G.R. Steele

Both private and public institutions make use of economists to particularise broad themes which are the bedrock of economic science. Stated boldly, they will often appear trite: for example, that if prices/wages are raised, sales/employment will fall; that if more money is printed the value of the currency will be reduced. It is well to retain these simple ideas, especially since economists may be employed to arrive at different conclusions more favourable to some political interest. Economists may become paid propagandists (justifying their role by reference to the lawyer and his client).

As Milton Friedman once remarked:

> There is nothing that produces jobs for economists like government controls and government intervention. And all economists are therefore schizophrenic: their discipline . . . leads them to favour the market; their self-interest leads them to favour intervention.[1]

An apt illusion is provided by the analysis first presented by Roy Hattersley in a speech to the Teesside Fabians, on 13 January 1985; the proposals made then have since featured in the joint TUC/ Labour Party pamphlet, *A New Partnership, A New Britain,* which re-emphasises traditional belief in planned economic development, and in *Investing in Britain,* published by the Labour Party.

Mr Hattersley's brief was to formulate a scheme to be used by a Labour government to achieve 'substantial and sustained growth'. Close examination shows it to bear the imprint of professional economic advice – analysis tailored to meet given conclusions.

In Mr Hattersley's format, the authorities must have at their disposal substantial sums to be invested directly in British industry. The source is to be 'the

trade stifled

vast amounts of British money which have been invested abroad by investment institutions', although there would be no attempt to *enforce* repatriation, or to introduce foreign exchange controls to deter further outflows. Exchange controls would be anachronistic, cumbersome to administer and, if effective, stifling to trade and to competitive efficiency. They are ruled out on the grounds of their minimal effect upon the bulk of currency transactions. Rather, it is proposed that some kinds of British investors should be made an offer they could not refuse.

All 'fiscal privileges'—tax exemptions, taxation at composite rates, Capital Gains Tax (CGT) and Capital Transfer Tax (CTT) relief – would be withdrawn from institutions which failed to meet specific investment criteria. The criteria would comprise a limit upon the proportion of foreign assets held, and the requirement that a proportion of all funds be placed with a new National Investment Bank (NIB). Guaranteed gilt-edged NIB stock would be sold at market rates of interest. Then, with additional government finance, low-interest investment loans would be offered to favoured projects.

There are a number of cunning features in the proposals:

1. Arrangements would be entirely voluntary. Hard financial calculation is expected to convince institutions that *their* interest lies in repatriating funds; but if they refuse, the gain in revenue to the Treasury arising from the removal of fiscal privileges would be immense. Either way, the NIB would receive money from the institutions directly, or from them indirectly by higher taxation.
2. Removal of fiscal privileges gains approval on the ground that it removes distortions to the allocative efficiency of the price system; although here the threat of their removal is simply a device to retain institutional funds in the UK. Nevertheless, it could be argued that the proposals would reduce allocative distortions.
3. The repatriation of funds would create additional demands for sterling. This by-product would prove convenient to a Labour administration which, in running a 'high employment economy' would be setting up reverse pressures upon sterling. This constitutes a fortuitous balancing act which would reduce the need for 'other measures' to protect either the balance of payments or the value of sterling.
4. There are costs to the scheme. The funds obtained overseas would be higher. This is recognised, but it is argued that the sacrifice would be to the common good, the price of rescuing the economy from 'permanent stagflation and permanent mass unemployment'. In any case the beneficiaries of pension funds, etc. have a prime interest in the 'overall health and prosperity of society'.

6th-form economics

Mr Hattersley believes his scheme would work by reducing the cost of investment funds to companies which now are unable to pay commercial terms – the thousands of companies all over the country which find it impossible to finance the expansion they seek. Given that funds would be repatriated to be used by the NIB, would Mr Hattersley's objectives then be met?

Two fundamental economic propositions are here relevant – points so basic that they are covered by sixth-form economics and could not have been unknown to Mr Hattersley's advisers. The first is that there is in any given period an inverse relationship between the rate of return on investment expenditure, and the total expenditure, between price and supply. The second is that, without the most stringent of foreign exchange controls, internationally mobile capital is attracted by the highest returns on investment, which produces a tendency towards uniformity of rates of return.

United Press

Roy Hattersley MP—misled by his economic advisers?

If these relationships are borne out in practice (and is there any doubt?), Mr Hattersley's proposals cannot succeed.

In the first instance, the removal of fiscal privileges and the repatriation of capital would have the desired effect. With the demand for investment funds unchanged, the increased domestic supply would force down rates of interest in the UK. But it is proposed to absorb repatriated funds into the NIB which, in offering existing market rates to the funds, would prevent such a fall.

When the NIB begins to make finance available at *subsidised* rates, new projects would begin to compete (in product, factor and raw material markets) with those established earlier. Although these new projects would previously have been financially viable on commercial terms, it is unlikely that all would remain so when exposed to newly subsidised competition.

The return on many of these investments would then be insufficient to warrant further commitment. Given that sunk costs *are* sunk, there may be a short-term gain (in the total of capital investment undertaken in the UK) but, beyond that, those projects would no longer be viable. The reduced return on UK projects would stimulate capital outflow, which would again work to restore the original position.

Unlike the administered and documented activities of the NIB, this outflow of capital would be unobserved. By contrast, Mr Hattersley would be able to itemise the new projects financed with funds made available by the NIB, thereby to demonstrate its successful achievements. Among the more manifest failures of the next Labour administration, these arrangements would be difficult to fault. The companies affected by the subsidised competition, and the inefficiencies introduced by backing the mediocre against the best, would not be monitored by official statistics.

contradictions

This outcome would not be new. Similar events have occurred in employment subsidies (the Temporary Employment Premium) which allowed weak companies to remain in business at the cost of job losses elsewhere in otherwise viable companies.

It is revealing that, in contradiction of Mr Hattersley's original proposals, the TUC/Labour Party pamphlet does argue the necessity of 'effective exchange controls'. Someone has consulted his school textbook! Yet, however effective such proposals might be in channeling *British* funds into second-rate schemes, it is inconceivable that a Labour government could maintain financial autarky and an indifference to the importance of the UK's remaining attractive to foreign investment. If movement of foreign capital is to remain unimpaired, the rate of return to projects in the UK would be unaffected by Mr Hattersley's scheme: and so, too, would be total investment. EA

[1] Quoted in Alex Rubner, *The Price of a Free Lunch*, Wildwood House, London, 1979, p.141.