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

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Prosperity in the Aftermath of Crisis – *Oren Sussman* 3
The Future of Private Equity, Post the Crisis – *Tim Jenkinson* 7
Britain's Banks II: How to Restructure our High Street Banks – *Christopher Meakin* 11
The UK Motor Industry, Past, Present and Future – *Paul Everitt* 16
The 'Tripartite Concept' and the Revival of British Manufacturing – *David Fifield* 20
Cantering Around our Economic World – *Damon de Laszlo* 24
The Alternative Manifesto 25

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PROSPERITY IN THE AFTERMATH OF CRISIS

Extracts from a talk given by Professor Oren Sussman, Said Business School, to members of the Economic Research Council on Tuesday 2nd March 2010

Growth and Risk

'Nothing ventured, nothing gained' is a wise old saying that has historically applied to macro as well as micro economics. In the 18th century Britain moved from the 'security' of mercantilist controls (even the local blacksmith needed the local authority's permission to trade) towards risky economic freedom and the industrial revolution was on its way. In the 19th century risky freedom in international trade progressed and the world economy grew.

This point can be illustrated by Figure 1 using United States figures. The horizontal axis shows average rates of economic growth for 25 year periods 1800–1824, 1825–1849, and so on. A reading towards the right shows a more prosperous quarter century than one towards the left. The vertical axis indicates the level of risk measured by the variation ('standard deviation') in growth rates during each 25 year period. A reading towards the top shows a quarter century when growth rates varied greatly whilst a reading lower down indicates a more steady year-by-year performance – ie one that is 'less risky'.

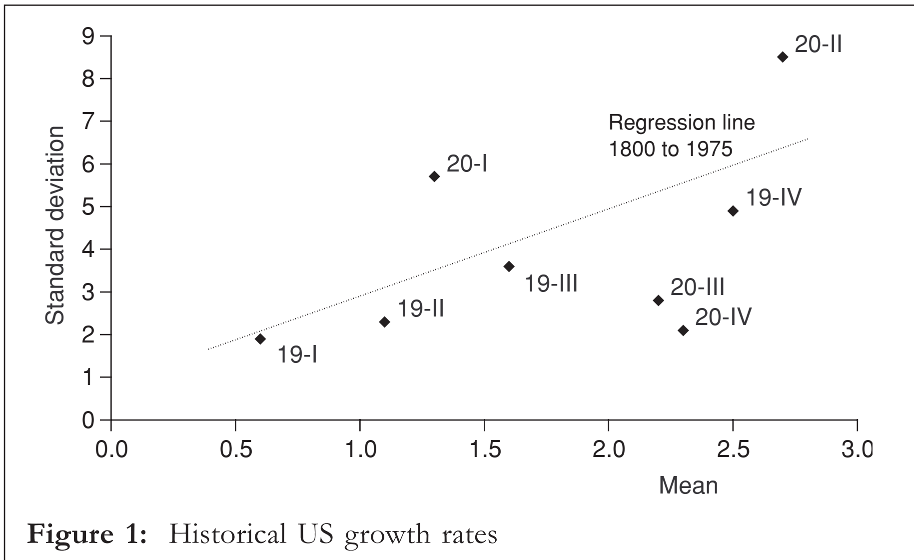


Figure 1: Historical US growth rates

Up until 1975 (the end of the 20-III quartile) the pattern is clear as indicated by the dotted regression line, especially if we make some allowance for the impact of the two world wars. But reading 20-IV is out of line, so what has happened since 1975? And what now for the future?

Expectations and outcomes 1975–2010

1975 was actually quite a nervous year. In 1971, the US had announced that it had abandoned the convertibility of the dollar to gold, signalling the breakdown of the Bretton Woods pact and the fact that exchange rates from then on would fluctuate with market forces rather than managed by governments. At about the same time steps were being taken to curb the powers of the trades unions. Both the foreign exchange markets and the labour markets would have to stand on their own. These were bold steps into a riskier world. The future did not look too rosy – in 1975.

But the outcome – reading 20-IV – has been steady continuous relatively high growth rates. This could be interpreted as just a temporary stroke of good luck but a more optimistic interpretation is that governments succeeded in telling the market and voters that they could not guarantee the stability of the foreign exchange and labour markets any longer and that these two markets would have to work to survive on their own; they would have to cope with functioning in these markets without relying on help from any authorities.

The foreign exchange markets have indeed succeeded moment by moment in setting the prices of the various currencies taking into account all the relevant information. (One could say that each foreign currency is essentially a 'security' whose trading obeys the 'official market rule' – the notion that all the relevant information is incorporated into the price – the 'informationally efficient price'.) Risk has been 'contained' whilst growth has been 'maintained'. And each time that governments or central banks have tried to manipulate foreign exchange rates (ie create a deviation from the 'informationally efficient price') they open, almost by definition, the door for speculators who can make a huge amount of money at our expense. Black Wednesday cost the UK tax payer £3.3bn, with the additional embarrassment that the money was lost to foreign speculators.

Now if this is the case with the foreign exchange market, then there must be some analogy to the financial market which is the big question today. Can we keep on thinking about the financial market in terms of controls and restrictions in the same way that the Bank of England used to think

about the foreign exchange market, or the European Union kept on thinking about the foreign exchange market, at least until Black Wednesday?

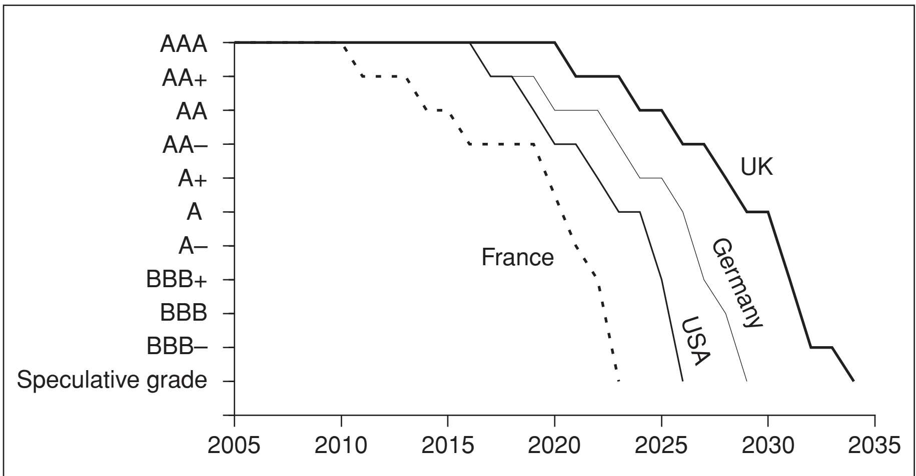
Today's 'too big to fail' financial institutions

The subsidy involved in the protection that the 'too big to fail' institutions are getting, if you include the money involved in the Troubled Asset Relief Program, amounts, in the US to something approaching $34bn.

This is a huge sum – something like double the US expenditure on temporary assistance to needy families. This comparison tells us something, not only about affordability, but about the ability of the government to convince voters that it is really worth paying such sums in order to save the big institutions on Wall Street.

And the true cost is higher still because of the substantial fall in tax revenue during the three to four years that the crisis is going on. Which all means that the national debt rises – Standard & Poor have projected that all the developed countries are going to lose, sooner or later AAA rating for their government bonds with even the possibility that they will lose investment grading, perhaps as soon as 2020 or 2025.

So my guess is that it will be impossible to sustain the financial markets through subsidies from the state, and these markets will have to go through



Source: Financial Times. March 21, 2004

Figure 2: The decline of the rating of government bonds

the same processes that the foreign exchange market had gone through by 1975 and this is, essentially, to learn how to walk on their own without help from the federal government or the national budget in the UK.

How financial institutions will learn to 'stand on their own feet'

What do the financial markets need to learn, and to what extent can they still be helped by the state? When I say that markets will have to learn to walk on their own, I don't mean that the state has no role whatsoever in these markets. We all rely on the state to provide important information for example. To expand that point, in the US we rely on the state via the Food and Drug Administration, to give us information about what kind of food and drugs are safe, but we don't expect them to commit large amounts of money in order to compensate us if in some cases the market gets it wrong. More specifically, what will need to happen is the following. First of all, there will need to be a receivership system for banks that go bust and this was not quite the situation before this crisis. Actually it is interesting that in the United States the Federal Deposit Insurance Corporation does work like a receiver, like an English receiver of the old days. It has the power to seize control over a commercial bank that has become dysfunctional, take the assets and sell the whole thing if possible as a going concern as quickly as possible and with least interruption to business and depositors, in order to run the institution more efficiently. This doesn't quite exist for large financial institutions so one thing that we need is the ability of the government to work as a receiver, to seize control over institutions that have become dysfunctional.

The second thing that needs to take place is that banks will need to hold much more capital.

The third thing that needs to happen is that the regulation of these institutions will have to become much more market led and I want to point your attention to an interesting piece of research that has been done recently by two American economists, Hart and Zingales[1], (Hart is British actually but working in the United States) and the idea that they try to promote is the following. That we have to think about the capital of big financial institutions, just as we think about traders' margin requirements. This is a piece of capital that is being put on the market and is taken away

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1 Oliver Hart and Luigi Zingales, 'A new capital regulation for large financial institutions', Pub. Centre for Economic Policy Research, Paper 7298

by the broker whilst the position turns negative. So the way they suggest to apply the same idea to bank capital is to use indicators that are taken from subordinated debt of American or any big listed banks. Then we wait to see if the spread over these subordinated debts is widening to a certain point automatically, either the capital is being taken away or if the owners can top it up they can retake control over the banks. This would be way more market oriented and does not commit the government to inject large amounts of money into the market in case things go wrong. My gut feeling is that the amounts of money have become too big and the basic funding of the government too weak in order to allow financial markets to operate on the expectation that if something goes wrong the government will step in.

THE FUTURE OF PRIVATE EQUITY POST THE CRISIS

Extracts from a talk given by Professor Tim Jenkinson, Professor of Finance, Said Business School, Oxford University and Director of the Oxford Private Equity Institute, to members of the Economic Research Council on Thursday 28th January 2010

The term 'private equity' refers to fund managers who raise money from investors and then risk this money on anything from venture capital to help start-up and innovative firms right through to big buy-outs; money for growth and money for restructuring. In fact the venture capital end of this activity has been disappointing, earning very low or negative returns on average and so, not surprisingly, most of the money has gone into restructuring. In Europe there have been lots of opportunities to do cross-border deals and link European businesses in what had been a relatively fragmented industrial picture.

Looking therefore at the restructuring end of these activities, the fundamental issue is: what are the sources of value added? What advantages does private equity have over 'public equity' (where investors provide funds by buying extra shares in firms that are restructuring) or other forms of financing? What can be achieved when a private equity fund, after a buy-out, both owns and controls a company – as compared to public equity where there is a separation of ownership from control with all the corporate governance questions that are expensively involved?

Six possibilities come to mind:

i) Superior governance. Managers can focus on value creation without as much distraction with compliance, codes (and lawsuit avoidance).
ii) Given that public equity firms must aim at quarterly announcements of results whilst private equity firms often have a holding period of three to five years, fundamentally transformative things can be achieved which perhaps couldn't be done under public equity.
iii) Investors can benefit from optimal financial and tax structures – high leveraging raises equity returns and offshore arrangements can reduce tax liabilities.
iv) Managers can be offered eye-watering incentive arrangements – the chance perhaps to increase their funds invested by ten or twenty times if they stick to the plan. Such sharp incentives can be absolutely transformative.
v) Sometimes, though not as often as one might wish, good market timing can mean that companies can be bought cheaply, sold in better times, and
vi) In the private equity sector there are smart people with new ideas who can bring value to conservatively managed companies.

The sums raised by private equity have, in recent times, been impressive. Figure 1 shows that in 2008 private equity raised about twice as much as

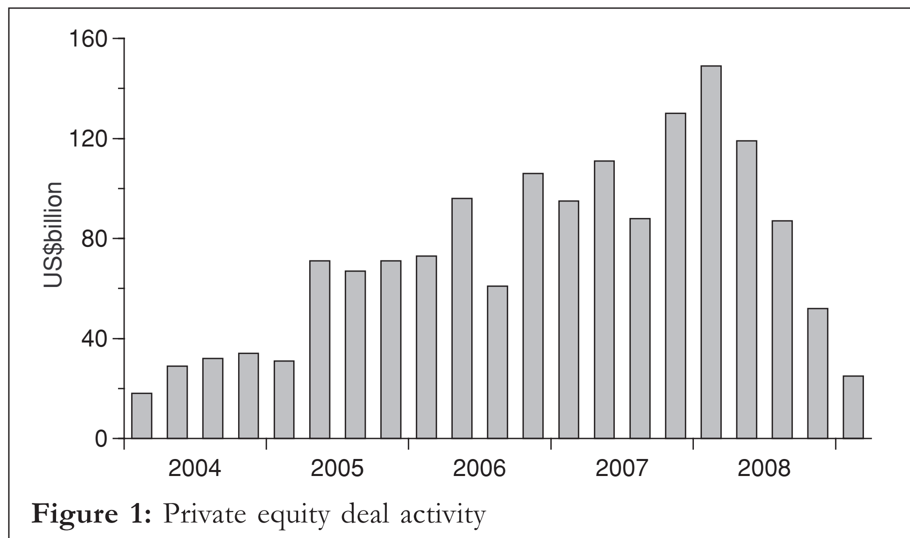

Figure 1: Private equity deal activity

the UK government is borrowing this year! Again, in 2007 private equity deals accounted for around 15% of all mergers and acquisitions.

Private equity is attractive to investors because the alternatives are or have been disappointing – a decade of low returns on equity accounts and a desperate need by pension funds for extra returns to meet their liabilities for the next few years. And we should note that Europe has a long way to go to catch up with the level of investment that has been made in America in private equity. But the problem in the current crisis is that the expected returns have, for the moment, dried up and so investors representing pension funds, endowments and fortunes are reluctant to extend their commitment and are fed up with the whole scene and all the costs involved – fees upon fees for doing everything from management, to arranging debt finance, to sitting on the board, to getting out of bed in the morning ….

Remember that buy-out deals are typically done with high leverage, perhaps 30% of the money coming from equity and 70% from bank loans. When earnings by the acquired company fall, as they will have done in the current crisis, all the income must go to the banks. There may be nothing left for equity. And the banks would prefer to offload their debts as much as possible. And so a lot of the deals done two or three years ago are deep under water. We might call them zombies – the living dead because the banks choose not to foreclose. You therefore do need to ask 'who are the private equity firms working for, their investors or the banks?' Often

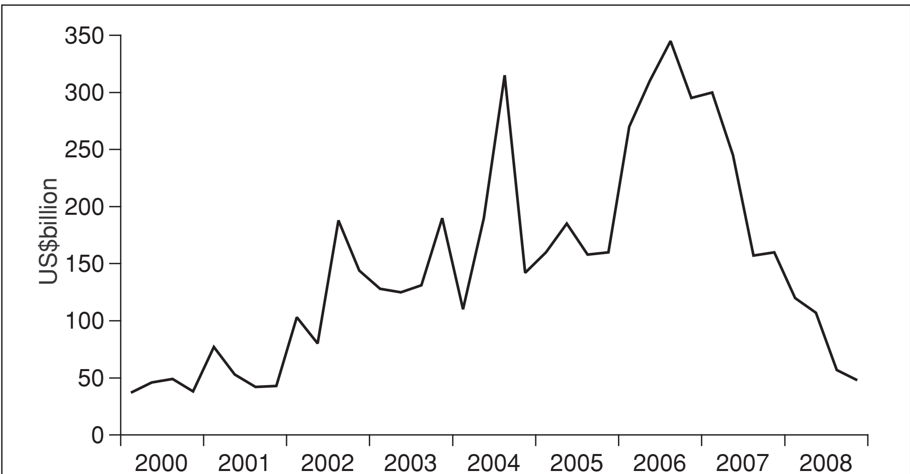

Figure 2: Private equity fundraising

the fund managers are anything but 'Masters of the Universe' and some of the shenanigans between banks and private equity firms are, I think, disgusting.

And we should notice that a high proportion of deals have been mere sales of existing buy-outs between different funds – adding more debt each time. I have seen one estimation of there being around 300 investments from hell currently languishing in City institutions' portfolio.

So private equity firms must now become more realistic – realise that 15% is a good rate of return as against the hoped for 25%. And General Partners in these firms need to remember that although expected equity returns increase with leverage, this increases risk and does not create value of itself.

The current crisis has caused huge problems for private equity – existing investments are in trouble, governments and pension regulators are threatening tax and regulatory changes, and managers have raised large sums which now need to be invested if they are to keep the fees they have already charged. Small wonder that there is relief that at least now bankers have replaced private equity bosses as the City bad guys. This is the 'negative approach'.

The alternative, positive, view is to say that there is a role for private equity but there needs to be a shake-out – and we are at the worst point in that process right now. Economic conditions will probably improve and leverage lending will probably return. In fact it is already returning and might even return to 2004 levels.

In the meantime, private equity managers are buying minority stakes in public companies (possibly for want of anything else to do), and are re-visiting existing deals to relieve the banks of some debt into equity. And for the future, some managers are looking south and east – to Africa and to India and beyond. Some funds are really specialising in these areas and making good returns – though the economics are very challenging. With high costs, small funds and low fees this is a very different world to the previous multi-billion dollar scene.

So it is a very mixed outlook. The banks are bearing part of the risks – through past silly lending, and a continuation of the stock market recovery is hoped for. I hope that quantitative easing, when it goes, doesn't affect asset prices and interest rates in a very serious way. There are going to be many very difficult re-financing decisions, whether to put more money into the deals or not, in the next few years. But fund raising *is* really challenging

(which is the justification for high rewards) and many funds will probably disappear in the next few years.

But in time I think that the private equity sector will grow. Understanding of how much this really adds to economic well-being is limited – and academic research could make a big difference. This may well be a good moment for some very well chosen investments in this sector.

BRITAIN'S BANKS II:
HOW TO RESTRUCTURE OUR HIGH STREET BANKS

*By Christopher Meakin**

In the last issue of Britain and Overseas the present writer took a hard look at the causes of the recent crises in banking, primarily Anglo-Saxon banking, and specifically at the immoral excesses of its bonus culture. The article went on to suggest a way of restructuring bank accountancy so that the bonus culture which has caused so much public outcry in recent years could instead be helped to die of natural causes.

This article now takes a fresh look at the plight, or rather the near plight of the victims of that drawn-out calamity. The liquidity crisis in banks (it was never really a capital crisis, except in certain ill-managed cases such as Northern Rock) triggered many ordinary people into staging a 'run on the bank' – unseemly activity more frequently associated with third world countries. If further evidence were needed, that sequence of events demonstrated all too clearly that the structure of our retail banking industry is no longer, to use the fashionable phrase, 'fit for purpose'.

There is an old saw about banking and it runs thus: 'Owe the bank fifty thousand pounds and the bank owns you. Owe the bank fifty million pounds and you own the bank.' So let's take a look at what can, (and I believe should) be done for the people who owe the bank, give or take, fifty thousand pounds.

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* *Christopher Meakin is a former head of public affairs for two of the world's largest banks, a former Fleet Street financial journalist and a Fellow of the Royal Statistical Society.*

The first aim must be to separate the bank which looks after their money from the bank which looks after the money, or rather lends vast sums to, a major public corporation. There is a vital and fundamental difference between the two. The large company can afford to employ a highly-paid treasurer, or perhaps finance director, who can then play the big banks at their own game on equal terms. As noted, if they owe the bank an eight figure sum then they do have quite a lot of leverage. Such finance experts are paid a very generous salary to handle their company's banking needs, and no doubt rewards their employer with more financial savings than the substantial cost of employing them.

Now contrast Mr and Mrs Brown of a Town Somewhere In Britain. They enjoy no such expert assistance : instead they have to struggle to understand the gobbledygook and do it all by themselves. Yet the big banks treat them as insignificant and inexpert miniaturised versions of their big company customers. According to everyone from the Consumer's Association to the Financial Services Authority, such small private customers are fed a diet of often misleading information, all too often spiced with extortionate fees for doing very little. Such is the behaviour of big banks today toward their little customers. There are times when the fury of the medieval church against 'usury' is brought vividly back to mind.

There is an obvious reason for this cocktail of banking disdain, indifference and poor service. None of the 'small' customers is any longer, individually, of any importance to his or her bank, no matter how much money is lavished on flashy advertising agencies to try and persuade them otherwise. Thus a small business involving the present writer was promised by NatWest that its business account would be conscientiously looked after the same person for at least two years, a grandly-titled 'Relationship Manager'. In practice, it was never the same person twice running.

Most readers of this article must by now be sick and tired of having to start at Square One each time they need to explain their particular financial circumstances to yet another ill-informed functionary of their bank : 'My name is grumble grumble, and how may I help you today?' It is a joke, but not one from which we can extract very much laughter. Money is but rarely a laughing matter, even if big banks seem to see it that way themselves.

The United States began to acknowledge some of these problems over eighty years ago. The American banking industry has much more of a huckster origin than its British equivalent, which originally developed to meet the needs of an educated and literate middle class. America's banking industry in sharp contrast developed to open up the country, its customers

and managers alike often a bunch of very rough diamonds. Inevitably all kinds of endemic fiddles and dishonesty followed, and these problems came to prominence when the Great Depression pushed millions of debtors into huge difficulties.

So in 1927 Congress passed the McFadden Act. It prohibited America's banks from operating in more than one state. In extreme cases such as Illinois they were even prohibited from opening more than one branch, and well into the 1980s the international bank of Continental Illinois still operated from a single gigantic building in Chicago. By the late twentieth century with the advent of computers and then hole in the wall banking, MacFadden was eventually repealed. But for the half century of its existence it patently ensured that American banking was truly local in practice, and not just in unconvincing advertising hype.

America's banking problems did not stop there. The deep-rooted conflict of interest between the need for ultra-safe retail banking for private individuals and small businesses, and the very different world of highly speculative investment banking playing fast and loose with very large sums of money, as witnessed much more recently here in the UK, is anything but new.

In 1933 the US Congress passed the Banking Act, always known as the Glass-Steagall Act after its two legislative sponsors. This far-reaching measure enforced a clear separation between investment banking and 'High Street' banking – American financial institutions had to choose to be one or the other. They could not be both. Glass-Steagall also permitted the Federal Reserve to regulate interest rates on savings accounts, the notorious Regulation Q. In the later 20th century this provision forced America's Savings and Loans institutions (the US equivalent of Britain's Building Societies) to pay out more in interest to their depositors than they were allowed to rake in from their mortgage borrowers. It was a disastrous situation – an early harbinger of the chaos which was to follow in summer 2007.

That absurdity aside, the overall effect of these measures by Congress was to instil some probity and common sense into America's once wild banking industry. Moreover it seems to me that between them, McFadden and Glass-Steagall set out some important principles which we would be well advised to copy here in the UK as we seek to reconstruct our banking industry's trustworthiness and effectiveness from the debris of the banking crises since 2007.

First, there is no good reason why the bank which looks after your current and deposit accounts – or whatever it chooses to call them nowadays – should also be allowed to speculate in ten figure sums on the international

financial markets. The two functions need to be clearly separated, both in law and in corporate structure. If big banks want to play big games on big markets with other people's big money, by all means let them do so. But then apply an updated British version of Glass-Steagall and force them to divest their High Street banking functions. Ask any big bank and it will quietly confess the branch networks are an asset-rich, revenue-poor component of their Balance Sheet anyway. That is why they keep closing down local branches – in a 21st century version of the long-derided way Richard Beeching kept closing down local railway lines fifty years ago.

The best way forward would be to amalgamate the local post office with the local bank, and provide one-stop shopping for a whole range of financial services, from state pensions to foreign exchange to current accounts to mortgages. Welded together, the two High Street functions might well survive in smaller communities – separately they die.

The great difference in all this from local branch banking of the past is the advent of modern electronics. When someone operates a 'hole in the wall' they also do all the expensive electronic key-stroking which in the past required an army of banking clerks using pens and paper. So the local bank of the future could operate with far fewer personnel. Its central computer system running holes in the wall and tellers' desks would mean that most of its employees could be real bank managers.

As of old (and as of a 'Premier' service at the big banks today) bank managers could once again track the financial behaviour and needs of individual customers whom they should know personally. The more such accounts a banker could hold in his head, the higher up the management hierarchy he or she should be. It was once a basic tenet of good banking 'always lend to the man, never to the asset' and that should now be revived. Among traditional bankers well into the 1980s, 'asset backed' lending was regarded as no more than glorified pawnbroking with somewhat fancier wording on the relevant documents.

Such true bank managers are crucial to an industry based on individual knowledge and individual trust. Yet they were the very people sacked in their tens of thousands by the High Street banks in an orgy of 'modernisation' in the early 1990s. Once the banks abandoned such genuine local banking, they also surrendered any real entitlement to run local banks. After that bloodbath of expert personnel, the depersonalised, computerised 'asset backed' lending services they offer today as a substitute could be performed equally well by check-out girls at Sainsbury's or Tesco's.

There are good models overseas for all of this. German's Landesbanken,

Japan's Trust Banks and the French regionalised system of what originated as credit agricoles all have something to offer to the UK of the early 21st century. The Japanese show there is no need to structure such banks as plc's – they would be far better off running as local trusts with a structure more akin to that of the John Lewis Partnership. The Germans and the French teach us that the proper, effective answer is regionalisation – not depersonalised centralisation.

The answer proposed here is that the branch networks should be removed from the big commercial banks – probably to their quiet relief – and reconstituted as regional retail banks owned as regional trusts. Chambers of Commerce, local authorities, all such interested bodies could well have a stake and then provide the all-important board of non-executive directors.

Traditionally, a bank's Board of Directors would have no paid employees of the bank on it except one, the general manager or nowadays the 'Chief Executive'. There was no way its top salaried employee could then pack the board with people whom he also controlled as their employer, people who would feel obliged to do his bidding. By excluding any further paid employees from the Board, its independent-mindedness could be more or less guaranteed.

Independent-minded bank directors; local branches offering a full range of banking and post office services; bank managers who know their customers individually; banks which are not obsessed with generating profits to keep the vultures of the city quiet; hole in the wall computerised systems which eliminate the need for expensive armies of clerks pushing pens. None of it is exactly rocket science, none of it is even new, yet in total it could equip the UK with banks which are far more 'fit for purpose' than they are at present so far as Mr and Mrs Brown Of A Town Somewhere In Britain are concerned.

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THE UK MOTOR INDUSTRY
PAST, PRESENT AND FUTURE

A talk given by Paul Everitt, Chief Executive Officer of the Society of Motor Manufacturers and Traders, to members of the Economic Research Council on Wednesday 14th October 2009

Perhaps I should start by dispelling a few myths. The UK motor industry remains extremely important employing more than 800,000 people across the design, development, manufacture, sales and servicing of all types motor vehicle.

The UK is home to seven volume vehicle manufacturers (Honda, Nissan, Toyota, BMW, VW, Ford and General Motors). In addition we have Jaguar and Land Rover, Aston Martin, Lotus and a host of other specialist producers making trucks, trailers, buses and coaches.

And these companies make iconic products in the UK that sell in every corner of the world – whether it's a Jaguar, a Mini, a Rolls Royce or a Bentley Continental – 80 per cent or around a million vehicles a year, are made in the UK and exported.

You maybe surprised to know that the UK is the second largest producer of premium or luxury cars in the world. It is also a centre of excellence for engine development and manufacture producing more than three million automotive engines each year.

So we do have an industry and it remains strong and resilient, despite the current economic difficulties.

An Industry Transformed

The UK motor industry has been transformed since the mid 1970s – first by the inward investment from the Japanese vehicle manufacturers in the 1980s, which created word class facilities and a step change in quality, reliability and productivity.

And then in the late 1990s and the early part of the 21st century we saw a second wave of investments in engine production by Ford at Dagenham and by BMW at Hams Hall, then the investment in the new Mini and the reinvention of Rolls-Royce and Bentley. At the same time Ford's ownership of Jaguar and Land Rover saw sustained investment in facilities, design and R&D.

An Industry in the UK

What is also obvious is that this industry is not domestically owned. The big decisions are made by global companies headquartered in Germany, Japan, the US, India, Malaysia, the Middle East and now Canada. This can be a concern for some – if we do not own it how can we take pride in it or worse still actively support it?

This unease contrasts starkly with the pride that successive governments have taken in encouraging inward investment and the way that individuals and companies have found the UK to be a welcoming and successful home.

I think we should be proud that the UK is seen as an important location for the global automotive industry but it should also inspire us to work harder to build and maintain close working relationships with the key decision makers in these global enterprises. And to build a better understanding of the value inward investment has for our economy.

New Automotive Innovation and Growth Team

Earlier this year Richard Parry-Jones, the Ford Motor Company's former chief engineer, led a team of senior executives from industry, government and academia to look at current performance and future prospects for the UK motor industry. The New Automotive Innovation & Growth Team (NAIGT) report was published in May this year and provides an important guide to how we need to move forward.

The team concluded that some significant changes were required to prevent a continued erosion of industrial capability, particularly in the supply chain. One of the major changes they recommended was the establishment of a long-term strategic partnership between industry and government.

Successive governments have had an ambivalent attitude to the motor industry, responding actively to periodic crises, but then disengaging when the immediate problems had passed. If every country adopted this type of a laissez-faire approach, we might be OK.

But in a world where others actively compete to build and sustain a motor industry there are real dangers. So a new relationship between industry and government has to be a key part of building a stronger and more sustainable UK motor industry.

Ultra-low Carbon Vehicles

The team also concluded that the market for automotive products would continue to grow, mainly in the fast developing countries like China, India, Russia, across Eastern Europe, Asia and South America, and that demand in all markets would be for progressively low, lower and ultra low carbon vehicles.

The challenge for the UK is to exploit the transition to a low carbon future to strengthen and deepen the industrial value of the motor industry here in the UK. To help support this, industry has developed a technology roadmap, a research agenda and is currently completing an evaluation of the relative strengths of the UK in the technologies likely to be required to deliver ultra-low carbon vehicles.

We hope this will provide guidance that will help direct public and private investment into appropriate research, development and demonstration programmes.

We have already seen government part-funding one of the largest trials of ultra-low carbon vehicles in the world and commit to up to £230 million for consumer incentives. This has attracted the interest of global vehicle manufacturers; the next test is to see whether we can encourage others to invest in the industrial infrastructure needed to fully exploit this future potential.

The most worrying aspect of the work by the NAIGT was the hollowing out of the supply chain. Whilst there are still significant numbers of jobs in the UK supply chain these are mostly assembly operations, the high value design, development and engineering tends to done elsewhere, mostly in high cost countries like France, Germany and Japan.

I believe we need to launch an active campaign to encourage key global suppliers to invest more intellectual capital in the UK. In the 80s and 90s we won investment from vehicle manufacturers, we now need to do a similar job on the component suppliers.

We do have a strong case. The combination of major global players, a strong cross-party commitment to a low carbon future, active incentives for low carbon vehicles and a reputation for academic excellence and engineering innovation is an attractive proposition. We now need the political and industrial will to convince sceptical investors that it is worth taking another look at the UK.

Surviving the present

I am very optimistic about the future opportunities for the industry in the UK. We entered this recession stronger and more resilient than at any time in the recent past and have responded quickly to the very dramatic fall in demand.

This has been painful; redundancies, pay cuts and short-time working all designed to ensure that companies survived and maintained their core industrial capability.

The credit crisis has served to remind us all that we need to have a more balanced economy, where manufacturing and the design and engineering skills that it requires have a higher priority.

The economic conditions in the years to come should encourage industrial investment and international trade. Inflation and interest rates will continue to be relatively low, consumers are likely to save more and spend less, and exchange rates will favour UK manufactured goods for some considerable time.

For the motor industry to benefit it must first survive the short-term pressures. I think that the recovery remains extremely weak and government should focus on sustaining and strengthening it. There is a need to put in place measures to curb public expenditure and reduce debt, but it is a question of timing and the risks of cutting too soon, are in my view the greater concern.

For the motor industry the core support requested from government was the availability of loans and loan guarantees to help sustain investment during the downturn, a scrappage incentive scheme to stimulate demand and measures to encourage more and better priced consumer finance.

Whilst the Automotive Assistance Programme provides loans and loan guarantees it has not delivered as much or as quickly as industry would like. To date only £10 million of an available £2.3 billion has actually been delivered. Not surprisingly we want to see the much faster delivery and where necessary some greater flexibility to ensure companies in the supply chain get the support they need.

Despite a wide range of schemes to support lending, there has been relatively little improvement in willingness of the banks to lend to industry.

The scrappage scheme launched on 18 May has been extremely successful. The extension announced earlier this month will see demand sustained through to the early part of 2010 and strong registration data through the first half of next year.

There are understandable concerns about the potential impact once the incentive has been removed. I am hopeful that underlying demand will strengthen during the next six to eight months, particularly in the fleet and business markets. This should mean a relatively soft exit from the scrappage scheme.

Conclusion

All of industry's efforts have been focused on sustaining its industrial capability. The short-term measures have been necessary to ensure that the UK motor industry is able to contribute more to a stronger and better balanced economy.

The transition to a low carbon future is an opportunity for the motor industry and the country. A strategic partnership between industry and government will be necessary to help foster and realise the potential.

There will be a market for ultra low carbon vehicles in the UK; the choice for us is where the vehicles and technology required for them will be designed, developed and manufactured.

The UK has a strong motor industry, we have an important share of global demand, and a new approach and new enthusiasm for the industry is capable of delivering jobs and prosperity for the long-term

I am clearly biased, I am an enthusiastic supporter of the industry and all the people that work in it, but I hope you will recognise the transformation that has taken place, the strength that currently exists and the opportunities that lie ahead.

THE 'TRI-PARTITE CONCEPT AND THE REVIVAL OF BRITISH MANUFACTURING

By David Fifield

As the UK pulls out of its banking/debt induced recession, thoughts are moving towards the need to rebalance the economy in favour of manufacturing. Manufacturing as a sector has been shrinking and now, although it still provides half of UK exports, makes up only 12% of GDP. Its revitalisation would add 'balance' as well as extra export income – and

make better use of the science, technology and engineering skills which bring high-tech added value.

The need for an improved business paradigm

This is unlikely to become possible unless we move on from simply viewing economic development in terms of markets and think more in terms of husbanding assets to create value. We need to go beyond mere balance sheets and nurture the real, often invisible values within companies. By over-concentrating on cash flow, bottom line profits and share prices, management are making a classic error, mistaking cause and effect, and often doing vast damage to core value drivers in the business.

A useful structure for understanding company values is to divide them into 'ownership expectations', 'corporate character' and 'market opportunities'. To survive and prosper, the aims of all three have to be met and maintained. They require freedom from interference to evolve and flourish in line with competitive pressures and opportunities This is the 'tripartite concept'.

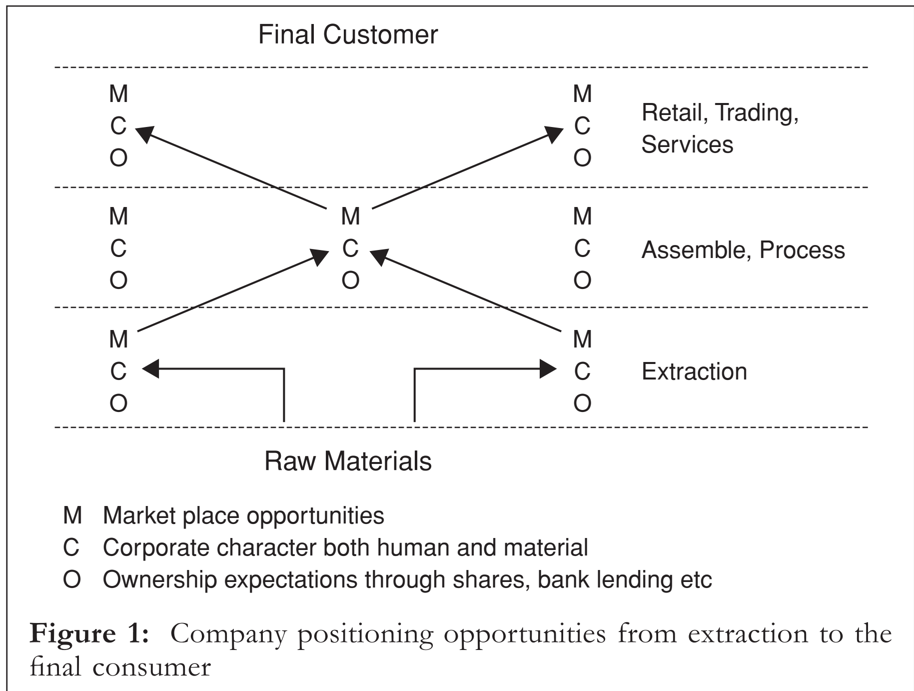

Figure 1: Company positioning opportunities from extraction to the final consumer

An example

The strategy of a long established UK based paper company was to concentrate on high value-added papers requiring multi-sourced pulps. These ranged over fine writings and coatings, carbonless copying, vegetable parchment, plastic laminating and niche industrial papers etc. The company was committed to a stable corporate culture aided by training and secure employment. With special papers, 'short runs' and frequent customer contact, technical staff held central positions. A functionally and financially astute board highlighted 'fine paper makers' as the core value. The Financial Times in May 1986 commented that the company was 'the one to be most admired'.

However, ownership was changing hands. At first an American organisation took a major shareholding and later control was taken by French investors. The company increasingly found itself in difficulties such that by 1999 The Independent stated that it was 'a text book example of how mergers, especially cross border ones, go wrong'.

The paper company's experience provides a commentary on the changes that have affected much of British manufacturing over recent years. During the 1960s manufacturing growth rates averaging 3.7% exceeded national growth. In the '00s manufacturing by the same measure was not just stagnant but actually shrinking. Britain, with the exception of major players such as oils, pharmaceuticals, aero engines, defence, niche players etc., has become more financial services/consumer centric.

The German contrast

Germany places a greater emphasis than Britain does on private limited companies and committed bank lending. As a result Germany's business ownership time horizon is longer. Germany's business corporate character, comprising staff and fixed assets, also reflects a longer time horizon. The nature of assets demands much thought before purchase or replacement, followed by commitment to the investment. The assets then influence the selection and retention of staff. Employees can expect training matching the evolution of product and asset upgrades. Defined by law according to numbers employed, staff may occupy seats on supervisory boards.

Napoleon understood Britain

'Trading ownership' – the emphasis placed on buying and selling companies

encourages short term expectations. Indeed, many shareholders are remote from internal corporate affairs especially when represented by pension funds and unit trusts. A further boost to the short term can arise with the 'quick buck' approach via mergers and acquisitions, as may directors having a share owning interest.

When considering corporate activities from manufacturing to retailing, 'trading ownership' has more in common with retailing than with manufacturing. Both have a eye for the best deal rather than the ways to create long term value. They are both interested in grabbing opportunities. By contrast manufacturing involves a product cycle that is often complex and long, followed by incremental changes. Maybe Napoleon was a little early when he said we were 'a nation of shopkeepers'.

Can foreign ownership solve the problem?

If British ownership is short-termist and damaging to the organic longer term growth of business organisations, can foreign ownership, arriving here with more broad based conceptions of corporate management – as suggested by the 'tripartite concept' revitalise or reinvent British manufacturing? Foreign acquisitions often bring funding and technical benefits as well as different industrial relations practices – as seen with the UK car industry.

But the danger is that limited resources may be prioritised in favour of the acquirer's home interests and the existence of favourably backed foreign owned companies benefiting from development costs borne elsewhere and financial resources that can sustain sharp price competition, may inhibit existing or potential indigenous competition.

On balance, extensive overseas ownership of a nation's corporate assets runs the risk, in the context of the tripartite concept, of putting the home nation's economic well-being at a fundamental and competitive disadvantage. Once out of a business sector getting back is often very difficult.

UK future prospects

As a counter balance to banking and consumerism, manufacturing is poorly positioned to either revitalise or reinvent itself. A change to director responsibilities might help. Matching welfare interests and expectations for both shareholders and staff, especially in takeover situations, might engender a more cohesive culture. More likely, a really dramatic change will come via shock rather than political diktat. There was perhaps a chance that the cur-

rent banking crisis would provide such a shock but now general expectations are for things to return, in time, to 'normal'. If this is the case the current shock has not been strong enough. Rebalancing, when it comes will manifest itself, if it is for the long term, through the 'tripartite' concept.

CANTERING AROUND OUR ECONOMIC WORLD

By Damon de Laszlo

As we approach the end of the first quarter of 2010, it is difficult to find any real changes in direction in the various corners of the global economy.

Having spent most of February away in Argentina and kayaking amongst the ice-floes in the Antarctic, there is a strange feeling that the world has stood still. There is an extraordinary constancy about the suspended financial crisis and in particular crisis talk that pervades the Press and other commentators.

Britain in its state of political suspension rolls on without addressing any of its fiscal and financial problems. Government pronouncements are basically ignored and the Prime Minister's ability to be 'economical with the truth' has become so blatant that it hardly excites comment; everyone awaits with some boredom the announcement and onset of the election battle.

Europe continues in its own introverted sweet way. In Greece nothing has changed, the economy remains a mystery, bankrupt along with its Mediterranean neighbours, but no bail out, only a smoke screen of European ministerial meetings. It seems that the core of the dilemma facing the European Central Bank and Germany is that a very large percentage of the Greek government debt is owned by Deutsche Bank and their French counterparts. For the time being, one can only guess that Greek debt will go on being absorbed by these banks and then possibly recycled into the ECB, a party that can continue for quite a long time.

The big elephant in the room, America, and the smaller elephant, China – continue to dance, reminiscent of young and old bulls in African safari parks, kicking up dust and bellowing. Interestingly, the US government seems to have reached a state of paralysis as Congress ties itself in knots over the major issues of health care reform and bank reform. Both are intractably complicated, and made more so by the hugely powerful lobbies

in the respective industries using their weight to derail the legislation.

Unable to address internal issues, it is worrying that Congress is focusing on the exchange rate and China. Today, it is probably in the best interests of America to have a fixed exchange rate with China; a floating exchange rate would create a situation where Chinese actions could drive the dollar up or down any time they wished by announcing or actually executing a buying or selling of dollars. Congress has forgotten the old adage that you should be careful what you wish for!

In the meantime China which, as I have said before, is probably the only country that has an executive that can plan intelligently for the short, medium and long term, and has a fair chance of executing those plans, is encouraging rapid growth within its own economy. To stay in power and avoid civil unrest, Beijing knows that it has to deliver steady growth. Inflation itself is growing, however, and this is more difficult to control with a fixed exchange rate against the dollar. This present currency lock does mean that Chinese inflation continues to grow as wage and food prices rise and will be exported to the US in the form of higher prices. A phenomenon that is of considerable benefit to US industrial recovery which, as it happens, is taking off at a great rate.

The rapid pick-up in US industrial output is flowing through into capital expenditure and is beginning to stabilise the job market.. There is also a growing trend for US companies to bring home production from Asia, all of which augers well for a general improvement in the US economy over the next twelve months. As is often the case, this could be derailed by the politicians, particularly if political grandstanding sparks off a round of protectionism.

With Spring in the air and the problems of winter receding, the rate of recovery in the private sector will increase. If the politicians can control their desire to spend and reign in the public sector, then there will be a general economic recovery. It is a big 'if' but possible!

THE ALTERNATIVE MANIFESTO

By Eamonn Butler published by Gibson Square p/b 2010 £8.99

Here is a thought. Let us say that all of society is a sort of large version of that basic building block – the family. In the family the parents are

the supervising authority whilst the children develop and grow and are the hope for the future. We all know that good parents provide a secure framework but allow the children to take some reasonable risks, learn from their own mistakes and own the value of their efforts. But bad parents stifle development with petty rules, bully kids for their own gratification and exploit children for their own pride – and even economic gain.

In Britain, our rulers – politicians, authorities and bureaucrats, have simply become bad parents. Like bad parents they don't seem to know what else to do other than bring out more and more petty rules, push us around ever more absurdly and exploit us with ever craftier taxes. The exploitation has become a gravy train and those who can have realised that they may as well climb aboard – as public 'servants', quango members, public pensioners, overcharging consultants and not-too-competitive contractors to the public sector – and much more.

There are plenty of us who realise some – or much – of what is being done in this dysfunctional trap – and a fair summary can be found in Eamonn Butler's recent account 'The Rotten State of Britain'. Yes, we know what is wrong. The problem is that we haven't got a clear idea on what to do about it. Of course, one looks at the election manifestos of the Labour, Liberal and Conservative parties – but somehow they seem like the pretence of bad parents on their best behaviour when the vicar comes around.

What we desperately need is a clear statement of how good parents would behave if they were empowered to take charge. Infused by a more genuine spirit, what would they do? Butler this time has canvassed ideas and proposals from many of the London 'think tanks'. In his introductory acknowledgements he mentions the Adam Smith Institute, the International Policy Network, the Taxpayer's Alliance, Reform, Civitas, the Centre for Policy Studies, the Economic Research Council, Policy Exchange, Conservative Home, Lombard Street Research, the Institute of Directors – and others. Remarkably, he has found agreement rather than mere controversy and constructive thoughts to match each criticism. Thus we have 'The Alternative Manifesto – A 12-step Programme to Remake Britain'.

This book is a truly valuable contribution and reference manual for policy makers. I hope that it will be widely read.

J.B.

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.