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AND OUR ROLE IN OVERSEAS TRADE AND PAYMENTS

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THE SHIFT IN GLOBAL ECONOMIC POWER BY 2050 TO THE E7: OPPORTUNITIES AND CHALLENGES

A talk given by John Hawksworth, Chief Economist at PricewaterhouseCoopers, to members of the Economic Research Council on Monday 9th May 2011

Why 2050?

A lot of economics gets focused on short term business – on business cycles, the effects of various shocks and on predictions of changes in aggregate demand. Having done work on pensions policy and on the effects of climate change my own interest has recently been in the long term, looking at least to 2050. There are at least some things that economists can say about the long term that are useful. Of course like anything else economists say they are subject to caveats, margins of error and so on, but nevertheless, I think it is at least interesting. And for the focus of our attention the subjects change with time – twenty years ago I would have been talking about subjects like the launch of the Euro but now we have to start talking about China because there has been a shift in the way we look at the world towards understanding the importance of emerging economies.

Currently the G7 (the USA, Japan, Germany, France, the UK, Italy and Canada), the established old economies, produce about a half of world income – GDP. They are still reasonably dominant. But whereas in 2010 the G7 had 35% of world GROWTH, the BRIC economies (Brazil, Russia, India and China) had 38% so they are actually more a driver of world growth than the whole of the G7.

The Longer Term Methodology and Model

We start with the huge exercise co-ordinated by the United Nations with participation by the World Bank, the IMF, the European Commission and the OECD that periodically updates estimates of each nation's GDP on a purchasing power parity basis. This represents an indication of real GDP, of the real quantity of goods and services that different countries produce. We chose to look at 17 economies – the G7 plus Spain, Australia and South Korea and the E7 which is Brazil, Russia, India, China, Indonesia, Mexico and Turkey. Recently we have extended our study to look at five further economies; Vietnam, Nigeria, South Africa, Saudi Arabia and Argentina.

The reports are published on our web site and are freely available for anyone to go and have a look at.

Each country is modelled individually but with linkages via an assumption that the USA is at least initially the highest productivity country, representing the global technological frontier. Growth in each country is established with production function ideas used in hundreds of academic textbook articles – driven by investment in physical capital, working age population growth, investment in human capital linked to rising education levels and a catch-up factor with US productivity levels (which is quite judgmental as it depends on assessments of institutional capability and various other factors that have been shown by academic studies to influence productivity). And then we allow for the market exchange rate in emerging economies to rise over time. It is a historical fact that the less developed a large economy is, the lower its market exchange rate is in comparison to its PPP rate. Mostly, prices are lower for example for an average hair cut, in Beijing than in London. But over time as they develop, their market exchange rates will tend to rise in real terms, either because their price levels will rise or because their nominal exchange rate will rise or some combination of the two.

Of course these projections should not really be regarded as forecasts because, looking that far ahead, one cannot be precise. They are indicators of potential if broadly growth-friendly policies are followed.

By 'growth friendly' we mean not doing things that disastrously cut them off from the world like putting up protectionist barriers or have political chaos. And we assume that there are no major global catastrophes like nuclear war or a radical climate change that completely throws the whole world economy off track permanently.

But we are looking through any short term things – even wars. Look at America in the 19th century. It had a civil war, all sorts of booms and busts, all sorts of presidents being assassinated and so on, but it still maintained a pretty good growth rate on average.

Some Starting Points

(i) Countries by PPP

In 2009 (we don't have the 2010 data yet) if we set the US at 100 and measure things in dollars so the market exchange rate and the PPP rate is the same for the US, we can see that Japan is, depending on how you measure

it, round about 30-35% of the US; China in terms of market exchange rates is about the same size as Japan. In terms of PPPs however, China is already more than 60% the size of the US and twice as big as Japan. India similarly, quite small in terms of market exchange rates, quite a lot smaller than economies such as the UK, but in terms of PPP rates would already be in fourth place in the world, ahead of Germany and the UK. In terms of market exchange rates China only just overtook Japan in 2010 but in terms of PPPs that happened a long time ago. So in terms of the actual quantity of goods and services produced China is already hugely bigger than Japan and hugely more influential in terms of quantity of world trade and some rather less good things like the quantity of carbon emissions.

(ii) Demographic Profiles

Distinct demographic profiles underlie a lot of the results. Over this kind of time horizon, demographics is one of the few things you can predict with a degree of certainty. There is a big distinction between fast ageing countries that are already rapidly ageing and countries with younger populations. Russia is a very fast ageing economy as are most of the Eastern European economies. So is China (partly due to its one child policy) and to a lesser extent, Korea. On the other hand some of the emerging economies are tending to stay younger for longer. Even the US, relative to most of the European economies, is relatively young. So are economies like Australia whilst the UK is somewhere in the middle.

One way of quantifying this is to look at the projected average growth rate per year of the working-age population. How many people are there in the key age groups, say between twenty and sixty four?

Working age population is growing very fast in some economies such as Nigeria, India and Vietnam, relatively fast in economies such as Australia, the US, Brazil and Turkey, but declining quite sharply in Russia, Japan, Korea and some European economies. Germany, Italy and China are pretty close to zero at present but had fast working age population growth in recent decades and are projected to have quite slow growth by 2020.

Predictions

So, if we turn the handle on this kind of methodology, what do we get out? Well, you can get economies like Vietnam and India having very strong growth potential that lasts quite a long time. China has somewhat lower long term average growth because of the demographic slow down and

because China has already caught up to an extent, so there is less room to catch-up and its growth is very capital intensive. To an extent you cannot just continue to invest more and more, you run into diminishing returns to investment after a while. We have seen this in a lot of other Asian economies – like Japan. Some other economies, like Brazil will continue to grow at a more steady rate. Russia I think has rather poor demographics but reasonable growth potential otherwise. And then you get the whole mass of the more established, developed economies that tend to be lucky to grow at much more than 2%, or even less than 2% in the case of countries like Germany and Japan. 2% average growth is very much the case for the UK, US, Canada and Australia.

G7 v E7

By 2050 the E7 is anywhere from two thirds the size of the G7 to even bigger, double the size. Some time in the middle of the next 40 years, depending on which measurement base you use, the E7 will overtake the G7. That crossover point, given the recent monetary crisis in the G7, could well occur quite a lot earlier than we expected 5 years ago. G7 countries have seen 5% drops in output whilst China has been growing at 10%, India at 8% and Brazil at 7.5%. So at market exchange rates we are looking at maybe 2033 but with PPPs it could occur as early as 2020. Indeed, in PPP terms, China could overtake the US even before 2020. Within our lifetime China is going to become the biggest economy in the world. I think that you can argue about the timing, but the way things are going it certainly seems a reasonable bet. Even India, by 2050, is getting up to quite similar levels to the US. India will continue to grow faster for longer than China because its demographics are all positive and there is more catch-up potential.

The Picture in 2050 and the Very Long View

The 'big three' will be the US, China and India. In the 'second tier' Brazil will likely lead the way followed by Japan. Russia, Mexico and Indonesia can be bigger than Germany or the UK on some measures and Turkey can be of similar size to Italy.

Perhaps this is a kind of return to the norm rather than anything surprising or new. Estimates by historian Angus Maddison suggest that in the year zero AD, emerging Asia, (including today's China and India

but excluding Japan), would have been 75% of world GDP. Even by the year 1000 – two thirds of world GDP. Even by 1820, when the industrial revolution had already started, it was still well over half. It is only when you roll forward to the most recent date he calculated, 1998, that it is down to about 30%. In our estimates, roughly speaking, you are getting back to somewhere close to 50% by 2050, but still lower than it was in 1820. OK, there are all sorts of caveats, but in a sense there is a return to the norm, which is that shares of world economy are more proportionate to shares of population. There will still be a large gap but the point to note is that, in today's money, an average annual income in China could be $40,000, and in India $25,000. Since the advanced economies will have moved ahead by then it is a sort of 'tortoise and hare' thing.

Inevitably, the UK's share of the world will go down. Depending on whether you measure it on market exchange rates or PPPs, it is currently around 3–3.5% and will probably steadily decline on these numbers to more like 2–2.5% by 2050. But bearing in mind that our share of world population is going to be quite a lot less than 1%, that still puts us above the average.

China, India (and Russia): What could go wrong?

These two countries have very different comparative advantages. India has got very strong strengths in IT skills and technologies, very strong engineering institutes, mechanical engineering, chemical engineering. The top people in India really are the top people and they often go to the US and other places and make great successes of themselves; although that maybe does not go down the scale a lot in terms of education levels across the board. China is actually quite a bit stronger in its average education levels. Certainly India has more of an advantage in terms of English speaking but the Chinese are making a great effort to teach English in schools. China has higher savings rates, higher investment rates and better infrastructure. China is stronger in manufacturing whilst India is stronger in certain types of hi-tech areas and services, which actually should be quite complementary and should mean that they become very big trading partners. If they can maintain good terms with each other there are huge potential benefits for them from trade. But at the same time they are competing for things – particularly natural resources.

There are all kinds of scenarios on what could go wrong. Currently the Chinese authorities are concerned with the problem of overheating and property bubbles. Shanghai is worse than London in terms of people complaining about high house prices, speculation and about young people

not being able to get married because they can't afford flats. They have got the English disease of being obsessed with property. Then there are obviously longer term political issues. Will there be a transition from communism to some other kind of regime? How will that be managed? Huge shifts of people around the country from rural areas to the cities. What sort of tensions does that lead to? What about capital allocation? State banks are basically told to invest in certain types of things to keep the economy going, keep jobs being generated. Often allocation is on the basis of connections – not the most efficient way. And there are tensions around protectionism and exchange rate policies. This is not to mention the environment and the problems of pollution and global warming, China being the biggest carbon emitter in the world now.

I think in India there are problems with the government sector being quite inefficient with high budget deficits that eat up resources and crowd out to some degree, private investment. This can lead to higher interest rates, which sometimes leads to sucking in hot money from abroad in a way that is potentially destabilising.

In Russia, you've got the classic resource curse, over-reliance on oil and gas, leading to all kinds of rent seeking behaviour where a lot of people's attention is focused on trying to grab a share of the natural resources pie rather than trying to push forward the agenda in terms of developing hi-tech industries and human capital intensive industries where Russia has a lot of potential.

So there are all sorts of things that can go wrong, one should not minimise these challenges, but one also should not forget about the potential and the fact that we can talk about wars, assassinations, depressions and so on, but in the end, countries come through it.

The Opportunities

Although places like China have so far been seen as places to go and make things cheaply, they are now increasingly good places to sell things. Wall-Mart, Carrefour and Tesco are beginning to be successful in these markets and everyone who has a good global brand can exploit and leverage across a much bigger market and therefore spread their fixed costs of investing in that brand more broadly. I think that there are still opportunities at least for the UK around business and financial services. We have a lot to offer in the UK in the creative industries, in advertising, in cultural areas, in health care and in education. Some schools and universities in the UK have done very

good business either importing Chinese students to here or going and setting up offshoots over there. With an ageing population in China and Russia the health care market is huge as they become rich enough to switch from traditional Chinese medicines to more advanced pharmaceuticals. I think that in certain niches of high value added manufacturing we can do well.

Manufacturing generally is no longer where the UK's comparative advantage is anymore but maybe countries like Germany, who have been successful in exporting to China so far, might be rather worried in the future when China gets a handle on their technologies – which is happening quite rapidly. China is already very big in all kinds of green manufacturing; solar power, wind power, electric cars, hydrogen fuel cells – I can see them being quite dominant in a lot of those industries. So the idea of a green jobs dividend in the UK and elsewhere in Europe might be a bit optimistic.

The big Chinese banks have enormous strengths and could potentially come and buy up large parts of the financial services sector here, particularly given that so many of the banks in the West need extra capital to meet Basel requirements and other types of requirements. There could be huge ownership transition there and some of these big companies, depending on their strategies, becoming really dominant players in many financial markets around the world.

But one also has to accept that many companies find these countries to be extremely difficult places to do business. You certainly need the right local partners, the right business strategies, the right understanding of local regulations and taxes and other things to be successful. They are often, certainly for China and India, very difficult places to do business.

So there are certainly opportunities and challenges.

THE RESCUE OF BRITISH LEYLAND: ITS IMPACT ON TODAY'S UK MOTOR INDUSTRY[1]

By Garel Rhys

In a previous paper[2] it is demonstrated that there is a strong possibility that UK car production may reach 2.2 to 2.3 million a year circa 2015/6

1 see also *21st Century Motor Industry Economics* by Garel Rhys in *Britain and Overseas* Vol.37, No 3, 2007

2 Superlatives in UK Car Production, Sunderland City Council, 2011.

and exceed the long time record of 1.9 (plus 112,000 car derived vans) reached in 1972 in the golden age (1963–73) of UK car output. If the plus 2.2 million total is achieved this will be significant in itself but will also cause a re-appraisal of the effectiveness of the state rescue of British Leyland in 1975.[3]

In today's money the UK taxpayer involuntarily 'invested' (aka subsidised) British Leyland to the tune of £11.6 billion between 1975 and 1988. This is a staggering amount especially as the company, notwithstanding this largesse, soon entered a period of long term decline resulting in its disappearance as a competitive entity. It was death by scores of cuts. As a result the common consensus is that the rescue of British Leyland was a total waste of money, time, effort and anything else that might be thought of. However, the structure of the car industry even now but especially so circa 2015 requires a reassessment of this view.

The distribution by firm of output in 1972 and the possible position around 2015 is shown in the Table. A comparison of the two columns of production is informative even if the circa 2015 one is still conjecture.

The bulk of production in 1972 came from four groups owning 13 major car assembly plants. In the present and mid decade picture there are now six groups owning 8 major assembly plants.[4] Clearly the average size of plant has grown with the 2010 average output exceeding that in 1972. If the mid decade output becomes fact then the plant economies of scale at the assembly level will be impressive. (Minimum efficient scale at this level is 250,000 units a year.) In addition, all the companies identified in the right hand column are part of global groupings. Hence UK based engine plants serve an international clientele and can easily reach optimality (UK engine production is often over 3 million a year. Optimality is circa 756,000 units a year.) Also the global operations means that company-derived economies of scale can be captured with some ease.

Another point that emerges from the table concerns British Leyland. Of the companies listed in 1972 only Vauxhall (GM) appears on the right hand list. The 1972 structure is unrecognisable in circa 2015 with firms dropping out, or entering, the 'leagues'. However, this is not the real position as

3 Contrary to popular misconception, British Leyland was not nationalised. It was a state controlled company and subject to the Companies Act with private shareholders who never sold to the state. As a result the Board had to act in the interest of *all* shareholders and not just the Secretary of State for Industry. This gave them a huge degree of autonomy.

4 Longbridge (MG) may return as an extra major source of output.

1972			*2015*		
No of Major Assembly Plants (Cars)	*Firms*	*Output*	*No of Major Assembly Plants (Cars)*	*Firms*[b]	*Output*
7	British Leyland	916,240	3	JLR	650,000
2	Vauxhall	183,976	1	MINI	250,000
2	Ford	546,728	1	Vauxhall	215,000
2	Chrysler	263,906	1	Nissan	600,000+
			1	Toyota	280,000
			1	Honda	246,000
13		1,916,844	8		2,235,000+
	Others	10,467		Others	30,000
	TOTAL	1,927,311[a]		TOTAL	2,165,000[c]

a. Source: SMMT
b. As seen below, MG's Chinese owners could be making up to 200,000 cars in 2015
c. Source: Rhys, D. G., *Superlatives in UK Car Production*

British Leyland had a major impact on the right hand column.

Jaguar Land Rover (JLR) and MINI were once parts of the British Leyland empire. If they do succeed in producing an aggregate volume of 900,000 between them in mid decade this will almost match British Leyland's record output in 1972. It would also be close to the combine's record financial year car production in 1972–3 of 947,000. (In addition there were 60,000 car derived vans and 50,000 heavy commercial vehicles and buses.)

In addition there are other British Leyland heirs including: Leyland Truck; Optare; UNIPART; Multipart; LTI; the Krupp and Calsonic operations in South Wales; MG and so on.

All these operations together employ over 35,000 people. This compares with the 170,000 UK employment by British Leyland in 1975, the year of the rescue. Of these 145,000 were in the car business. Against this, the current figures appear small but there are a number of points to consider before a more realistic comparison can be made.

The need for the state rescue was the parlous financial and competitive position of British Leyland. Productivity in the car plants was on average 30% less than the European average. Hence, British Leyland's car operations were overmanned by 34,000. Since 1975 effective labour productivity in the motor industry in the UK has more than doubled. Hence the 145,000 in 1975 would, by today's measure, be no more than 70,000 employees. (Of

course a super competitive British Leyland in 1975 would have grown to be a European giant with more employees than that. However it was not and it did not.) So in effect the formerly British Leyland operations employ about 50% of the 1975 figure. (Also see Appendix for comparison between 1972 and 2010 for entire industry.) So the employment loss is much less than a crude comparison of the 'British Leyland' position in 1975 (145,000 car employees) and today, ie, NO British Leyland therefore no jobs.

In fact there are 35,000 jobs which could increase to 40,000 by circa 2015 and hopefully 900,000 cars. The latter does not include any Shanghai Automotive Industry Corporation (SAIC) inspired recovery of MG to circa 200,000 units.[5] Bearing in mind that Lazarus appears to be the patron saint of the motor industry in the UK this cannot be discounted.

The existence of former British Leyland operations gives some anchorage to the traditional geographic distribution of car production and employment. However, the overall distribution has changed markedly since 1972: the Maps show the changed landscape.

Of the plants extant in 1972 only Halewood, Ellesmere Port, Solihull and Oxford have survived. Hopefully Longbridge's Chinese owners will revive the plant's fortunes sufficiently for it again to be a major producer. New production centres have appeared in Sunderland, Derby and Swindon. In addition JLR's Birmingham plant in Castle Bromwich was not a car plant in 1972. Of the older car making areas the North West of England has showed the greatest stability retaining two of its three car assembly plants. Scotland no longer figures in the list, and the South East of England lost all of its plants except Oxford, which in reality was part of the West Midlands cluster.

The West Midlands has totally lost its Coventry sub-cluster of three plants, but Birmingham still retains two plants, the same as 1972. If Longbridge is re-activated then this sub-cluster gains an extra plant. Overall the West Midlands is now a much lesser force than it was in 1972.

The three new locations of Swindon in the West, Toyota in the East Midlands, and Sunderland in the North East make most of the cars in the UK. Indeed, the latter is now the leading car making region. The old traditional car making regions of the West Midlands and South East are very much in a junior position. Interestingly the regional policy of the late 1950s and early 1960s that pushed the motor industry into new regions

5 SAIC is sitting on about 200,000 units of car making capacity. If this is eventually unlocked, MG would bring the 'formerly' BL car output up to 1.1 million and perhaps 50,000 'saved' jobs. This would increase the number of major assembly plants in 2015 to 9, and aggregate car production to 2,465,000.

Key for 1972 Map

1. Chrysler – Linwood
2. Ford – Halewood
3. British Leyland – Speke
4. Vauxhall – Ellesmere Port
5. British Leyland – Longbridge
6. British Leyland – Solihull
7. British Leyland – Coventry (Browns Lane)
8. Chrysler – Coventry
9. British Leyland – Coventry (Canley)
10. British Leyland – Oxford
11. British Leyland – Abingdon
12. Vauxhall – Luton
13. Ford – Dagenham

Key for 2010 Map

1. Nissan – Sunderland
2. Jaguar, Land Rover – *Halewood*
3. Vauxhall – *Ellesmere Port*
4. Toyota – Derby
5. Jaguar, Land Rover – Castle Bromwich
6. MG – *Longbridge**
7. Jaguar, Land Rover – *Solihull*
8. Mini – *Oxford*
9. Honda – Swindon

* May become major again by 2015

The plants in italic existed in 1972

may have failed in Scotland but has been vindicated by the dynamism of the firms in the North West and the prosperous motor industry in Wales, based on the component sector. This, added to the continued influence of British Leyland, means that public expenditure on the UK car industry was not without merit.

Although a sum of £11.5 billion to maintain British Leyland was excessive even with the qualification of the above analysis, the rescue was far from being a total waste of resource. There were after all activities within British Leyland which have stood the test of time. If JLR and MINI achieve the volumes intended the rescue has left a substantive legacy. Of course if British Leyland had been allowed to go bust, or substantially downsized, parts of the group may have been saved anyway. However, that is a matter of hypothesis. The fact is the rescue did result in long-term current output, employment, research and development, and such like. One is almost drawn to the conclusion that we behaved like the French.

Appendix

In 1972 the motor industry in the UK employed 510,000 people. In 2010 the figure was 142,000, or 27% of the 1972 total. In 1972 the UK motor industry made 1.91 million cars compared with 1.27 million in 2010, or 69% of the 1970's total. Of course those employed made commercial vehicles as well as cars but the vast majority were involved in car production and car related components.

In 1972 about 300,000 of the cars made were 'kits' for final assembly abroad. This meant that their British value was just over 50% of the final total. At the same time in 2010 the average UK 'content' of the cars made was just over 65%, so the nature of car production was similar. Therefore, it is legitimate to say, on a like-for-like basis, that a workforce just over a quarter of the 1972 total made almost 70% of the cars made in 1972. This approaches a three-fold increase in productivity. In terms of unit cost per car, a manufacturer that makes cars in both Germany and the UK now finds that if German unit costs are set at 100, the UK costs are set at 61 and only bettered by Poland. In other words the motor industry in the UK is viable and sustainable, and a long term foundation of the UK economy.

Emeritus Professor Garel Rhys CBE
President, Centre for Automotive Industry Research
Cardiff University Business School

ENERGY, ENERGY

Damon de Laszlo

Since April there have been few significant events compared with the first quarter. The earthquake in Japan and the tornadoes in the USA have had considerable economic impact. The Japanese disaster will continue to affect the major economies in the world for some time to come. Japan itself, in spite of optimistic noises, is unlikely to be able to grow its economy in the near future. The loss of electricity generating capacity has far greater long-term significance than is being accounted for. The effect of this loss of capacity on the economy should be a warning, which is not being heeded, to western governments of the relationship between electricity generation and economic growth. The lack of coherent government energy policy in the US, UK and Europe has very serious implications for western economies five to seven years from now. Germany is heading for a major economic slowdown if the Chancellor's policy of closing its nuclear capacity is implemented. No amount of political hot air is going to turn wind energy into a reliable and constant source of industrial power.

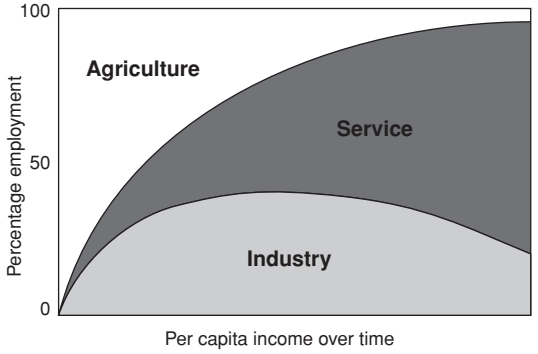
It's also worth noting that the Green band-wagon is doing increasing damage to economic growth by pushing up energy prices as well as food prices by promoting biofuels. The conversion of corn, sugar and palm oil into ethanol, apart from the subsidies required, is having a larger and larger impact on cereal and meat costs, not to mention the side effects of fertiliser run-off and deforestation in developing countries.

The increase in demand for oil is not sustainable and prices of this commodity will inexorably rise. In the normal course of economic development, rising prices encourage trade and industry to develop more resources or find alternatives. However, in the energy sector it is so tightly controlled and regulated by governments, the free market for innovation has little room to operate. The peculiar paralysis of western democracy to produce coherent policies, particularly in areas where scientific and engineering knowledge is required is worrying for our medium term future.

RISE OF THE 'SERVICE' ECONOMY

By Robert McGarvey

According the Organisation for Economic Co-operation and Development (OECD), post industrial economies (i.e. Western developed economies) are now solidly 'service' oriented. By some estimates over 75% of US GDP is composed of services, the UK comes in at 71.6%, Switzerland at 72.1%, and Luxembourg at 79.4%.



Source: World Bank

The truth is the underlying engines of growth in our economy are changing rapidly. The economy is transitioning from a traditional (and predictable) industrial asset foundation to a new and immature knowledge-asset foundation.

Unfortunately this transformation presents a series of problems. Economists, being economists, describe it in terms of productivity. For instance, according to economists at the UK Treasury: '*The service sector is at least one third less productive than manufacturing*'. In some sectors, services reach only 50% of the productivity per head of old line manufacturing. Many believe that services processes have not been designed with the 'rigor' applied to such activities as industrial engineering.

Looking beyond the economist's palette of analytics, there are even more problem areas. The old industrial economy was underpinned by tangible assets with solid collateral value, which have a number of advantages. First of all tangible assets are familiar physical realities, but more importantly

they are given formalized treatment by management and important social institutions. For instance, there are reliable valuation standards for these assets, they qualify under GAAP (Generally Accepted Accounting Practices) which means these assets appear on company balance sheets and are accepted by banks, securities regulators, investors and others as representing legitimate value.

The real advantage of assets lies in their financial strength, which is a combination of the sustainable value of the asset and the dependability with which they deliver consistent earnings. These qualities allow an asset to be geared or *leveraged, something that is almost impossible with a service.*

This reality is stifling many businesses. Many small to medium sized companies today are underpinned with services and/or intangible assets. Unfortunately in these circumstances there are few possibilities for financial leverage and therefore these businesses are unable to capitalize themselves sufficiently. As a result many underperform or simply fail. Public companies are the exception in this respect. They are, for instance, able to leverage their income streams, even one generated from services, through their price to earnings multiples in the stock market.

Banks (which leverage assets on a 10-1 basis) are desperately trying to increase their asset bases to meet the demands of regulators and shareholders; however many are trying to do so with thinly disguised 'services' which at present don't have the collateral value of older class assets. For example, many banks got in trouble recently when the value of their sub-prime mortgage assets collapsed in the financial crisis of 2008. Few realized at the time that the process of securitizing mortgages through a network of fee-generating agencies essentially degraded the underlying mortgage assets, converting them from one the economies strongest asset classes into a 'service' with little collateral value.

The bigger problem with this trend is obvious; with upwards of 80% of our economy now in services our economic leverage is vanishing, and with it our ability to reliably finance growth.

It is a fact that civilizations rest upon their asset foundations, solid assets allow them to mobilize their human networks to all kinds of productive purposes, investment in new business opportunities, building systems of education, health and or security. The growth of the service economy is very exciting and it is delivering an economic benefit, generating its fair share of GDP. But presently constituted services are not building solid dependable assets which individuals, companies and society can leverage efficiently to build a sustainable future.

SOME RESPONSES TO 'DAVID CAMERON'S CALL FOR NEW ENTREPRENEURS' (B&O SPRING 2011)

Sir,

All too often Government schemes supposed to help small businesses are akin to Russian tanks in Afghanistan – they knew there was a target out there somewhere but they could not get the gun barrels down low enough to hit it. Europe-wide some 95% of all businesses are micro businesses with most employing 0-5 people. These are the ones, without inhouse armies of lawyers and accountants to comply with the ever increasing rules and regulations, who need the help. If each one employed just one extra member of staff the EU unemployment problem would be solved at a stroke. If. 'Enterprise Zones' are such a good thing, remember that one man's aid (inside such a zone) is another man's (outside) unfair competition, then why not make the whole of the UK such a zone?

Yours etc,

Dr Bernard A Juby
A past National Chairman of the FSB.

Sir,

A lot of the people you describe as being 'non entrepreneurial' are actually anything but. They may not be in the same sense as the examples you give – wholesale confectionery, builder etc – but none the less they are not employees in the same sense as the 20 labourers you quote within the building firm. Let's take lawyers. The vast majority work within an equity structure with some if not all their income delivered through fees directly generated. They also carry significant risk in the form of personal guarantees for the vast (fixed) overheads they are obliged carry in order to carry out business. (An uncomfortable number are going to go out of business over the next year or so as the recession catches up with them – I'm advising several as we write.) For each full time lawyer, they require/generate 3.6 fte in support staff. Doctors are increasingly becoming responsible for their own financial affairs as the NHS desperately looks to find a way to make the unworkable work. I think the structure in which a significant proportion of

those who work in the private sector, do so in a much less 'employee role' than they used to. Thatcher's reforms may have had a lot to do with this, but possibly the sheer burden of TUPE, European and UK employment regs etc, has forced employers to find other and more innovative ways of achieving a work force. And this in turn has generated a raft of people who are already half way to starting a new business – without really knowing it!! The leap to business ownership is much easier for them.

I appreciate my next point is somewhat controversial (and contentious in present company) but I believe the last 30 years of government obsession with Education being the solution to ending all social and employment problems, is actually one of the principal causes of these issues. This policy has led to a dearth of skilled – but considered 'low value' – workers, to the extent that it's not worth getting such a skill any more. Employers can't hire staff to train them as the costs of release if they don't work out, no aptitude etc, is prohibitive. Students head off to uni with expectations that are unmanaged, leave with an investment deficit (debt) that is unsustainable as that investment has been made into a skill(?) that's not required. This cannot be generalised of course, since the next generation of skilled doctors, lawyers etc have to be trained – but regrettably our system has simply ignored the majority that don't fit into these (few) categories. And that's why we've a generation of unemployed young people for whom I despair. I'm sitting right now, no more than 20 feet from a 26 year old who has just qualified as a doctor! And he's working on a property helpdesk earning £16,500 a year gross! Oh he'll get a doctor's job I've no doubt but what a bloody waste of taxpayers' money in the meantime.

Yours

Jon Bourlet

Sir,

Perhaps Peter Thiel, Silicon Valley's most celebrated venture capitalist, has an answer for creating more entrepreneurs.

One of the few who saw the 2000 Nasdaq crash coming, he then correctly diagnosed that 'the equity bubble had simply shifted onto the housing market', says TechCrunch. Now he claims that America is under the spell

of a 'higher education bubble' that saddles its brightest with ruinous debts for little discernible return. Hence his plan to offer 20 young entrepreneurs $100,000 in grants – on condition that they drop out of college to pursue their ideas.

Yours

P. A. Goulder

JAPAN

By Ian de Stains. Published by Stacey International p/b, £15.00, 2009

Over the years there have, of course, been many guide books for foreigners visiting Japan, and within that genre, a sub set aimed at business visitors. Such books are needed both by visitors for whom Japan appears a daunting prospect and, curiously enough, by Japanese expecting to come into contact with foreigners at home or abroad, who expect to be asked about their homeland and need to find ready-made replies. Given this dual market such books tend to be journalistic, impressionistic and rambling – playing to the market rather than sticking to authoritative, concise information.

Not so this superb (precisely) 200 page guide. Ian de Stains has, after a career spent directing the British Chambers of Commerce in Japan, honed, shortened, incrementally improved, made precise, tested, repeated and polished his opinions, advice and knowledge to the point where this book is like a Japanese manufactured product – excellent in form and precisely right for the task of guiding those hoping to do business in Japan.

References, information, historical background, contacts, company details, tax discussions, social aspects, names, addresses, telephone numbers and e-mail addresses are given but just the right amount of 'soft' advice can be found as well. Here is a paragraph about business meetings:

> Personal posture is important. Sit firmly in chairs at meetings even if they are armchairs. Don't slump, don't cross your legs and do maintain a fairly formal style. Don't blow your nose noisily. Don't drink tea offered to you before your host has indicated that you do so. Shake

> hands at the beginning and end of meetings. Never be late. Don't overrun the designated period for the meeting unless your interlocutor clearly wants to extend it. Don't hog the conversation. (p. 87)

Just as the Gidean Society helpfully places copies of the Bible in hotel rooms all over the world I – unrealistically – wish that this book could be placed on every business class seat of aeroplanes landing at Narita.

J. B.

NOTES

The Root Cause of Recessions?

> As population grows and technology advances, land values rise. This steady increase leads to speculation, as future increases are anticipated. Land values are carried beyond the point at which labor and capital would receive their customary returns. Production, therefore, begins to stop.
>
> Production need not decrease absolutely – it may simply fail to increase proportionately. In other words, new labor and capital cannot find employment at the usual rates.

From Chapter 22 of the simplified version (http://www.henrygeorge.org/pchp22.htm) of Book 5 of *Progress and Poverty* by Henry George, published by the Henry George Foundation 1931. (With thanks to Tommas H Graves for pointing out this quotation.)

VAT in the USA

> In the past proposals for a VAT in America have been rejected as 'regressive' by the Democrats and a 'money making machine' by the Republicans. But there will one day be a VAT in America – when the Democrats regard it as a 'money making machine', and the Republicans regard it as 'regressive'.

Professor Robert Barro, speaking at the IEA annual Hayek memorial lecture on Tuesday 5th July.

Representing Britain in Japan

Members masochistic enough to follow EU developments may be interested to note the diminished role of the British Embassy in Tokyo signalled by the following extract from the 'Europe Day' speech recently given in Tokyo by Hans Dietmar Schweisgut, Ambassador of the Delegation of the European Union to Japan.

> This is my first Europe Day since becoming EU ambassador to Japan in February, assuming the helm of the Delegation of the EU to Japan under the newly created European External Action Service, the EU's foreign policy arm. The EEAS was established to enable the 27-member EU to speak with one voice in the international arena and thereby make it more effective and influential. The delegation now coordinates the positions of the member states, and the EU ambassador speaks on behalf of them when holding discussions with the Japanese government.

The Japan Times 9/5/2011

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.