deal only with income tax and ignore social security contributions.

Most countries subject those in employment to social security contributions (National Insurance in the UK). Because they are collected and redistributed at the behest of central government, social security contributions are in practice indistinguishable from normal income taxes and they substantially increase the effective income tax rate.

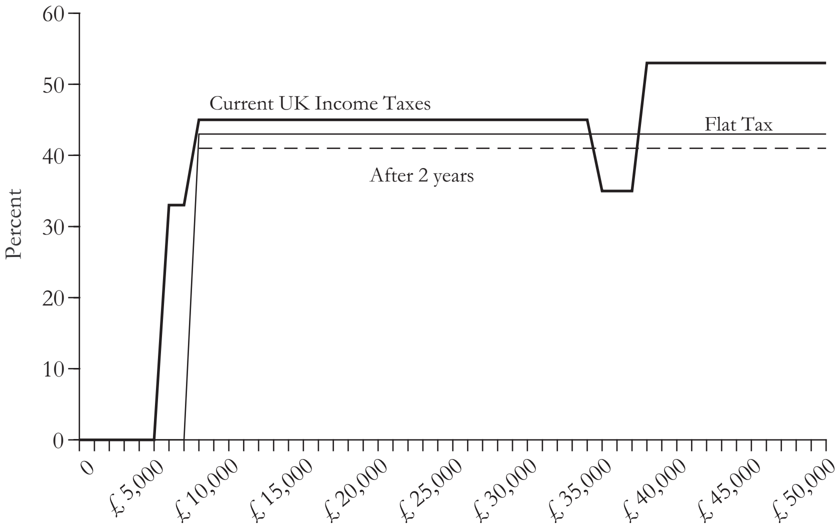
What is more, we must also include the employer's contribution. This is because employers simply pass on their social security costs to their employees in the form of lower salaries.

Flat Taxes In Britain & Scotland

A flat rate of income tax in Britain should involve eliminating the higher rate of tax, reducing the 10% band to zero, and incorporating National Insurance contributions.

Based crudely on current income tax and National Insurance receipts a

Figure: Towards Simplicity – Flat Tax Options for Britain



Source: Derived from HM Revenue and Customs calculations

flat tax rate of 44% would raise the same revenue as is currently received by HM Treasury from these sources.

This rate could probably be lowered as the benefits of flat taxes came through. The graph shows how this compares with the existing tax regime. This immediately presents two major issues for discussion.

1. The overall level of taxes remains high. Flat tax reform is mainly a matter of efficiency, not a panacea for a low tax economy.
2. Investment and dividend income would have to be taxed at a lower level to prevent capital flight. The problem with such an approach is that it maintains a potentially damaging distortion in the tax system.

A comprehensive flat tax on income is feasible, but only with significant overall cuts in government spending. Nonetheless, Scots should advocate simpler taxes, at whatever level – EU, Westminster or locally. Tax reform could also aid a transition to fiscal autonomy.

ECONOMIES AND US EQUITIES

Some 'diary notes' from Damon de Laszlo.

Economies

As always it is interesting to sit and think about the direction of economies. On a global basis economic momentum is slowing. This is a good thing as growth rates for the last eighteen months or two years have been well above a sustainable level. However, the statistics that show slowing economies cause alarm and despondency as a lot of them demonstrate changes in the rate of change. Couple this with the tendency of people to extrapolate in straight lines and you see there is a quick conclusion that disaster is around the corner.

The rate of change of growth in the *US* from over 5% to probably just over 3% in the current year does *not* necessarily mean that next year's growth will be only 1 or 2%. As things stand the US consumer driven growth appears to have slowed down, which is excellent. This will probably have the effect of improving the US balance of trade and taking some of the demand inflationary pressures out of the economy.

The Fed continues its policy of ratcheting up interest rates to dampen the mortgage refining market and the housing boom. It seems that the Fed is fully aware of the enormous amount of liquidity in the system that needs to be slowly reduced. There *is* a danger here that they miscalculate and there could be a market accident in the debt area. There is a lot of paper in the system that is over-rated and, as interest rates rise, holders of heavily geared funds are likely to receive a 'haircut'.

The big worry, the US balance of trade, is likely to improve with the decline in retail growth and so the impact of Chinese consumer goods will flatten out (and, as China encourages its domestic consumption, the cost of these goods could increase). This, as well as the global appetite for dollars, means that demand for the currency will continue. There is really no alternative to US Treasuries and Bonds for the World's Central Banks, which is why US long yields remain stubbornly low.

The Chinese Government is talking down the Chinese economy to try and reduce the building bubble and state sector industry capital expenditure, without destabilising the private sector. Consequently this economy is slowing, a bit, and is therefore probably now expanding at a sustainable rate without major dislocations. It is also 'a good thing' that Chinese poverty

is diminishing and the country as a whole has an interest in world stability. But China raises some major problems for the West in perhaps four or five years' time. Their rate of technological advance is prodigious and much of their industry is at the forefront of production techniques. Their manufacturing capability is likely to increase at a far faster rate than in the Western world. In 2004 China graduated 325,000 engineers – five times the number of the US. Virtually all global companies now have manufacturing facilities in China and inevitably R & D will follow. In practice R & D cannot for long be far away from production facilities in most manufacturing sectors.

India too is broadening out its economic growth. The development of the internet and the mobile telephone network is not only providing economic growth in the software industry, but also seems to be having an extraordinary political impact. India is a proud country with a great heritage and the Indian people have regarded themselves as a cut about the rest of Asia, if one is allowed to make this sort of comment in a Politically Correct world. The impact of greatly reduced costs of telephone communications and Internet facilities is bringing a realisation to middle class Indians that they are being overtaken by developments in China and Korea. This discovery seems to be galvanising political opinion into resisting bureaucracies that stifle economic and industrial growth. The globalisation effect at its best?

The *Japanese* economy is slowly reorganising itself after a long period in the doldrums and I believe will re-join the Asian growth phenomenon.

Globalisation

Globalisation of industry is keeping retail prices steady, a phenomenon that has not really been experienced since the end of the 19th century. One can make a rather generalised observation that Pax Britannica created a free trade world at the end of the 19th/beginning of the 20th century, and we are now seeing Pax Americana having the same effect.

But with the globalisation of trade also comes the globalisation of liquidity, this time without the fig leaf anchor of the 'gold standard'. The movement of funds around the world is today creating similar financial bubbles to those that were seen in the late 19th and early 20th centuries. The difference today is the speed of communication, along with the increased financial sophistication of markets, creating faster market gyrations, and this confuses the analysis of the major underlying trends.

US Equities

In America while the economy is intrinsically sound, the excesses in the financial markets could produce a crisis as interest rates rise. Startlingly the great GM is possibly an economic iceberg. In March, G E Capital withdrew a $2bn Loan Facility as GM's credit rate fell to BBB – and GM's market capitalisation also fell below that of Harley Davidson, a company making 317,000 motorbikes a year, compared with GM's 9,000,000 vehicles. GM, facing global competition, probably cannot trade its way out of these problems. None of its competitors has to support the incredible health care and pensions costs of its ex-employees. Each GM worker must produce enough profit to support 2.5 pensioners before the company makes a profit. In reality, the story of GM is getting to Chapter 11.

While there are always dangers, I feel basically optimistic about the US economy. The Sarbanes Oxley legislation is having an interesting and perverse effect. Companies are in a hurry to publish bad news and are more and more nervous about publishing good news. Also many companies are still grappling with publishing any information owing to the complexity of the Act. We can expect the first and second quarter reporting season to contain depressing reports and it won't be until we get into the third quarter that everybody will wake up to the fact that earnings are much higher than forecast.

The institutions appear to be underweight in Equities, and the Hedge Funds appear statistically to be heavily short. While US interest rates are likely to rise rather than fall, which may slow down consumer expenditure a bit, the economy as a whole looks very solid. The corporate sector is very liquid, employment is rising. It seems that the general nervousness is being sustained on a relatively rickety wall of worry. As every month goes by with earnings rising and the market going nowhere, the stock market looks a better and better bet.

Before the end of this year I suspect many institutions, with their consultants in the lead, are going to have to consider buying equities as any pick-up in growth and/or inflation is going to leave Bonds very vulnerable. In these highly volatile markets with the huge weight of money in Hedge Funds and alternative investments, small movements in sentiment will cause the markets to move very rapidly. The risk, I believe, is the market could move rapidly upwards and in quite a short period, leaving little opportunity to buy into the rise. Funds that are short or in cash or bonds are far more risky today than being in the equity market.

THE ETHICS OF FREE MARKET CAPITALISM

Robert McGarvey

Social Responsibility and Free Market Capitalism

In a landmark New York Times article (September 13, 1970), Dr. Milton Friedman laid out the case that managers in fulfilling their corporate duties should have no overriding social responsibilities: '*...there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.'*[1]. Given Dr. Friedman's standing as one of the world's leading free market economists at the time (leader of the Chicago School of monetary economics), his article carried great weight, and authority. Professor Friedman used his article to reinforce in blunt terms the modern theoretical separation between economics (good and liberating) and politics (bad and controlling). What was decidedly new in Dr Friedman's arguments were the associations he drew: *Businessmen who talk this way (about social responsibility) are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades*. In Dr. Friedman's mind the very idea of 'social' responsibility for corporate managers was wrong headed, amounting to nothing less than socialism in disguise.

The publication of Dr. Friedman's article contributed significantly to radical changes that were then taking place in American management practices. The late 1960s saw the rise of a new and much more aggressive managerial class, often trained professionally, many with MBAs. Their arrival on the business scene completed the ascendancy of a narrowly focused, Wall Street inspired, 'financial' theory of the business; its fundamental premise (relatively new at the time[2]) was – a business exists to return on shareholder equity; its measure of corporate success or failure, the

1 The Social Responsibility of Business is to increase its Profit, Milton Friedman, The New York Times Magazine, September 13, 1970

2 In *My Years with General Motors,* Alfred P. Sloan Jr. GM's share price hardly merited a mention and finance took a back seat to production, divisional structuring and most importantly GM customers. Peter Drucker, who studied Sloan's management system, would later coin his own (Sloan inspired) theory of the business: A business exists to create a 'customer'. In Drucker there is a cause and effect relationship between customers (cause) and profits (the effect) that had to be taken into consideration by management.

company's quoted stock price. Dr. Friedman's article could not have been more fitting or timely for the advocates of this management revolution. In tandem with other societal forces, the article contributed to the post war liberation of management from what many considered 'hidebound' corporate traditions, while simultaneously freeing management as a class from any independent ethical responsibility for the larger consequences of their actions. The message was unmistakable: so long as management 'played by the rules of the game' they had no larger obligations, beyond, that is, increasing corporate profits.

Modern Business Practices

What followed over the course of 35 years is now history. A brief list of notables illustrates the new ethical reality of modern business plainly, Charles Keating[3] of Savings and Loan fame, corporate raiders Carl Icahn, Henry Kravis, Irwin Jacobs, and – naturally – Michael Milken, the 'junk bond king', all were headline news in the 1980s. More recently we have the 'new economy' and the accounting gymnastics of Enron, WorldCom, Adelphia, AOL Time Warner, Global Crossing, Tyco, etc.

The now defunct Arthur Andersen leads a list of formerly august accounting and financial institutions that have been involved or implicated in dubious practices. Major mutual fund players including Putnam Investments, Prudential Securities, Alliance Capital/Alliance Bernstein, Bank of America's Nations Funds, Charles Schwab, Federated Investors, Franklin Templeton, Fred Alger Management, Janus Funds, Massachusetts Financial Services Co. (MFS), One Group Funds, Pilgrim Baxter (PBHG), Putnam Investments and Strong Funds – were accused of defrauding their own unit holders through decades of so called 'late trading', prohibited after-market trading schemes[4].

In 2003, some of the biggest investment banking firms on Wall Street reached a $1.4bn out of court settlement with the SEC and the State of New York. And while the firms admitted to no wrongdoing, the settlement alleged that during the stock market boom of the 1990s these major investment-banking firms essentially conspired with their largest fee generating investment-banking customers to the detriment of investors.

3 Binstein, Michael and Charles Bowden, *Trust Me: Charles Keating and the Missing Billions*, New York: Random House, 1993.

4 Mutual Fund Industry Fraud Investigation, http://www.lieffcabraser.com/mf_main.htm

The list of names reads like a Who's Who of investment banking: Salomon, Merrill Lynch, Credit Suisse Group's CSFB, Morgan Stanley, Goldman Sachs, Bear Stearns, JP Morgan, Chase, Lehman Brothers, UBS Warburg, US Bancorp's Piper Jaffray.[5]

The insurance industry, not to be left out of the action, is now facing the wrath of New York's Attorney General. Among the famous institutions implicated in the ongoing investigation of industry price-fixing are broker Marsh & McLennan, insurer AIG, and ACE, a property-casualty insurer; coincidently these famous institutions are each in their turn managed at the highest levels by the father and/or sons of a single family[6].

While clearly some of the above-mentioned scandals are based on illegal fraudulent practices, what is interesting for our discussion is that many of these serious breaches were NOT technically illegal. Indeed, defenders of the status quo have argued that the senior management in these institutions were themselves victims; management was simply 'playing by the rules' and while their actions clearly disadvantaged some they were customary practices, nothing out of the ordinary.

The investment banking industry for instance, while deeply implicated in practices that were disadvantaging their investment customers, were investigated and by and large absolved of legal wrongdoing. The mutual fund scandal is also troubling, in that while 'late trading' is clearly illegal, market timing as practised by many in the mutual fund industry is not. Ironically, a mutual fund only places itself in jeopardy of censure if it violates its own stated public policy against such trades (and then allows them nonetheless). But perhaps the greatest irony of all is Enron, where a history of dubious off balance sheet transactions, although clearly intended to misrepresent the true state of the company's finances were (for the most part) neither technically illegal nor (irony of ironies) non-compliant with GAAP (Generally Accepted Accounting Practices).

What is increasingly clear in retrospect is that during the 1990s deception and fraud had in some sense become established norms in the upper echelons of corporate America.[7] In the interests of maintaining a free and

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5 Wall Street settles analyst scandal, http://news.bbc.co.uk/1/hi/business/2981865.stm

6 The Insurance Scandal: Just How Rotten? The insurance industry is the latest financial sector to have its darkest secrets exposed to the light. The Economist October 22, 2004

7 Dr Friedman identified few qualifications on managements' actions "*That responsibility is to… make as much money as possible while conforming to the basic rules of the society,*

liberal economy perhaps we should be re-examining some of these 'customs'. Perhaps a review of the ethical foundation of free market capitalism is in order, to identify just where the responsibilities of management begin and end in a free market system.

Classical Liberalism

The theory of *laissez faire* capitalism owes a great debt to the classical liberals, most importantly its earliest theorists Adam Smith and David Ricardo. On the question of social responsibility opinions varied amongst early liberals, but Adam Smith in *The Wealth of Nations*[8] (1776) proposed one of the most popular solutions to the problem. Capitalists, he recommended, should be left alone to follow their own interests: *'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.*'[9]

Adam Smith championed a doctrine of natural liberty and supported the burgeoning late 18th century reform goal of lifting restrictions on trade; feeling that in removing societal restraints on the rights of property, the actions of individual businessmen would, in the larger collective sense, be guided by an 'invisible hand' that would advance the public interest: *He (the business man) generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it..., he intends only his own gain, and he is in this, as in many other cases, led by an* ***invisible hand*** *to promote an end (the public interest) which was no part of his intention*[10].

What lay behind the 'invisible hand' concept was Adam Smith's sincere belief that free and competitive markets were (are) in a sense self-correcting. This pragmatic doctrine clearly pleased entrepreneurs who made the assumption (not supported in Smith's writings) that the 'invisible hand' absolved them of all larger public responsibilities.

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both those embodied in law and those embodied in ethical custom. It is clear that rewarding 'insiders' became a behavioural norm, or 'ethical' custom in the 1990s.

8 Technically, "An Inquiry into the Nature and Causes of The Wealth of Nations"

9 Book I, Chapter II, page 18. Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, published 1976 by the University of Chicago Press, edited by Edwin Cannan. Cannan's edition of The Wealth of Nations was first published in 1904 by Methuen and Co.

10 *ibid.*, Book IV, Chapter II, p. 477

Smith's Theory of Moral Sentiments

To understand Smith's 'invisible hand' more fully it is necessary to investigate Smith's earlier writings on the subject of moral responsibility: *The Theory of Moral Sentiments* (1759). In this we have a slightly different, and more fully developed idea of ethical responsibility. In *The Theory of Moral Sentiments* Smith identified three factors (or virtues), prudence, justice and benevolence that he felt govern an individual's economic motivations. Prudence for Smith is relatively straightforward; it's simply self-interest by another name. Everyone, he realised, whether prince or peasant, has this sort of motivation. A 'sense of justice' is more complex; for Adam Smith it implies that rational individuals obey the law, and more importantly can be depended upon to obey the law most of the time. Benevolence is where Smith gets more controversial, for in Smith benevolence implies some sort of interest in people to do the 'right' thing even in the absence of specific law.

In *The Wealth of Nations* Smith deliberately focuses on elevating the virtue of prudence or 'self-interest', suggesting that it must be included in any commercial 'bargain' if it is to be entered into enthusiastically and voluntarily. Smith realized that the prevailing 'mercantilist' system of economic organisation was characterised by vast concentrations of economic power and authority. Indeed during this mercantilist period, monarchical benevolence (in its many forms) was, for many, the key to riches in the form of Royal Charters and other monopoly restrictions on competition. It is clear that Smith viewed this restrictive system of economic organisation as unworthy of a rational 'modern' society: *In almost every other race of animals each individual, when it is grown up to maturity, is entirely independent and in its natural state has occasion for the assistance of no other living creature. But man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only*[11].

In concluding his discourse on the subject of self-interest and the division of labour, Smith added, '*Nobody but a beggar chuses to depend chiefly upon the benevolence of his follow citizens*'[12], underscoring his principle that relying solely on the benevolence of others or indeed any one of the other virtues in

11 Book I, Chapter II, page 18. Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, published 1976 by the University of Chicago Press, edited by Edwin Cannan. Cannan's edition of The Wealth of Nations was first published in 1904 by Methuen and Co.

12 *ibid.*, Book I, Chapter II, p. 18.

isolation (self-interest included) was insufficient to sustain a natural liberty. It is clear that Smith's concept of natural liberty rests on individuals maintaining a balance between the three competing virtues of prudence, justice and benevolence: *The man who acts according to the rules of perfect prudence, of strict justice, and of proper benevolence, may be said to be perfectly virtuous.*[13]. For Adam Smith, a system of natural liberty was in this sense dependent upon conscious self-regulation, or self-command, as he preferred to call it. For Smith self-command was a crucial ingredient in the effective operation of a free market system: *'But the most perfect knowledge of these rules (prudence, justice and benevolence) will not alone enable him to act in this manner; his own passions are very apt to mislead him- sometimes to drive him, and sometimes to seduce him, to violate all the rules which he himself, in all his sober and cool hours, approves of. The most perfect knowledge, if it is not supported by the most perfect self-command, will not always enable him to do his duty.'*[14]

It is fair to speculate from a reading of Smith's greater works that the 'invisible hand' for Smith is really personal morality, a function of that balance of virtues, (prudence, justice and benevolence) exercised with knowledge and self-command. It is the consistency with which individuals 'do the right thing', in essence self-regulate their behaviour, that creates the generalised freedom of action in a free market capitalist system. It is also clear from the example of post-Soviet Russia – among others – that the absence of individual self-regulation creates an ethical vacuum leading to criminality, anarchy and eventually to government intervention (i.e. regulation or re-regulation) in the economy. Indeed following a period of unprecedented scandal, the United States is experiencing just such a period of re-regulation today. The extraordinary regulatory requirements of the Sarbanes Oxley Act are only one of many official over-reactions to ethical failure in corporate America. Such a reversal is happening to an even greater extent (in response to a far greater ethical failure) in Russia with President Putin's heavy-handed re-ordering of economic and political power in Russia.

If we accept that the 'invisible hand' presupposes some measure of self-restraint and that 'benevolence' as Smith describes it implies a responsibility larger than maximising corporate profits, what limits are we to place on these so-called 'social' responsibilities? As Professor Friedman pointed out,

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13 Part II, Section III, chapter 1, p. 387. Adam Smith, The Theory of Moral Sentiments, Published by Liberty Classics, Indianapolis, USA. This edition of The Theory of Moral Sentiments follows the text of the 'New Edition' published in London in 1853 by Henry G. Bohn.

14 *ibid.*, Part II, Section III, chapter 1, p. 387

taken to its extreme social responsibility would simply replace prudent business managers with what amounts to (unelected and unaccountable) public servants.

Manage with Knowledge and Self-Command

At the very least 'social' responsibility certainly implies that managers, if they are to serve the interests of the owners of the business, have a responsibility to look beyond their own personal self-interest. Managers must demonstrate sufficient 'self-command' to limit the worst excesses of the 'culture of greed'[15], which clearly overtook senior management in WorldCom, Adelphia, Enron and others during the 1990s. However in addition it is important for managers to demonstrate knowledge and foresight; to appreciate the limitations that apply to the normal 'rules of the game' or established 'customs' in periods of economic transformation such as we are presently experiencing. The economies of the west are being forced to rapidly adjust to globalisation at the same time as they are undergoing a fundamental shift in their asset foundations, moving from economies dominated by traditional 'industrial' type assets to economies that are increasingly underpinned by a suite of intangible 'knowledge' assets[16].

Just how radically and rapidly the 'rules of the game' change can be observed in the AOL merger with Time-Warner. AOL, an Internet service provider had, at the time of the merger, (January 2001) an astonishing market capitalisation of $164 billion (Time-Warner's market capitalisation at the time was $83 billion). Few of Time-Warner's senior managers or board members bothered to question AOL's numbers, most simply followed the 'rules of the game', accepting Wall Street's market-based valuation as true. A sober second look at AOL would have revealed that it was not 'asset light' as described in the press at the time; AOL was, in fact, underpinned by a variety of intangible assets, principally its very expensive brand asset. (Brand asset being a function of the attractiveness of AOL to new Internet subscribers and advertising customers and the willingness of

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15 For a fuller description of this phenomenon see Roger Lowenstein's '*Origins of the Crash',* Penguin, NY 2004 *particularly chapter 3, pp 34–54,*

16 See Britain & Overseas, August 2004 *'The Politics of Political Economy'* and B&O Winter 2004 *'The Knowledge Economy'*. These two papers by the author speak to the expansion that is taking place in the property matrix, and its effect on the underlying asset foundation of western business.

existing customers to continue doing business with AOL.) Because intangible assets do not appear on the corporate balance sheet (they are generally ignored or lumbered collectively into 'Goodwill'), few managers schooled in the 'financial' theory of the business would recognise brand as an asset at all. Therefore AOL's brand and other intangibles were never given a thorough examination, no qualification was ever put on the strength and sustainability of the AOL brand asset[17]. Because Time-Warner executives accepted the established customs, the 'rules of the game', they were completely unprepared for what happened next: the rapid collapse in 2001 of AOL-Time Warner's share price and market capitalisation.

Manage Beyond the Letter of the Law

Whatever else 'social' responsibility might mean, it certainly implies heavily that sound ethical judgment must supplement the 'letter of the law'. The Enron story is illustrative of how managing to the letter of the law can be astonishingly damaging to long-term shareholder value. Enron was (prior to 2001) a company that was known for its innovative spirit creating whole new industries with novel, exciting business models. Unfortunately for long-term shareholder value, so new were its 'novel' industries, new economy business models etc. that the company's auditors and legal advisors hardly knew what to make of them, opening the door to all sorts of nefarious practices by Enron's management.

As it turns out, very few of the fancy accounting manoeuvres or special purpose vehicle (SPV) structuring options put together by Enron management with their Andersen (auditing) partners were technically illegal – at the time. Nor indeed were its manoeuvrings greatly at odds with prevailing management and/or accounting customs. What is clear in retrospect is that most of the more creative activities existed in the legal 'grey zone' where the law and accounting standards had yet to catch up with the fast pace of economic change. The cumulative effects of these practices however, were fraudulent, devastating to Enron's debt holders, shareholders, employees and its own long-term prospects. Eventually various individuals did go over the legal line, but at every step of the way had Enron's senior management applied ethical judgments[18] to its own

17 Fools Rush In, Steve Case, Jerry Levin, and the Unmaking of AOL Time Warner, Nina Munk, HarperCollins New York, NY. p 179

18 Western ethical philosophy distinguishes three aspects to any action that an ethical value can be attributable to: (1) Motives, (2) Means and (3) Ends or Consequences

motivations (clear intent to mislead), and/or looked rationally ahead at the ultimate consequences of its actions (potential bankruptcy), there is no doubt they would have seen a vastly different picture[19]; perhaps they might have done things differently.

Accommodate Societal Change before it bites you on the behind

Despite Adam Smith's noted scepticism about '*those who affected to trade for the public good*' there is certainly implied in Smith's notion of benevolence a necessity for management to proactively respect larger societal changes, issues that Dr. Friedman dismisses out of hand: … *businessmen believe that they are defending free enterprise when they declaim that business is not concerned 'merely' with profit but also with promoting desirable 'social' ends; that business has a 'social conscience' and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers.*[20]

The 20th century was one of the most revolutionary in history, characterised by dramatic societal changes, in particular by a wholesale elevation of the interests of women, working men, visible minorities, the handicapped and other historical 'underdogs' in society. No senior manager today can ignore these major societal changes in their approach to marketing, hiring policy or planning; to do so would put their organisations at risk of losing precious market share, becoming involved in serious litigation, or worse. As for pollution, ask Lloyds of London if the Exxon Valdez or asbestos pollution are problems or merely the catchwords of reformers. Perhaps in 1970 corporate managers could pretend to ignore the consequences of pollution, today they cannot. Pollution's rise to prominence was simply a matter of society coming to grips (often retroactively) with externalities, something Samuel Brittan referred to as the '*spillover effect… in other words, costs and benefits imposed on others, which are not taken into account in*

of action. In other words, ethical value can be attributed to the motives or originating logic behind a given course of action, the means by which an action is undertaken and ultimately the ends or consequences of actions. These motives, means and consequences can all independently be assigned ethical value and in many cases can be judged quite differently.

19 The Smartest Guy's in the Room, The Amazing Rise and Scandalous Fall of Enron, Bethany McLean and Peter Elkind, Penguin Publishing, London, WC2R ORL, UK. p. 151, Chapter 11, Andy Fastow's Secrets.

20 The Social Responsibility of Business is to increase its Profit, Milton Friedman, The New York Times Magazine, September 13, 1970.

an unregulated market'[21]. Pollution is a serious social – and business issue – to suggest that it is beyond the scope of management responsibility, or worse – socialism in disguise – is irresponsible.

Preserving Free Market Capitalism

Dominic D'Alessandro, the head of Canadian insurance giant Manulife Financial Corporation, complained recently that the corporate governance pendulum *'may have swung too far.'* More to the point he added: *'It is now becoming fashionable to believe that corporate (management) behaviour should always be viewed with suspicion…this is a very dangerous premise upon which to develop a governance regime.*[22]*'* Unfortunately for Mr. D'Alessandro (and others who value free market capitalism) that is precisely the lesson that legions of legislators and regulators around the world are taking from the events of the recent past. If individual senior managers are unable or unwilling to regulate themselves, it is clear that governments will – eagerly – step in and regulate for them.

The question we all face today is the eternal one in any free enterprise system: will capital continue to enjoy its traditional freedom of action – the full run of its '*animal spirits*' – as John Maynard Keynes described them[23]? Or is global capitalism going to be subjected to an ever-growing host of bureaucratic constraints? The next steps taken in this arena could dramatically influence the future of capitalism. It is becoming increasingly clear that if we are to maintain a free market system founded in the principles of natural liberty, the burden of responsibility falls upon each and every one of us as individuals. It's no exaggeration to suggest that without greater knowledge and ethical accountability – including meaningful behavioural reforms at the management level – the very existence of a self-regulating free market system could be imperilled.

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21 What's Wrong with Economics?, Samuel Brittan: Chapter 21 of Economic Consequences of Democracy, Gower, 1977, 1988.

22 The Globe and Mail, May 3rd 2005, Report on Business

23 '*Thus if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die.*' Keynes, J., 1936, General Theory of Employment, Interest and Money, New York: Harcourt Brace 1936, p. 161).

MONEY PROBLEMS IN CHINA AND JAPAN

Reported from Radio Free Asia 9th May 2005

Ma Kai, director of China's National Commission on Development and Reform, expressed his concern about the nation's excessive investment in fixed assets and called it 'the unhealthy and unstable element' in China's economy. Ma made the observation at the 2005 Working Conference of Reform on China's Economic System held on April 24.

The adjustment of capital investment is the key link in China's macro-economic policy. A year after counter measures were introduced, however, the rate of over investment is still not being effectively controlled. In 2004, capital investment in China rose 25.8 percent over the previous year, considerably higher than the growth rates of the national consumption and income.

The rate of over investment is represented by both the overall high rate of growth, and the unreasonable tilt towards the secondary industry. The growth rate of capital investment in the secondary industry exceeded that of the overall capital investment by 50 percent. Even in real estate, the sector designated by the government as a target for readjustment, investment rates are still significantly higher than the overall level. This has raised questions about the effectiveness of the government's macro adjustment policy and worsened China's already irrational economic structure.

There are multiple reasons for China's inability to effectively control its capital investment. The main cause lies in its distorted dynamic mechanism and the poorly managed state credit system. China's economy is only partially market driven. While many end products have been governed by market forces, China's financial system, the lifeline of its national economy, still stays away from the stabilising element of market forces. The banking system in China is highly monopolised by the government. Such monopoly manifests in the state ownership of major banks' assets, and the banks' lack of autonomy and flexibility in determining interest rates and management.

Thus, a weird combination appears in China's economy of the state banks, with banks acting out distorted and rigid behaviour and savvy bank clients using this to their financial advantage. In this combination, banks will undoubtedly end up losers. This is because the bank managers lack the motivation to adjust and control credits based on market forces. Instead, they are able to join clients in seeking self-restraint by expanding credit.

The end result is excess expansion of credit and multiplication of bad accounts.

Another major reason for China's over investment is the administrative interference by governments at various levels in economic affairs. Ostensibly, the central government is determined to control the capital investment. Meanwhile, governments at local levels have made up their minds to push for more capital investments. Why, then, are the local government officials so insistent on scoring their political points through this situation? There are both public and private reasons behind it. On the public side, the local governments need to increase revenues and create more jobs. The simplest way to accomplish both is to inject more resources into capital investment. On the private side, hidden behind each project are huge kickbacks for departments and the related officials. The existence of these kickbacks is a well known fact in China. For these two reasons, local officials are absolutely tireless in lobbying for more capital investment.

In this battle between those who support controlling capital investment and those who are against it, one or two central departments have to face numerous local governments with various motives. Furthermore, central government officials are merely fulfilling their routine duties, while stakes are high for local officials. So the battle has really been decided before it even gets started.

A rate of excessive capital investment tends to occur in planned economies, and is relatively easy to be checked through administrative measures. Under the partial market and partially planned economic system that exists in China, this phenomenon appears more easily and is harder to control. This is due to the fact that government measures are restricted by warped market forces, and the economic possibilities that result become irresistible to already corrupt government officials.

Meanwhile in Japan …

'Some economists argue that rushing to mop up liquidity before deflation is defeated is dangerous. Liquidity targets should be maintained, or even expanded, until inflation is firmly entrenched.'

(Wow!)

Reported by David Pilling, Financial Times, 21st May 2005

BAD FOR BUSINESS?*

Are business schools responsible for what is wrong with corporate management

This is the time of year when MBA students run not from classroom to classroom but from interview to interview as they try to get the high paying job that they expect their qualification to deliver. It seems that the demand for MBAs is now strong again, after four decidedly weak years. Average starting salaries in investment banking for New York's Stem School graduates were – at $95,000 – up by $10,000 from a year ago. But just as the market value of an MBA is reviving, its academic credibility is being attacked. In a posthumous article in Academy of Management Learning & Education, Sumantra Ghoshal argues that many of the 'worst excesses of recent management practices have their roots in a set of ideas that have emerged from business-school academics over the last 30 years.'

Mr. Ghoshal was just such an academic, a professor at London Business School until he died 11 months ago at the age of 55. He believed that the desire of business schools to make the study of business a science, 'a kind of physics', has led them increasingly to base their management theories on some of the more dismal assumptions and techniques developed by economists, particularly by the 'Chicago School' and its intellectual leader, Milton Friedman. These include supposedly simplistic models of individual human behaviour (rational, self-interested, utility-maximising homo economicus) and of corporate behaviour (the notion that the goal of a firm should be to maximise shareholder value). These assumptions, though in Mr. Ghoshal's view badly flawed, were simple enough to allow business-school academics to develop grand theories of management supported by elegant mathematical models and empirical analysis that appeared scientific, and thus earned their subject academic respectability, but were, in fact, a pretence of knowledge where there was none.

Mr. Ghoshal's article is particularly critical of the management theories associated with two prominent Harvard Business School professors: Michael Jensen, whose development of agency theory has encouraged business schools to teach 'our students that managers cannot be trusted to do their jobs'; and Michael Porter, whose 'five forces framework' has been presented to 'suggest that companies must compete not only with their competitors

* Bad for Business contains extracts from an article originally published by The Economist, London.

but also with their suppliers, customers, employees and regulators.' A particularly worrying feature of these theories, says Mr. Ghoshal, is that they have no 'role for human intentionality or choice'. And not only do such theories falsely claim to be scientific, teaching them can make them self-fulfilling. Business-school students learn that managers cannot be trusted – so when they become managers their behaviour is of the untrustworthy sort. Students have been freed 'from any sense of moral responsibility'. Hence scandals such as those at Enron, where business-school educated executives were prominent. And hence, perhaps, future Enrons yet to be created by this year's much-in-demand crop of MBAs.

Mr. Ghoshal is not the only heavyweight academic to have come out with such a *mea culpa*. Jeffrey Pfeffer of Stanford University's Graduate School of Business, writes in the same journal that Mr. Ghoshal 'if anything understates the potential downside to the inculcation and acceptance of economic language, assumptions and theory'. In support he refers to a study in 2000 which found that a link between corporate size and the number of citations for violating health and safety regulations became stronger as the percentage of a firm's top managers holding an MBA rose. In a book published last year, 'Managers not MBAs', Henry Mintzberg, a Canadian business professor and a long-time critic of the degree, wrote that 'the MBA trains the wrong people in the wrong ways with the wrong consequences'.

Not surprisingly, many business schools reject these claims. It is hard to square Mr. Ghoshal's claim that recent scandals were the result of managers too eagerly trying to maximise shareholder value with the fact that shareholders have been some of the main victims of their actions. Nor for that matter is it true that everything taught in business schools is presented as scientific. Harvard and Stanford are among those to have introduced ethics classes into their MBA courses. This year's class of MBAs is coming from more ethics-conscious schools and, indeed, is being hired by more ethics-conscious businesses than any of its predecessors. But will that be enough to make firms, or their managers, more ethical?

FOOL'S GOLD

Ciarnan Parker & Gerry Griffin Published by Spiro Press 2005 Price £14.99

Visiting a leading City of London financial specialist bookshop my interest was in finding *Greenspan's Fraud* by Ravi Batra. This was a disappointment – a quick glance showed it to be just yet another Ravi Batra book based on the notion that when the distribution of incomes widens sufficiently there is trouble ahead. Batra has written a long list of books on this theme, such as his 1980s book *The Coming Crash of 1990* which had successfully forecast a non-event. This new book seemed to be supplemented by rafts of criticism of Alan Greenspan's career which seemed both familiar and irrelevant.

So instead another book on the 'current best sellers' rack drew my attention. *Fool's Gold* looked more useful. Subtitled 'Cautionary Tales of Greed, Speculation and Delusion', *Fool's Gold* has chapter headings on Speculation, Insider Trading, Power Play, Delusion – and more, plus chapters on notable figures such as George Soros, Jay Gould and Marcus Daly. This promised interest, analysis and some help in understanding the likely future direction of stock market prices, property movements and general investment strategies in a world of excess liquidity promising to inflate asset values during the coming decade. After all, it *is* a current best seller.

The two authors, both founders of a five year old company in London known as the 'Business Communication Forum' are Irish but the tone of the writing is leadenhandedly American. There is a kind of longwinded repetitive assertiveness labouring as novel concepts points which one knows already or are really very obvious. The assumption is that the reader has asked supinely naive questions to which grand superficial answers will bring profound enlightenment. Such a style makes for hard reading and boredom.

But it would be uncharitable not to forgive transatlantic conferencespeak. Businesses both there and (sadly) here, pay good money to have their junior executives hectored by the lectern-gods in this way. What of content?

'Speculation' looked promising – a possibility here for graphs about the prices of tulips in 18th century Holland, of golf membership costs in 1980s Japan and of the relationships between 1920s US stock market prices and (perhaps) US money supply or interest rate changes or the Terms of Trade. Charts could be displayed about the South Sea Bubble or, even if this was unyielding to patient research, at least some hard facts could be set out on

the amounts speculated in com shares in the 1990s. But no, just waffling prose, generalisations, moral homilies and questions given as conclusions.

'Insider Trading' on which, to some extent, all markets rely to make the world move on could also be subject to useful research. Surveys, brokers opinion polls, a review of legal cases, a summary of Inland Revenue investigations perhaps – anything to give some insight into the scale and pervasiveness of the problem would be welcome. But again, just generalities, some descriptive notes on individuals who have engaged in this activity and bland conclusions assumed to satisfy those who might have misunderstood the meaning of the term. A quicker way forward would be to look it up in a dictionary.

'Greed' is the opening chapter. We are told that this is what makes us all motivated but it is bad if taken to excess. References are made to biblical prescripts and to Sigmund Freud's use of the word when analysing childhood experience based adult behaviour. This is the high point of intellectual stimulation to be found in the book – but it only takes only a few lines.

So what of the mighty fortune-makers to serve as role models for those eager junior executive hopefuls? What do we learn of George Soros and Jay Gould? Certainly we know that mention of their names awes a business audience but by the end of these personal account chapters one is ringing one's hands in desperation for any tip, code, method or other pearls of wisdom. Any newspaper article in the serious financial press would be more worth reading than this.

In short, as a student project this book would warrant 'fail'. It is not recommended to members.

ELECTRIFYING BRITAIN –
FORWARD WITH COAL, GAS OR NUCLEAR?

NEW ERC Research Paper No. 21

Britain has an emerging energy hole and it can only be replaced – in scale – by coal, gas or nuclear power.

To quote the Cabinet Office's Performance and Innovation Unit's Energy Report of 2002:

> The current level of electricity generation in Great Britain is about 70 Gigawatts. In very broad terms we would expect one-fifth of the generating capacity to need replacing by 2010, one half by 2020, three quarters by 2030 and almost all by 2040.

The government however, has not heeded the urgency of its own report. It has overstated the case for renewables, anticipating its emergence as a full-scale replacement for large coal and nuclear power while gas will have to be increasingly imported from abroad, as the North Sea fields are run down.

In an earlier ERC Research Paper, *Recharging The Nation*, I looked at the potential for the expansion of off the shelf renewables available to the UK. Two years ago I concluded that it would be very hard to achieve 20% renewable electricity generation by 2020 without a Severn Tidal Barrage. Since then, renewable economics and technologies have not markedly improved, yet the government continues to dither, further increasing the odds of an energy crisis by simply not replacing lost capacity.

There has been too much debate about renewables – a relative sideshow – and next to none about conventional power. That's why to complete the research picture and to stimulate informed public debate, the ERC has commissioned three excellent studies by Messrs Lodge, Cragg and Grimston, experts in respectively coal gas and nuclear. They have concisely and comprehensively assessed the technological and economic cases for each power source. The Paper is intended as an independent guide through the maze of prejudiced interest groups that bedevil the energy industry. It is then left up to the reader to decide, which is the most suitable for Britain: coal, gas or nuclear?

Dan Lewis

LETTER

A Topical Comment from Mr Brian Lewis

Dear Sir,

My haircut in Manila costs me £1.30: my Japanese lunch of sashimi and sushi here £1.40: one litre of petrol is 30 pence. A junior assistant's wages in Manila are £100 a month. The ratios to UK prices are between 6, 10, 3 and 10. Now why should this be so? Most economic commentators accept it as a given and pass by on the other side. Yet the implication is that barriers erected are impossibly high and will not be lowered. Yet the Philippines is said to be teetering near economic collapse and 8 million Filipinos are already working overseas (90,000 in the UK).

Such differences in price must be due to huge and ruthless restrictions on free passage of people and trade between the West and the rest of the world. Yet our politicians, aware of problems in Africa and elsewhere, like to give the impression that a few strokes of the bureaucratic pen – and a bit more aid and debt forgiveness will solve all. The word "ruthless" again comes to my mind.

Some cures to global poverty are obvious. Reducing tariffs in Europe, Japan and the USA on rice, cotton, sugar and coffee (and other agricultural commodities) from developing countries would go a long way immediately to reducing global poverty. But it does not happen. It must take some gall for a Western politician or entertainer to sing pretty songs for Africa, and yet remain the squeezing, wrenching, grasping, scraping, clutching, and covetous old sinners that they are in defence of their own interests.

In 1945, I had a bicycle, and the environment and I were happy. Will that time come again?

15 Calcutta Street
Merville Subdivision
Parañaque MM

NEW MEMBERS

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

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

OBJECTS

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.

BENEFITS

Members are entitled to attend, with guests, normally 6 to 8 talks and discussions a year in London, at no additional cost, with the option of dining beforehand (for which a charge is made). Members receive the journal 'Britain and Overseas' and Occasional Papers. Members may submit papers for consideration with a view to issue as Occasional Papers. The Council runs study-lectures and publishes pamphlets, for both of which a small charge is made. From time to time the Council carries out research projects.

SUBSCRIPTION RATES

Individual members	£25 per year
Corporate members	£55 per year (for which they may send up to six nominees to meetings, and receive six copies of publications).
Associate members	£15 per year (Associate members do not receive Occasional Papers or the journal 'Britain and Overseas').
Student members	£10 per year
Educational Institution	£40 per year (for which they may send up to six nominees to meetings and receive six copies of publications).

APPLICATION

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.

APPLICATION FORM

To the Honorary Secretary   Date ....
Economic Research Council
7 St James's Square
LONDON SW1Y 4JU

APPLICATION FOR MEMBERSHIP

I am/We are in sympathy with the objects of the Economic Research Council and hereby apply for membership.

This application is for *(delete those non-applicable)*

Individual membership (£25 per year)
Corporate membership (£55 per year)
Associate membership (£15 per year)
Student membership (£10 per year)
Educational Institutions (£40 per year)

NAME ....
(*If Corporate membership, give name of individual to whom correspondence should be addressed*)

NAME OF ORGANISATION ....
(*if Corporate*)
ADDRESS ....
....
....   TEL. ....

PROFESSION OR BUSINESS ....
REMITTANCE HEREWITH ....
SIGNATURE OF APPLICANT ....
NAME OF PROPOSER (*in block letters*) ....
SIGNATURE OF PROPOSER ....