

# **CAN WE AFFORD POLITICIANS?**

**Address by Patrick de Laszlo, M.A. B.Litt.**

**to the**

**Economic Research Council**

**on**

**June 14, 1966**

**The Economic Research Council,  
10 Upper Berkeley Street, London, W.1.**

**Two shillings and sixpence**

## INTRODUCTION

When I approached Mr. Patrick de Laszlo with the intention of persuading him to address our members, he expressed considerable reluctance because he felt that, as Chairman, it was imprudent for him to encroach on the territory of our Guest Speakers. However, I persisted, because in addition to a thorough knowledge of economics, Mr. de Laszlo has a remarkable gift for understanding what people are thinking as well as an unusual facility for putting these thoughts into simple and often entertaining words.

Since he gave his address on June 14th there have been so many requests for copies of the text that we have decided to print it. This pamphlet has been taken from the original text but it includes a number of paragraphs which were omitted at the time because Mr. de Laszlo wished to restrict himself to the customary limit of 45 minutes.

Since the address was delivered much has happened in the economic sphere. Further measures have been taken by the Government in an attempt to cure our economic ills. Much that Mr. de Laszlo has to say is extremely relevant to this paramount issue which faces the country today. I therefore recommend his words to members of our Council and to the far wider audience who will, I hope, take an interest in this important and very pertinent view of the source of our troubles.

EDWARD HOLLOWAY.

5th August, 1966.

Second Edition, October 1966.

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## CAN WE AFFORD POLITICIANS?

I am not going to try and justify the rather frivolous title of this talk — I will only explain it.

The moment Edward Holloway (Hon. Secretary of the E. R. C.) had persuaded me to address the Council he demanded that I should choose a title for the address even though, at that stage, the subject-matter had scarcely been considered. We had been discussing the strange phenomenon that for the past eighteen months our leading politicians had indulged in an orgy of gloom by telling us that we couldn't afford the things we wanted while at the same time committing us to great expenditure on things that we didn't particularly want.

**ROADS** We can't afford the road programme which all experts consider to be the minimum necessary to keep our traffic flowing, but we can afford to allow a torrent of imported fuel to be wastefully consumed while vehicles stand idle in traffic blocks.

**TELEPHONES** We can't afford to bring our telephone system up to date but we can afford to lose over £100M a year on our coal mines.

**HOSPITALS** We can't afford the new hospitals we need, in spite of the fact that patients often have to wait as long as eighteen months for a bed, but we can afford in the course of one year to add 10,000 bodies to the Civil Service at a cost of well over £10M a year for many years to come.

**AIRCRAFT** We can't afford English aeroplanes, with dire consequences for many branches of advanced technology, but though we are told that there is a critical shortage of foreign currency we apparently can afford to consider buying American aircraft at an estimated cost of \$2.5B.

**OVERSEAS INVESTMENT** We are told that we are so short of foreign currency that industry must be restrained from investing overseas in spite of the fact that such investment will yield future profits which will add to the £800M income we now receive from past overseas investment — yet at the same time our leaders think that we can afford to give away £200M this year to under-developed countries which will yield no income and probably very little goodwill.

We can't afford this! We can't afford that! In a moment of exasperation I said to Edward "I wonder if we can really afford politicians" and so we agreed to use this as a title of my address hoping that it would at least reassure our members that they were not going to be subjected to some closely reasoned argument for a new economic panacea.

Of course the title is frivolous and you must be prepared for parts of this address to be frivolous but I am not going to launch an attack on politicians — They, like the rest of us, do their job as best they can, but I believe that it is increasingly difficult for them to do it efficiently because they are so poorly briefed. I am simply going to use the title as an opportunity to try and put into words some ideas about this matter which I believe are widely held among our members.

My thesis is that most of the economic issues which come before Parliament are predominantly "political" in the sense that some people may reasonably prefer one thing while others prefer something else — there are other economic issues which are not predominantly political because there is almost universal agreement about what we want but successive Governments have failed to secure it for us.

It is easy to find examples of issues which are predominantly political — If a Government has a limited amount of money to spend it is really only a matter of opinion whether it would be better to spend more on schools rather than on hospitals; more on slum clearance rather than on roads; or more on an improved health service at home rather than increased aid to under-developed countries.

In contrast, there are two economic issues which are not predominantly political. They are INFLATION and our BALANCE OF PAYMENTS.

There are some people, though I think they are mistaken, who believe that mild inflation is necessary to ensure full employment — but I am sure that even they would agree that, though most of us would like a bit more spending power for ourselves, none of us want more wages which are immediately offset by rising prices, increased taxes, and the threat of deflationary measures and possible unemployment. Moreover, all of us are aware that inflation is a cruel fraud on the small man who has saved by putting money into a Post Office Savings account, or by buying Government savings certificates. When he comes to retire, he will not get back the purchasing power which he contributed. In plain English he will have been cheated and exploited by the Government.

### **STOP-GO**

It is also quite certain that nobody wants another balance of payments crisis — The old story of a year or two of expanding trade, during which our political leaders take the credit for improved conditions and remind us that we have “never had it so good”, followed by a sudden announcement that the country is facing a balance of payments crisis, for which the greedy citizen is blamed, and that once more we must “tighten our belts”.

I contend that in order to deal more effectively with these major non political issues — INFLATION and the BALANCE OF PAYMENTS — three changes are necessary:-

Firstly, we must get rid of emotional language and emotional thinking when these problems are discussed.

Secondly, the Parliamentary machine must be adjusted so as to bring it up to date and put Members of Parliament in a better position to deal with these problems.

Thirdly, the public and our Members of Parliament must be given a great deal more information about our economic affairs and this information must be presented in a much more comprehensible form than has been the custom hitherto.

In order to illustrate the very real danger of emotional thinking I would like to remind you of what I believe to be the greatest example of economic generosity which the world has ever known which, in spite of the generous intention, ran into

unexpected difficulties due to wholly unreasonable emotional anxiety.

You will remember that when most of Europe as well as Russia lay devastated at the end of the war, nearly every country had to turn to America to obtain the very necessities of life as well as to obtain the equipment with which to restore their economies. They had little to offer in exchange except gold and so gold flowed out of Europe and into the vaults of Fort Knox until America eventually accumulated some \$21B worth of gold. However, there was not nearly enough gold to pay for all that was needed. Fortunately the Americans were inspired by a generous desire to help their old allies; to put their defeated enemy on his feet again; and to assist the under-developed countries to catch up with the industrial progress of the West and so America poured out Dollars in the form of payments for their overseas military establishments; Marshal aid, and outright gifts to the under-developed countries.

Some people may argue that America was inspired solely by self interest but I cannot believe that any unprejudiced person who has visited America and spoken to Americans could deny the sincere and altruistic desire of the American people as well as the American Government to help their fellow men — a desire which goes far beyond the needs of self interest.

When America gave Dollars to the under-developed countries she could have insisted that they be spent in America but, in order to avoid any suggestion of “economic imperialism”, which is part of the jargon used by those who seek to degenerate the generosity of America, the Americans attached no strings to their gifts. As a direct result the under-developed countries tended to spend their Dollars in Europe because they found they could buy most of what they required more cheaply in Europe than in America and this fitted in with the general aim of America which was to help the under-developed countries but also to help Europe get on its feet again.

The consequences of this amazing generosity of America can be better understood if it is divided roughly into five stages though, of course, there was no such division in reality since the whole process was continuous.

## FIRST STAGE

The Dollars collected by the European countries, from American military expenditure, Marshal aid, and the sale of goods to the under-developed countries for Dollars supplied by America, were used to buy consumer goods and the equipment necessary to re-establish industry in Europe.

Many of you will remember the time when any man who visited America on business was expected to bring home a pile of nylon stockings for his wife or his girl friend, but after a few years nylon stocking factories were built in Europe and it was no longer necessary to spend dollars on nylon stockings because wives found they could buy what they needed more cheaply at home.

## STAGE II

The Dollars still flowed into Europe but since Europeans no longer need so many consumer goods from America they began to collect in Central Banks and were treated as part of the gold and Dollar reserves of each country. This was a direct result of a series of international agreements entered into immediately after the war by which rates of exchange were fixed and Dollars came to be treated as the equivalent of gold. We in England still refer to our "gold and Dollar reserves" which at this moment stand at about £1.1B of which only £800M is actually gold.

## STAGE III

American business men started to invest in Europe by building new factories or by buying up existing Companies. They were inspired by perfectly legitimate business motives and they probably also felt that they were helping Europe with their Dollars and with their advanced production know-how. These Dollars also made their way into the Central Banks.

## STAGE IV

Those European countries which did not feel it necessary to apply a large part of their gross national income to military expenditure soon became very prosperous. The most conspicuous was Germany. She re-established her industry so effectively that she needed practically nothing from America and she was also so successful in promoting exports that Dollars flowed in abundantly. The Central Bank soon collected all the Dollars required for reserve purposes. That is to say,

the German Central Bank assembled a large enough pile of Dollars to meet any sudden call for settlement in Gold or Dollars and it was uneconomic to add more Dollars to this pile since gold and Dollars held by Central Banks earn no profit.

The Germans then began to spend their Dollars on American military equipment but they were in no hurry to build up their armed forces so they looked around for the cheapest thing available in America on which they could spend the rest of their surplus Dollars. This proved to be gold, because the price of gold had been fixed by the Americans at \$35 an oz. — well below its market value.

Finally, we come to **STAGE V**, when France, in spite of heavy military expenditure, also managed to get into the same position as Germany. The Central Bank of France found itself with more Dollars than were required for reserve purposes, and the French Government was not interested in buying American military hardware because she preferred to make her own, so the French also started to buy gold from America.

At this stage some seven Billion Dollars worth of gold had flowed out of America. This reduced the pile of gold in Fort Knox from \$21B to \$14B which made the American people feel distinctly uncomfortable.

Prominent Americans toured the capitals of Europe to persuade the Central Banks to hold on to rather larger parcels of Dollar notes than were really needed for reserve purposes. The Central Banks were reminded that if too much gold were withdrawn from America the public might lose confidence in the Dollar and this would be just as disastrous for the European economy as it would be for America.

Unfortunately General de Gaulle, being a brilliant Frenchman, introduced a novel argument which foxed the Americans. He explained that if an American business man, for purely legitimate commercial reasons, purchased a French cosmetic factory he would pay in Dollars but the Dollars would find their way into the Central Bank of France because the Frenchman who sold the business really required Francs with which to buy additional dresses for his wife or to buy himself a villa in the Mediterranean, but, the Central Bank of France didn't want more Dollars since it already had as many as it required.

He pointed out that if the process continued, and, at the same time, the French Government was not allowed to exchange Dollars for gold then it would mean that the French

Government was being asked to supply French Francs free of interest to American business men to enable them to buy up profitable French businesses. The logic of the General's argument was very simple. He merely repeated that if a French business passes into American hands in exchange for Dollars the profits from that business will thereafter flow over to America, but the French Government will be landed with a packet of dollar notes which will earn no profit and which they were being asked not to exchange for gold — he didn't think this a fair deal.

### PRICE OF GOLD

Of course I have over-simplified the whole story but I don't think I have distorted the underlying truth because I remember being in America at a time when Sir Roy Harrod was delivering a series of lectures in which he argued that though gold had been flowing into America, conditions would soon be so changed in Europe that gold would start to flow back again and it would therefore be prudent if America allowed the price of gold to be fixed by market conditions.

Unfortunately leading Americans tended to scoff at Sir Roy and, as a result, they failed to prepare the American people for the possibility that gold might flow out of America and they also failed to make it clear that it would probably be a good thing for America, as well as for the rest of the Western world, if a good part of this gold did make its way back again to Europe. As a consequence, when gold started flowing out of Fort Knox the American people were taken by surprise and were assailed by a growing wave of anxiety — an anxiety which, I suggest, is born of emotion and is completely unreasonable.

It is easy for us now to be wise about America but we must not forget that it was not so long ago that most leading English politicians and bankers, not to mention the Governor of the Bank of England, thought that the number of notes in circulation, and so indirectly the amount of money in circulation in England, must legally depend on the amount of gold lying in the vaults of the Bank of England.

When Sir Winston Churchill was Chancellor of the Exchequer in 1925 he put England back on the gold standard. He did so with the full support of his political colleagues and on

the advice of Mr. Montague Norman who was Governor of the Bank of England. The result was disastrous because, of course, there was not enough gold flowing into the Bank of England to support the increasing supply of money needed to finance our expanding industry. It promptly led to stagnation and unemployment. We learned our lesson in a painful way and in 1931 we went off the gold standard again and are never likely to return to it.

One of the marks of greatness in Sir Winston Churchill was his willingness to acknowledge a mistake. In April 1932 in a speech to Parliament he took full responsibility for his action in 1925 and recognised the tragic folly of it. He did us a great service by crystallising the essential issue in the following simple words:-

“Is the progress of the human race, in this age of almost terrifying expansion, to be arbitrarily barred and regulated by fortuitous discoveries of gold mines ..... Are we to be told that human civilisation and society would have been impossible if gold had not happened to be an element in the composition of the globe?”

I am sure that everybody in this room realises that there is not the slightest connection between the note issue or money in circulation in England and the gold which happens to be lying in the Bank of England, but, unfortunately, this is still not accepted on the other side of the Atlantic because in 1913 the Americans passed a Federal law which requires that there shall be 25% gold cover for the Dollar note issue and so \$12B worth of gold must be held in Fort Knox in order to cover the present note issue.

There is now only about \$14B gold in Fort Knox so there is a very real anxiety in America about the possible consequences if another 2 or 3B Dollars worth of gold is withdrawn which will cause the gold reserves to drop below the legal minimum of \$12B. It is seriously asserted that Four \$ notes will have to be withdrawn for the loss of every \$1 worth of gold and that this could lead to a steep reduction of credit followed by a slump comparable to the catastrophe of 1930 and the end of the happy American theory of a continuously expanding economy rather similar to the theory of a continuously expanding universe expounded by Professor Hoyle.

It has been perfectly obvious that at no time since the war has the American note issue been related to the gold in

Fort Knox. America didn't print more notes as gold flowed in and didn't reduce the number of notes as \$7B worth of gold flowed out.

In brief the removal of \$7B worth of gold didn't make the slightest difference to anybody in America, save perhaps to the guards who had to load it on trucks for export, so we can see that if it had not been for emotional thinking America could long since have remedied the situation either by increasing the price of gold—they could have doubled or trebled it with advantage to us all—or they could have rescinded the Federal law which requires a 25% gold reserve for the note issue. It would have been easy to take these steps while gold was flowing into America—now that the situation is charged with emotion it is very difficult.

The unhappy outcome of this wave of emotional anxiety is that the American Government has been obliged to restrict the outflow of Dollars by voluntary restraint and by a 15% tax on overseas investment and it is seriously suggested that they may impose a poll tax for every day an American tourist spends abroad. In consequence the whole of Europe is suffering from a shortage of money and interest rates are rising.

All this anxiety seems like something out of Alice in Wonderland and if one probes for an understandable explanation one can only discover the two rather unattractive emotions of PRIDE and SPITE.

PRIDE enters into the matter because of the myth that if one day a Dollar note can only buy a smaller quantity of gold the American people will somehow be poorer or will have suffered a loss of status.

SPITE is evident when Americans explain that they are unwilling to increase the price of gold because it might help South Africa or Russia.

I suggest that the best thing which could have happened to the economy of the whole Western World, would have been for James Bond to have joined up with Mr. Goldfinger and with the help of all those skin divers and glorious blondes successfully tunneled under Fort Knox and stolen the remaining \$14B of gold.

I warned you of the frivolous element in this address, but is this idea really so frivolous? Let us carry it to its conclusion. The American Government might have concealed the theft from the American people in which case the loss would have made

not the slightest difference to them. But the American Government is rightly proud of revealing failure as well as success and so it would certainly have disclosed the truth. This might have come as a horrible shock but within a few weeks the American people would have discovered that the loss of their hoard of gold had no effect whatever on their economy. Dollar notes would not have been withdrawn from circulation and their economy would have continued to expand. They would have gone on exporting more than they import, and they could then have used their favourable balance to buy back the gold from James Bond or else to continue giving it away as aid to the under-developed countries.

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### THREE CHANGES

It is time to return to our own economy and try to develop my original proposition that three changes are needed if we are to deal more sensibly with our own fundamental economic problems:—

1. We must get rid of emotional language and emotional thinking.
2. We must bring our parliamentary machinery up to date so as to secure that our politicians are better able to do their job.
3. We must be given a great deal more information about our economic affairs and it must be presented in a more intelligible form.

I have talked at great length about the unfortunate result of emotional thinking on the other side of the Atlantic. This is largely because I wanted to make my point without appearing to criticise any particular political party in England though

I am convinced that the use of emotional language by our own politicians is one of the most dangerous elements in our economic situation today.

Too many of our political leaders of all parties, when faced with an economic crisis, have used emotional language to divert attention from the truth. For instance, when cash deposited in London for perfectly legitimate business reasons is withdrawn, because the depositor can earn more interest elsewhere or because he fears that the £ may be devalued, it is referred to as "hot money" — an expression which I believe was coined during the war to describe money improperly acquired either by theft or tax evasion. It is curious that nobody complains when foreigners deposit money here — we are only offensive when they take it away.

Another example of misleading emotional language is the statement that "the Gnomes of Zurich have been attacking the Pound" — Who are the Gnomes of Zurich and why should they wish to attack the pound? The phrase is clearly intended to shift the blame for our own folly on to the private banks of Zurich who have, in fact, generously co-operated with their Central Bank to support the pound by making massive loans to Britain and it would certainly not be in their interest to attack the pound and deliberately bring about devaluation.

### **"SELLING BRITAIN SHORT"**

The latest addition of this sort of language is a reference to people who are said to be "selling Britain short" which is merely an unworthy attempt to convey that there are disloyal Englishmen who are somehow responsible for the economic crises for which, of course, the Government is alone to blame.

I am not just criticising the present Government — similar emotional language has been used in the past when inflation has got out of hand. Successive chancellors, when they have failed to nip inflation in the bud, have talked about "too much money chasing too few goods" and have referred to our "overheated" or "overstretched" economy. They have also used this sort of emotional language to justify exploiting the situation by imposing more taxes with the spurious argument that they are "siphoning off surplus purchasing power". They have claimed that their additional taxes will take excess money out of circulation but the records show that purchasing power

taken out of the hands of the civilian population by additional taxation has invariably been spent by the Government and has never reduced the amount of money in circulation.

In contrast to the behaviour of our own Governments the Swiss Government some years ago became concerned at the growth of excess purchasing power in Switzerland so it deliberately borrowed from the open market some two billion Swiss Francs. (Nearly £200M). The Swiss Federal Government sterilised this money at great cost to the State — that is to say they neither spent it themselves nor did they put it back into circulation through the banking system. They genuinely reduced the amount of money in circulation instead of merely pretending to do so.

I may have over emphasised this point but I know that many of you share my view that emotional language has too often been used by our political leaders either to shift responsibility from themselves or for party political reasons to postpone taking necessary remedial action.

Emotion may be the very substance of our personal relationships; it is certainly the fuel on which artistic geniuses thrive; but it is the most insidious of poisons when introduced in economic thinking.

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### **PARLIAMENTARY PROCEDURE**

My second point was the need to amend our parliamentary procedure. My case is a simple one. I need only ask you — is it reasonable that once a year (unless there is a crisis in the meanwhile) the Chancellor of the Exchequer at the beginning of April should appear like a prima donna in Parliament and produce out of a box a vast book of new and complex tax regulations as well as a budget for the coming year all of which has to be considered by M.P.s who are totally unprepared and are obliged to debate the issues in a hysterical hurry so as to get the bill through before the Summer recess?

Do you think it efficient or even tolerable that anything so complicated as the Selective Employment Tax should have to be debated between 10 at night and 6 in the morning by M.P.s who have sat up night after night debating clauses of



the Finance Bill and who have never had an opportunity to be adequately briefed?

This system may have been tolerable in the days when new taxes suggested by the State could easily be understood. For instance, anybody can understand the implications of an additional 3d on beer or 6d on income tax but today we are in a new era in which Government has discovered that it can extract money without frightening the public and, which is more important to them, without frightening its own supporters, by imposing more and more taxes on companies. Four new company taxes have been added during the past year.

The Treasury has also discovered that it can use such devious language to define new tax regulations that not one man in a thousand can understand what is really happening and even the majority of our Members of Parliament have only a hazy idea of the real implications.

I am not in this address attacking company taxation though I think it would be far better for the country if a genuine attempt were made to simplify the whole machinery of taxation by introducing an Added Value tax which could be collected through Companies and which could be understood by the public, in place of the present conglomeration of company taxes which seem designed to conceal what is really happening and which certainly waste a great deal of the time of business executives who would be better occupied improving their production techniques or seeking wider markets for their products.

My complaint is that the general public is completely unconcerned by the vast new taxes imposed on companies because they are under the happy illusion that the money is going to come out of the pockets of companies and not out of their own pockets. They do not appreciate that these taxes must in the end be passed on to the public who will then blame industry for putting up prices instead of blaming the Chancellor of the Exchequer.

In short I am saying that in this new era the public is being fooled and industry is being loaded with an ever increasing burden of paperwork quite apart from having to find the money in the first instance.

You may not agree with my views on taxation but I hope you will agree that it is intolerable that Parliament, which claims to be sovereign, should be compelled hurriedly to debate

tax regulations which are so complicated that very few Members of Parliament really understand their meaning.

The remedy I suggest is a permanent Royal Commission representing both Houses of Parliament and all three political parties which should have the power to call for expert advice from every section of the community and which would be entrusted with two main duties.

- (1) To keep a constant watch on Government expenditure which I suggest is at the root of our inflation.
- (2) To study the implications of different schemes for raising taxes and to report openly to Parliament on its findings.

We all know the argument that only the Government should initiate new taxes and we all know the dangers of "budget leaks" but this would not affect the working of a Royal Commission such as I have suggested which would be in permanent session and could keep the public and Parliament informed so that M.P.s and their supporters outside Parliament, would be in a better position to consider proposals put forward by the Chancellor for additional expenditure and for new forms of taxation.

In America they have the Congressional Ways and Means Committee which is in permanent session and broadly speaking carries out these duties.

I will now give you a more formidable example of the way in which Parliament is not allowed to exercise its sovereign powers. I have in mind the mechanism by which money is created in England—that is to say the banking system as a whole which, in practice, is under the control of one man—the Chancellor of the Exchequer.

I don't think it exaggeration to say that the Chancellor of the Exchequer through the Bank of England and by means of orders to the banking system can cause the supply of money to be increased or diminished. My objection to this is that the Chancellor exercises these powers without consulting Parliament and in any case the Chancellor is a politician who at best has only had a little academic training in economics. He must have devoted most of his working life to becoming a successful politician otherwise he would never be appointed to this great office, and, he is only likely to hold office for a year or two—

never long enough to gain sufficient experience to control efficiently this complex mechanism which is the basis of our whole economic life.

## HOW MONEY IS CREATED

Most people have no idea how money is created and even when you tell them they are unwilling to believe you. This is still true in spite of the Radcliffe report which was published as long ago as 1959 and which has been followed by much debate, and in spite of the recent speech by Lord Cromer which in the politest language repeated the essential points so I hope you will forgive me if I attempt a brief summary.

The simplest source of new money is the additional notes which are printed and put into circulation by the Bank of England. In 1964 £157M notes were added and in 1965 nearly £200M. They were spent by the Government and they are included in the official figures which show the sources of Government income. The only cost of this £200M was the cost of printing so it is clear profit for the Government but it added £200M to the money in circulation. In fact it went further because these notes formed the basis for creating still more new money in a manner which I will now attempt to explain.

The second source of new money is the banking system itself. As you know the basis of our banking system is that if we deposit money with a bank they keep one-third of our deposit, more or less in cash, and lend the remaining two-thirds, but the two-thirds lent by the bank immediately reappears for a second time as a new deposit with the banking system. The banks then hold on to one-third of the new deposit and again lend the other two-thirds which for the third time re-appears as a deposit and so the process is repeated in a sort of diminishing spiral. This is generally referred to as the "multiplier factor" and you will see from a simple piece of arithmetic that if the Government prints £200M new notes the multiplier factor turns it into a much greater amount of new money in circulation.

Thirdly we have "overseas residents," as the Central Statistical Office calls them, who deposit money with British Banks — Total Bank Deposits are today approximately £15B of which nearly £4B belong to "overseas residents" and half of this £4B consists of non-sterling deposits — Once again the Banks lend two-thirds of these overseas deposits internally in

England and if you take the multiplier factor into account it forms a very large part of our Total Bank Deposits. This may be useful for our economy but, of course, if the "overseas residents" think that the £ may be devalued or find that they can get better interest elsewhere they may withdraw some of their deposits in which case the multiplier factor will cause a much greater amount of money to be withdrawn from circulation.

In this connection it is worth noting that the Swiss have been very conscious of the danger of this situation — They are cautious people and don't care to allow the money in circulation in Switzerland to be arbitrarily increased or decreased as a result of the whims of foreign depositors, so the Swiss Banks are not allowed to treat foreign deposits as a basis for internal lending within Switzerland.

Let me make this point absolutely plain — If an American deposits \$1M with a British bank the banking system will lend two-thirds of that amount internally in England and due to the multiplier factor the amount of money in circulation will be increased by a good deal more than the equivalent of \$1M. If the same American deposits \$1M with a Swiss bank there will be no increase in the money in circulation in Switzerland. The Swiss Bank is only allowed to act as an agent for the purpose of holding the money in safe keeping or investing it for their client outside Switzerland.

Finally, if the Government borrows from the British banking system it will give Treasury Bills in exchange and these Bills will be treated as the equivalent of £ notes. This means that money lent to the Government by the Banks does not diminish the amount of money the banks have available for other borrowers — on the contrary it increases their lending power because if a Bank lends the Government a million pounds and receives Treasury Bills in exchange the Treasury Bills are treated as cash, so the liquidity of the bank has not been diminished, but the million pounds is immediately spent by the Government and appears as additional deposits and the following day the banks put one-third of this into their liquid portfolio and lend the other two-thirds — Incidentally all this is also true of money lent to commercial firms against bills.

There are many ramifications of this system with which most of you are familiar but I only seek to expose the bare bones of a mechanism which is fully described in the Radcliffe report.

## THE CHANCELLOR'S ROLE

I am not suggesting that there is anything wrong with this mechanism save that it is uncomfortable to realise how much of our money in circulation depends on Overseas Depositors. The thing which is wrong is that if an excessive amount of money is created we have "inflation" and since the banking system is now under the absolute control of the Treasury, it is the Chancellor of the Exchequer who, in the last resort, has the power to encourage or discourage the creation of new money and, I repeat, he does so without consulting Parliament and I know several Members of Parliament who are totally unaware that the Chancellor has these powers.

It must be clearly understood that the Chancellor has two quite distinct functions though they are to some extent interconnected. His first and main function is to raise money and control its expenditure on behalf of the Government and he is under constant pressure from his political colleagues to make more and more money available for their departments and they, in turn, are under pressure from their political supporters to spend ever increasing sums on popular projects.

Excessive Government expenditure is itself I believe always at the root of inflationary spirals. If the Government grabs too large a slice of the gross national cake by additional taxation and additional borrowing it not only stimulates the creation of new money through the banking system but also encourages every organised group in the country to follow the example of the Government by trying to grab an extra bit of cake before it is too late.

The Chancellor must be a man of unusual courage if he is to resist the demands of his party for more cash at times when he knows that just a little more Government expenditure will push the economy over the brink of inflation.

This function of the Chancellor is fully accepted as an essential element of the Party Political system.

The second, and quite distinct, function of the Chancellor of the Exchequer is his power, through control of the banking system, to cause the supply of money to be increased or decreased. I suggest that this should be completely divorced from Party Politics, and I further suggest that it is impossible for the Chancellor of the Exchequer to carry out this function dispassionately when he must be almost overwhelmed by the

ordinary work of his department and when he is so exposed to political pressures.

The remedy I suggest is a Board, similar to the Federal Reserve Board of America — or the Swiss Federal Banking Commission — which should be answerable to Parliament in place of the present system by which the Governor and the Directors of the Bank of England are appointed by the Chancellor and report only to him and he can, if he wishes, pigeon-hole their reports and never reveal these to Parliament.

The Bank of England should be responsible to Parliament and not to the Treasury. This does not mean that the advice given by Governors of the Bank of England has always been right but at least they are free from politics and it would ensure that the opinions of the Bank of England are made known to Members of Parliament and as a result Members of Parliament would learn a great deal more about what is happening than they do at present.

It may be desirable that the Bank of England should report to some form of permanent Royal Commission with power to approve recommended changes in the supply of money, but the essential point is that the creation of money should be taken out of the political arena because if only the supply of money can be more effectively controlled it will put an end to the periodic bouts of inflation which, once they get out of hand, require drastic political action such as hire-purchase restrictions and wage-freezes etc. to restore the balance.

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My final plea is for more statistical information. Here at least I am confident that none of you will disagree with me. No worthwhile figures were published before the war but there has been a great improvement since the war. It started under Mr. Macmillan and has been much advanced under the present Government. No doubt a real effort is being made to supply the information which is needed but it is still inadequate and the manner of presentation is antiquated and unnecessarily confusing. In short we are still groping in the dark.

I would like to give you another analogy intended to bring out the importance of this point because I have so often had to listen to the tedious witticisms about Economists in which Politicians think they are entitled to indulge. If you discuss serious economics with a politician he is likely to try and escape the issue by quoting the old chestnut that if you have twelve economists in a room and one of them is Lord Keynes you will end up with thirteen opinions.

### LACK OF INFORMATION

My analogy is that economists are in the same position as medical scientists at the beginning of the last century. Medical scientists were then literally in the dark and it was only when better microscopes were invented after 1830 that medical science began to take such tremendous steps forward. When they were able to see a microbe they could find a remedy and today they have an electron microscope with which they can "see" a virus. As soon as they were able to see their problems medical scientists found remedies and showed the Government how to rid the country of such horrors as the plague, smallpox, and T.B. which must have made life a misery in the past.

Economists are in a similar position today. They have been given a little information which is still so sketchy that you can compare it to the microscopes of 1820, but even with this elementary information Lord Keynes and his successors have made it possible for us to understand a great deal more about our economic problems than was ever dreamed of in the past. If only economists can be given sufficient information I am confident that within this generation they will show the Government how to get rid of the worst of our economic plagues—that old crazy swing from boom to crisis.

Let me give you a topical example of the danger of inadequate information by reminding you of the statement made by the Chancellor of the Exchequer in November 1964 when he told the country that it came as a GREAT SHOCK to him, on the day when he assumed office, to learn that there was a prospect of an overseas deficit of £800M. The question is, why did it come as a great shock to him? After all the figures are published regularly, though it is true that they are about 3½ months in arrears and not easy to comprehend.

The emotional words used by the Chancellor of the Exchequer led people at home and overseas to believe that he had discovered facts not previously disclosed and that the whole of our economy was in jeopardy. When the figures were eventually published it was discovered that nothing unexpected had occurred. We had simply overspent on current account by some £460M which the monthly figures had already indicated as likely. In addition we had during 1964 invested some £300M overseas — a total overspending (if that be the proper word) of £760M.

The emotional language used by the Chancellor coupled with the lack of statistical information caused some overseas residents to withdraw their deposits from London which made it necessary for him to run to the American and Continental Central Banks for help. But was it all really necessary?

It is exceedingly difficult to comprehend the significance of hundreds of millions of pounds. There are some men in this room who often write cheques for £1000 and one or two may write cheques for £10,000 but not one of us has ever written a cheque for £100M. For this reason these large figures take on an abstract quality almost divorced from reality.

It must also be remembered that half our voters are women and very few women have ever written a cheque for even £1000. In fact I find that ordinary capital sums mean very little to most women though they all have an incredibly accurate understanding of the difference between 39/3 and £2. For example my wife makes a great fuss about paying for a taxi when it is possible to go by bus, but if I try to talk to her about our small capital assets she finds it an effort to pay serious attention. For this reason, and because my wife has been patient enough to come and listen to this address, I want to try and put into homely language the situation which existed in 1964. Once again I shall have to use an analogy which is naturally imperfect.

Try and imagine that Britain is just one family which has inherited a very large and profitable factory which owns land, dwelling houses, factory buildings, plant and transport.

This family can consume some of the produce of the factory but most of it is sold to the outside world and provides the means (the foreign exchange) to buy what is needed in the way of raw materials and consumer goods. Imagine that broadly speaking the income of the family is £7,000 a year

(equivalent to £7B in Britain's visible and invisible imports). The family naturally spends this income (equivalent to our £7B imports).

The main capital assets of this family, as I have indicated, are land, buildings, machinery, transport, and stock and these capital assets are very great but they have never been valued and in addition imagine that the family, over the years, has accumulated investments worth about £15/20,000 (equivalent to approximately £15/20B — the estimated value of the British overseas assets which yielded dividends to this country of over £800M in 1965).

In order to operate the factory to its maximum efficiency the family borrows from outsiders and because their credit is good they may even borrow on short term in order to make additional long term investment overseas.

Now imagine that in the Autumn of 1964 this family had overspent by £460 and in the same year they had invested another £300 overseas.

You can easily picture the family conference. Father telling Mother she must cut back her expenditure and Mother talking about special expenses due to children being at school or the need to buy new curtains and bath towels. Of course she would agree that the situation must be put right during the next year or two but she would point out that it is not very serious to overspend £460 on an income of £7000 particularly if you take into account capital assets at home and overseas about which her husband is so proud.

One thing is certain, no reasonable family would make much fuss if they had overspent £460 on an income of £7000 and had also invested £300 overseas in the same year. Their credit was excellent so they would simply have borrowed a bit more and could have offered plenty of collateral.

I think you would regard them as irresponsible if they proclaimed to the World that due to the inefficiency of a previous manager they were facing a formidable crisis of which the full extent was still unknown and thereby frightened their creditors into calling in their loans.

I believe that a sensible family would have moved into 1965 without any crisis at all though I can imagine that if Father went on having sleepless nights because he had been obliged to borrow an extra £760 Mother might have suggested that he could always consider selling one of his many assets.

You will realise that I am trying to say in simple language that the financial situation in 1964 was not nearly so serious as our politicians suggested because they completely disregarded our capital resources, though the imprudent language which they used caused foreigners to withdraw their deposits and led them to believe we had lost our will and ability to manage our own affairs.

If there is really such a crisis and if we really desired to remedy the situation I would, for the fun of it, like to put forward the following suggestion:-

You have all been maddened by our telephone system. You can't get an extra telephone line because Post Office engineers are too busy or the local exchange is already overloaded. When you dial a number you are misrouted because the exchange is out of date. If it is a long distance call you are likely to hear a plushy tape recorded voice telling you that the lines to Portsmouth are engaged and instructing you to ring again later. If you speak to the operator she finds it difficult to understand what you say or has never heard of the Scottish exchange for which you are asking.

Now, in America, most of the telephones are operated by the American Tel. and Tel. Co. The market value of the whole issued share capital of American Tel. & Tel. is today about \$27B — say £10B — ten times as much as the total gold and dollar reserves of this country. So far as I have been able to discover from the public relations department of the Post Office the British telephone system has about one-quarter of the number of subscribers of the American Tel. and Tel. Co. so why don't we sell the whole British telephone system to American Tel. & Tel. — On the face of it they might be willing to pay us about £2B which would treble our gold and dollar reserves and free us from the Gnomes of Zurich for the next 100 years. What is more we would probably get a far better service from the American Company and I am sure they wouldn't take long to connect up households now waiting for a telephone and would soon re-equip our obsolete exchanges.

Moreover, in addition to the fact that the American telephone system works a great deal better than ours they give a service which might do much to help exports if it were introduced in this country. I refer to the courteous efficiency of the American telephone operator in tracking down a person you wish to contact. If you explain that last night you met

a charming brunette whose Christian name was Mary and you think her surname was Smith and that you know she lives on 82nd street and that she is a member of the Colony Club, the operator will very politely offer to trace her and in a few minutes you will be talking to her. A valuable service for tired business men from overseas.

I hope you will forgive me for concluding on this very frivolous note. It is merely intended to show that though we have made quite a good start at assembling and publishing the facts about our economic affairs a great deal more information is needed and it is time we started publishing the value of our capital assets at home and overseas.

I seriously suggest that if more information had been available in November 1964, and especially if more information had been available about our capital assets, the fact that we had in that year overspent by £460M in current account and had also invested £300M overseas might have been seen in better perspective — it might have been less of a shock for Mr. Callaghan and so he might have spoken less passionately and avoided frightening the "Overseas Residents," or Gnomes as some politicians now call them, into withdrawing their deposits as they have been doing ever since.