

Economic Notebook

SECOND-CLASS PASSAGES TO NEVER-NEVER LAND

1958 was surely the Bankers' year—a year that began with 7% and the white-washing report of the Tribunal on the Bank Rate leak, saw the ending of the credit squeeze and concluded in a burst with sterling convertibility.

Freed from years of restraint by the Government's decision in the middle of the year to encourage once more an expansion of the economy, the Bankers went to town. The Joint Stock Banks bought up the top eight Hire Purchase finance houses; they offered personal loans for purchases of cars, television sets, washing machines, etc., the Midland alone lending £7 m. to 45,000 people by the end of the year; they recommended banking accounts for all and payment by cheque for workers, the Midland making a start by introducing a Personal Cheques service, for what the Chairman of Barclay's rather disparagingly called "second class" passengers; Westminster and Martins actually began to build "drive in" banks in Liverpool and Leicester to help solve the parking problem in the anticipated rush to open accounts.

The Merchant Banks for their part established three new Unit Trusts, which issued blocks of shares amounting to some £7 million (a fourth was to follow in January and collect another £2.5 m.); and plans of many other sorts included a free investment service inside the factories which were being prepared to catch the new wage-earner investor. In this heady atmosphere of freedom the profits of the Banks have risen rapidly and there has been a minor boom in Bank shares on the Stock Exchange.

These innovations might suggest an early birth for Sir Anthony Eden's "property owning democracy" but for a few cold facts: no more than 6% of persons over 25 own stocks and shares at present and 3% own two-thirds of the property; £7 m. of personal loans must be compared with a total of £2,000 m. of bank advances; more serious, real earnings over the year actually fell one point for the first time since 1952; even the rise in H.P. debt from £400 m. in 1956 to £600 m. at the end of 1958 raises it little more than a fifth above its previous post-war highest of £500 m. in 1955 and brings it up to a bare 3% of total personal incomes. This may be compared with H.P. debt amounting to 10% of personal incomes in the U.S.A. Indeed, the Bankers are well aware that liquidity—currency notes and bank deposits as a proportion of current incomes—is lower than at any time since 1919, partly as a result of the 20% rise of money incomes since 1955 when bank deposits were as high as they are today. Well, if they want our savings and they want us to spend more, they will have to let us earn more. And there's the rub!

REFLATION WITHOUT INFLATION

Now that they've got their deflation some of the Bankers seem not to be, after all, so pleased with it. A real distinction of emphasis appears here. Bank chairmen with merchant banking connections like my Lord Aldenham of Gibbs and Westminster, Sir Eric Carpenter of Grey Bros, and Williams Deacons and Sir Harold Bibby of Bibby Bros, and Martins feel that 7% was abundantly justified and congratulate the Government on its "successful and courageous steps in saving the value of the £" and "arresting the downward trend of our fortunes", albeit "at the cost of some slight loss in production". Others are not so sure.

Mr. Tuke of Barclay's derides the notion that 7% saved the nation; advances, he says, had already been cut back four months earlier. The real cause of deflation, he avers, was precisely the decline in primary commodity prices which began in December, 1956, and continued throughout 1957 and 1958. This decline was caused in its turn by "overproduction due to world-wide inflation". So inflation caused the deflation! This is splendid and he draws a picture of the Trade Cycle's "pendulum swing governed by the inexorable natural forces of supply and demand."

Herein lies a real contradiction which faces the Bankers and leads them to disagree. They have become aware of something that would seem perhaps obvious enough to a mere layman; that, if you succeed in checking an investment boom by deflating the whole economy, and so reduce earnings by unemployment and short time at home and by lower prices for primary producers overseas, then demand for industry's products at home and abroad will fall. "A measure of unemployment" and "favourable" terms of trade (that is, better prices for our exports and/or lower prices for our imports) were assumed to be "good things". But when you've got them, how do you encourage expansion again? The trouble is that, in a free and open economy, when one firm and one country expands, all expand, and inflation and excessive demand for imports follow. Similarly, when one contracts all contract. These are Mr. Tuke's inexorable forces, which only the tabooed measures of planning and of discriminatory control can tame.

Thus, while Mr. Tuke is waiting for the upward swing for Barclay's widespread overseas interests, some of his colleagues—Lord Monckton, for instance, of the Midland, with its large stake in engineering and chemicals at home; and Sir Thomas Barlow of the District, with its major interest in Textiles—seem anxious to help the pendulum up, fearing that it might swing further down into a recession. What the Bankers are pressing for, with the aid of the *Economist*, is a reduction in income taxes. This would help the better-off members of the community who have a greater propensity to save and so would

encourage another investment boom, they hope. But with excess capacity existing already in many sectors of industry, investment cannot be started upon again until sales at home **and** overseas expand. It would seem more appropriate, then, to reduce indirect taxes, which fall most heavily on the less well-off members of the community, who have a greater propensity to spend.

Alternatively, prices could be cut or wages raised. Lord Monckton appeals to private industry to cut prices; but the absence of real competition, except among the giants, who mainly avoid price battles, means that price cutting does not take place under modern capitalism. And no banker has ever been known to appeal for wage increases. Sir Oliver Franks, thinking perhaps of Lloyds's major interest in steel and engineering, has however joined Sir Thomas Barlow in stressing the need for developing the underdeveloped lands and raising the earnings of the primary producers. But here again the object of U.K. overseas investment is higher profits and these tend to absorb a large part of overseas producers' earnings. Increased investment on traditional lines might do little to sustain British exports.

CONVERTIBILITY HAS A HISTORY

Here enter the merchant bankers, who seem so much less concerned about the ill effects of deflation and are glorying in their successful attainment of the latest step towards their sacred goal of full free convertibility of the £, that is, towards convertibility for British holders of sterling as well as for foreign holders. Lord Monckton, who is not a merchant banker, regards the present step, which has taken ten years to achieve, as half-way to the goal. Mr. Robarts of the merchant bank of Flemings and Chairman of National Provincial is all for "pressing on to full convertibility" and is most self-congratulatory at the "enormous achievements of the post-war years built as they were upon small financial foundations".

And indeed they were small; for Britain ended the war with much reduced overseas investments, with small reserves of gold and dollars, with exports at a third of pre-war levels and with debts of some £4,000 millions. Full convertibility of the £ was accepted as a condition of the Keynes loan from the U.S. and dutifully introduced by the Labour Government on the appointed date in 1947, whereupon holders promptly began converting their sterling balances into dollars. £150 millions of Reserves were lost before the game was called off, and the Labour Government has, rather unfairly, been blamed ever since. In defence of Keynes it should be said that he had hoped to get a much bigger International Monetary Fund—four times bigger—to cushion the loss. This was the assumption also of the Bretton Woods agreement to which Sir Oliver Franks now refers us as the authority for "establishing after a transition period a regime of stable and convertible currencies, free of exchange restrictions and discrimination".

After 1947 a more subtle policy of building up the Sterling Area in opposition to the Dollar Area was pursued. The huge sterling debts were used as an advantage—the prospect of annual repayments keeping independent creditors loyal to the bank, while colonial creditors' debts were simply allowed to accumulate. At the same time dollar aid, whether Marshall or Defence, South African gold production and colonial dollar earnings were all used to staunch the dollar deficit on the trade both of the U.K. and of the Dominions.

Today, dollar aid has been replaced by off-shore purchases and other U.S. Army expenditures in the U.K.; exports are largely paid for by imports; and even the deficit on dollar trade is much reduced. Some part of the debts to non-sterling countries has been cut, but only by increasing colonial debt and by borrowing in a crisis from the International Monetary Fund. The total figure of Sterling Debt remains stubbornly at £4,000 million, compared with reserves of dollars, to pay to any who wished to convert their sterling, valued at around £1,000 millions. It is well known that in a crisis the Government could throw in dollar securities held by private citizens and the Colonies could be prevented from converting. But the Colonies

are rapidly becoming independent. The margin is small and there are the borrowings from the I.M.F. and from the U.S. Export Bank to be repaid as well as the earlier Keynes loan.

THE HOLY GRAIL

According to Mr. Shonfield the present measure of convertibility was proposed early in 1952 by a group of bankers and civil servants and abandoned. Its introduction today is a colossal risk; its success depends largely on the current fears of international investors concerning the health of the U.S. economy. If a new U.S. boom began, conversion from £s into \$s would be immediate and it would be hard to stop British citizens from joining in. So it would be if Labour looked like winning the Election. Of course, no real assets would be lost, but the loss of foreign capital would demand widespread State intervention to prevent a breakdown in the finance of industry and to finance necessary dollar imports.

But all this is as nothing to the risks of full convertibility, where every Englishman and all members of the Sterling Area who had £s to spare could change them into dollars, as and when they wished. Of course, he would only so wish if dollar goods were cheaper at the present rate of exchange—and this is now only rarely the case—or if dollar goods were better—this may often be the case—or if he could get a higher return by investing his money in the U.S. or Canada. The loss of £s to \$s on any large scale—and we could as well consider the loss of £s to Marks—would lead to a devaluation of the £ in relation to the dollar or the Mark. Imports of dollar goods would become more expensive and although at the same time our goods would become easier to sell because cheaper, the barriers erected against foreign sales in the American market (apart from the present and probably short-lived small car boom) have been a permanent stumbling block to dollar trade since the war—as we found out last time there was a serious run on the £ and we had to devalue in 1949. And now similar barriers seem likely to be erected around the Common Market in Europe.

Why then the crusade for convertibility? "And what," as Dr. Jowett once asked of Mr. Tennyson, "will they do with the Holy Grail when they find it?" There were obvious advantages in Free Trade and convertible currencies in the Nineteenth Century when they gave to Britain as the world's chief manufacturing country and the chief source of international capital the right to penetrate the markets and industries of the world. But Britain has today been supplanted by the U.S. in both these respects. Convertibility now means freedom to convert £s into \$s and not other currencies into £s.

What then are the Bankers after? Are they dreaming of a return to 1913? or to 1925? They know they cannot rival U.S. production or U.S. investment. But they hope that existing political connexions will keep sterling supreme in the Commonwealth; and they see the City of London as attracting once more the financial business of the world, of sterling holding the one field where it can challenge the dollar—in the finance of world trade. A strong £ will attract short-term investors and make more sterling available for long-term overseas investment. London's commodity markets, Insurance Houses and Shipping Brokers will flourish. Long-term investment will be attracted to Britain, too, because of the convertibility of all profits earned in sterling. And the extension of convertibility to British citizens and British firms will make repatriation of profits easier.

LAST DOSE OF FREEDOM

Full convertibility would make possible more investment by British investors in \$ securities (or in German and Swiss for that matter) than is possible now through the Kuwait gap and other leaks in the Exchange controls. Mr. Butler once threatened to remove by the end of the present Parliament the machinery which Labour could "by the flick of a switch" use to reimpose controls on the economy. The exchange control machinery is probably the most complicated and tricky to

manage and re-establishment after a period of dismantlement would undoubtedly be a problem. Freedom to invest abroad, then, would become not only a useful hedge for investors against a Government that applied Socialist measures but, more, a useful threat to prevent a Government from so doing.

What the Bankers say is that "free convertibility is the best test and the only safeguard of the value of a currency" (Mr. Roberts). They welcome their new freedom as the best test of the health of the economy, even if it is at the expense of "some slight loss in production" (Lord Aldenham). They have probably become convinced by their own propaganda by now, but they certainly know that this freedom and even the loss in production helps the larger producers at the expense of the smaller and the more advanced industrial powers at the expense of the weaker. And, if there is some disagreement among them, it reflects a real difference of interests in a situation full of contradictions. On the one hand, there are those who are prepared to risk a contraction in world trade if they can get more of it financed in London—that is the merchant bankers—and with them those who will risk a cut in export markets so long as import prices fall—that is, those concerned with industries where imports are a large part of input, such as petroleum, food, drink and tobacco. On the other hand, there are those who are connected with engineering, shipbuilding and vehicle manufacture, etc., where import content is small but an expanding export market is essential to full and profitable utilisation of capacity.

So far it seems that the City of London with its close family and other connexions with the Government has been winning consistently against the purely industrial leaders, despite the steady opposition of top non-banking Controllers like Lord Chandos.

THE BATTLE FOR BRITISH ALUMINIUM

Yet at the height of their victory, with convertibility in their grasp, the City financiers showed themselves in the dramatic struggle for British Aluminium to be inept, intemperate and impotent to boot. This was not a battle, as they would have us believe, to retain the British in British Aluminium. A.L.C.O.A., to whom the board of British Aluminium in their need for capital offered a third share of an expanded total, is just as American as is Reynolds with whom Tube Investments proposed a 51/49 holding after take-over. The difference between the power of a 49% and 33% holding in a large company is not great; in either case such power assures dominance.

Reynolds, however, is a new company which has risen with meteoric speed since wartime conditions gave it the chance to break into Alcoa's near world monopoly of aluminium output. Alcoa is part of the gigantic Mellon financial Empire which controls aluminium output all over the world including Canada and the West Indies. Reynolds is an outsider, an independent. Kaiser, the other war-time independent, has been absorbed into the Mellon octopus, but not Reynolds.

Similarly, Tube Investments is a newcomer, one of the Birmingham Group that has risen to top 50 status since the war. T.I. has bankers on its board, including a merchant banker from Lazards. But the Chairman, Sir Ivan Stedeford, is an industrialist first and a banker (National Provincial) second, who has been noted for his criticisms of Government policy in deflating the whole economy to save the £. It is an interesting speculation what must be the personal relations between Mr. Macartney Filgate, who is the merchant banker from Lazards on T.I.'s board, and Lord Kindersley, Chairman of Lazards who led the City's trained bands against T.I. and Reynolds.

The board of British Aluminium made an initial error in not consulting their shareholders about the Alcoa deal, but once the gloves were off it was a straight battle of strength between the City houses which intervened on behalf of British Aluminium and Alcoa (with their offer of 82/- for every second share) and T.I./Reynolds (who, were quite prepared to buy all the shares in the open market and in fact ended up with over 90% paying a price around 84/- each for every second share, the other share being converted into a T.I. share).

What a lesson there is in all this, not only concerning the antagonisms inside Finance and Industry in the peculiar condition of British or, one might say, borrowing a phrase, second class capitalism, but concerning the relationship between ownership and control in modern industry. The spread of ownership among some thousands of investors, far from making ownership irrelevant, as some suggest, gives to the few largest owners complete control of any company, if necessary by buying out the rest—with U.S. help. Nor in such a trial of financial strength do the interests of the nation ever enter the picture. Which was the better arrangement for future aluminium production was never asked, except by the *Economist*; and the only way in which British control of the all-important Aluminium industry could be realised would have been for the State to put up the development capital that was needed. Nobody suggested this. How many more of our basic industries are we to lose to the Americans before we can persuade the British people to accept and make a good job of State intervention?