EXORCISING INFLATION

by
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Princes and sovereign states have frequently fancied that they had a temporary interest to diminish the quantity of pure metal contained in their coins; but they seldom have fancied that they had any to augment it. The quantity of metal contained in the coins, I believe of all nations, has, accordingly, been almost continually diminishing, and hardly ever augmenting.

Adam Smith
The Wealth of Nations
Book 1, Chapter V

1. Introduction

From an economic point of view the history of the world since 1939 might be described as 'The Age of Inflation'. In several countries, especially those devastated by war and in South America, currencies have become practically worthless. Most other countries have experienced steadily rising prices. In the United Kingdom, where the phrases 'As good as gold', or 'As safe as the Bank of England' originated, prices have been rising continuously since 1939, and the pound sterling in 1993 is worth about one twenty fifth (or 4 per cent) of its 1939 value. Clearly, during this period money has totally failed to fulfill one of its three essential functions -- acting as a store of wealth -- and it has served most unsatisfactorily as a unit of account and a medium of exchange.

Is inflation inevitable?

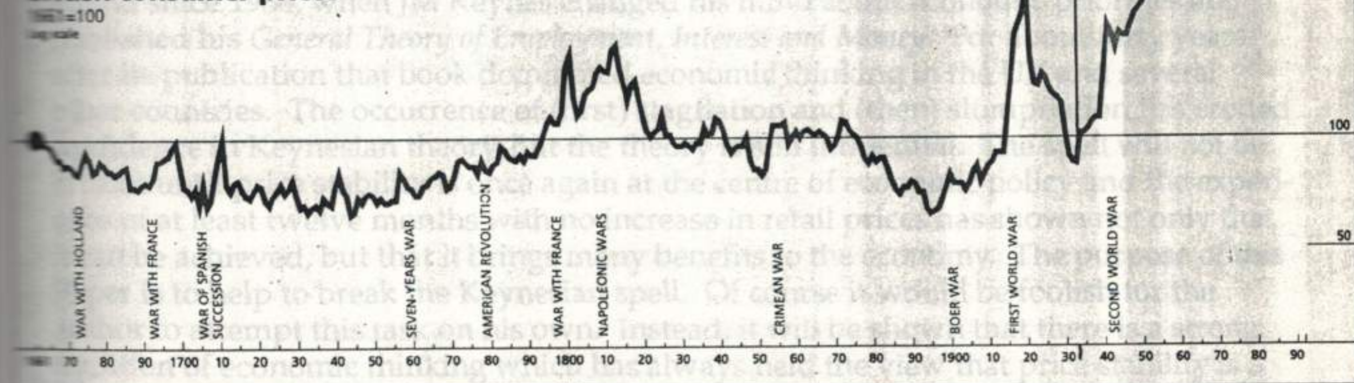
However, two things might be said about this world-wide inflation. First, there is the suggestion that it does not matter, or indeed that it actually stimulated economic activity, because for the period 1945-1970 the world experienced a period of unprecedented full employment and prosperity. And second, because all those under the age of 54 have lived with inflation throughout their lives, it might be said that inflation is inevitable; that the achievement of stable prices is a utopian fantasy and therefore not worth serious consideration.

Much of this Paper is devoted to refuting the first argument -- that inflation is usually beneficial to economic growth. But it is also necessary to destroy the fallacious notion that inflation is inevitable. Perhaps one of the best ways to do that is simply to look at Chart 1. This shows that, taking the period from 1661 to the 1930s as a whole, British consumer prices were stable. Looking at the more recent past, which includes a population explosion and a period of sustained economic growth in which Britain became the world's first industrial nation, between 1815 and the outbreak of the first world war in 1914 prices actually fell slightly. During and immediately after the war they rose sharply, so that by 1920 retail prices were two and a half times their 1914 level, but then they fell rapidly so that by 1933 they were only 40 per cent higher than in 1914.

We can say, then, that for most of the period 1661-1939, inflation was absent. It was assumed that money would be a sound store of value, and that assumption was shown to be correct. It was also assumed that it was a primary task of the government's management of the economy to maintain the value of the currency, and that such a desirable objective was attainable without undue difficulty.

Of course much has changed in the past sixty years, but none of the changes in recent economic thinking can eliminate the fact that in the UK it was possible to maintain the value of money over several centuries of tremendous economic change and development. Surely it is not unreasonable to argue that what has been achieved in the past can

Chart 1



be achieved in the present and the future, when we have more sophisticated methods of economic management. Inflation is not inevitable. It is perfectly possible to achieve and maintain stable prices in a growing economy. In fact one thesis of this Paper is that stable prices are a pre-requisite of sound growth, and that persistent inflation does immense damage to an economy.

Inflation and society

A second -- and perhaps even more important -- conclusion is that Keynes was absolutely correct when he wrote in 1920 that debauching the currency 'overturns the existing basis of society'. There is a moral element involved, although many economists shy away from admitting that their subject sometimes involves moral judgments. In his LSE lecture of 11th November 1992 the Governor of the Bank of England said that 'Inflation is about the honesty of government policy'[1]. Actually inflation is about the dishonesty of government policy, because governments are usually borrowers and inflation involves an arbitrary and dishonest re-allocation of wealth from lenders to borrowers.

However, in a democracy such as Britain where, in theory at least, the people govern, one might well ask about inflation 'Who is deceiving whom?'. If the government is defrauding the people, are the people not defrauding themselves? Or, in other words, is it not a case of self-deception, a preference for living in an illusory rather than a real world? It may be, then, that the primary condition for an end to inflation in Britain is an understanding by ordinary people of its damaging effects and a determination on their part to end it. Only then will the politicians adopt the necessary policies.

The title of this Paper suggests that British economic policy-makers have been spellbound since 1936, when JM Keynes changed his mind about economic priorities and published his *General Theory of Employment, Interest and Money*. For about forty years after its publication that book dominated economic thinking in the UK and several other countries. The occurrence of (first) stagflation and (then) slumpflation has eroded confidence in Keynesian theory, but the theory is still influential. The spell will not be broken until price stability is once again at the centre of economic policy and the experience of at least twelve months with no increase in retail prices has shown not only that it can be achieved, but that it brings many benefits to the economy. The purpose of this Paper is to help to break the Keynesian spell. Of course it would be foolish for the author to attempt this task on his own. Instead, it will be shown that there is a strong tradition of economic thinking which has always held the view that price stability is a primary element of sound economic policy. Three leading twentieth century economists who have held this view are Professors FA Hayek (Keynes' arch-critic), DH Robertson (Keynes' friend and critic and Professor of Political Economy at Cambridge 1944-57) and Milton Friedman. Sir Dennis Robertson is of particular interest, because he was one of the 'three wise men' of the Cohen Council on Prices, Productivity and Incomes which advised the Macmillan government in 1958. The first Report of the Council, which was drafted by Robertson, included a classic statement of the case for price stability. Not surprisingly it was ignored. Is it too much to hope that 35 years later economic policy-makers may be more ready to listen?

and Money, which must be the most ambitious economics text ever written. The author's aim, as he explained in the preface and the introductory chapters, was nothing less than to replace the classical theory of economics, painstakingly developed over the previous century, by a new *general* theory which would deal with the problem of involuntary unemployment. On the first page of Chapter 1 Keynes argued that the classical theory's 'teaching is misleading and disastrous if we attempt to apply it to the facts of experience'[2], and the rest of the book is an attempt to re-write macroeconomic theory.

The *General Theory* was written for Keynes' fellow economists, not for the general public, and in contrast to some to his earlier writings it is a technical and abstruse book. But the central theme was clear: through monetary and fiscal policy, and especially through schemes of public investment, governments could solve the problem of unemployment which had bedevilled so many countries in the inter-war period up to 1935. As the author put it in his 'Concluding Notes':

> 'I conceive, therefore, that a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment.'[3]

While this kind of reasoning had the support of a group of younger Cambridge economists known as 'the Circus', it is hardly surprising that others, including Dennis Robertson, remained unconvinced. In fact Robertson, who had seen the galley proofs of the book, wrote to Keynes in a letter dated 10th February 1935 that 'a large part of your theoretical structure is still to me almost complete mumbo-jumbo'[4].

Growing confidence in Keynes

Nevertheless, the enthusiasts overwhelmed the critics and only eight years after the publication of the *General Theory* it became clear, from the first sentence of the 1944 *White Paper on Employment Policy*, which stated that:

> 'The Government accept as one of their primary aims and responsibilities the maintenance of a high and stable level of employment after the war',[5]

that the Keynesians had occupied the commanding heights of British economic policy-making. And there they remained until the mid-1970s, with full employment as the policy priority and price stability (or low inflation) very much an also-ran.

The post-1945 boom, which continued unabated until 1971, with unemployment never exceeding 3 per cent, was one reason for growing faith in Keynesian economics. Another was the publication of an article in 1958 by Professor A.W. Phillips of the London School of Economics which showed that for much of the period 1861-1957 in the UK unemployment fell as money wages increased more rapidly. In other words, Phillips seemed to be saying (although he did not state it explicitly) that rising inflation, which went hand in hand with rising wages and a high level of demand for goods and labour, would usually boost employment. Or, to put it more crudely, inflation would reduce unemployment and should, therefore, be regarded as an economic good rather than an evil. However, by the late 1960s two American economists, Edmund Phelps and Milton Friedman, had exposed the theoretical shortcomings of the Phillips Curve analysis, and by the mid 1970s their view that it gave no place to people's expectations

of inflation had been widely accepted. This fundamental error was not surprising, because for most of the period 1861-1957 people rightly expected price stability, or even falling prices, in peacetime.

The lengthy debate about the Phillips curve was brilliantly summarized by Professor Friedman in 1992 when he wrote:

> 'We have been misled by a false dichotomy: inflation or unemployment. That option is an illusion. The real option is whether we have higher unemployment as a result of higher inflation or as a temporary side effect of a cure for inflation'.[6]

Putting Keynes to the Test

However, by the late 1960s Keynesian theory had still not been fully tested in Britain. The reason was simple--unemployment remained consistently low until 1971, when it began to rise above 3 per cent and move towards one million, a figure which was regarded as politically significant. It was this development which prompted Mr. Heath, as Prime Minister, and Mr. Barber, as Chancellor -- in a Conservative government -- to test fully the theory propounded in 1936, and in the budgets of 1972 and 1973 the British economy was given a large fiscal stimulus, mainly through cuts in taxation which produced a substantial budget deficit. It was understood that this policy might be inflationary, so the fiscal stimulus was accompanied by a package of direct controls on prices and incomes. How would this strategy (if it deserved to be called that) work out?

The initial employment effects were encouraging. Unemployment fell from 4.1 per cent (or 928,000) to 2.2 per cent by October 1973. But then it started to increase, so that by July 1975 it had climbed to 4.5 per cent and had passed the magic level of one million. Clearly the favourable employment effects were short-lived. On every other front the results were a catastrophe. Those who had predicted serious inflationary side effects were proved completely right. During 1972 retail prices rose by 7.7 per cent; in 1974 they rose by 20 per cent and the rate of inflation reached a peak of 26 per cent in the summer of 1975. So by 1975 Messrs Heath and Barber, who had been ejected from office by the electorate in February 1974, had created the completely new economic phenomenon of stagflation -- a state of affairs in which rising unemployment is accompanied by an increase in inflation. Previously, many economists would have argued that such a combination was impossible!

However, this was by no means the end of the story, because by 1974 the artificial fiscal stimulus had also created a massive deficit on the current account of the balance of payments, in line with the experience of the previous twenty years. At the same time, real incomes for most of those in work were starting to fall and many business firms, which had invested heavily in anticipation of a sustained boom, were facing acute difficulties as interest rates rose and demand fell.

The final stage of the saga came at the end of 1975, when Mr. Dennis Healey, as Chancellor of the Exchequer, had to go cap-in-hand to the International Monetary Fund to beg for a loan. It is hardly an exaggeration to say that, after a three year time-lag, Keynesian policies brought Britain close to national bankruptcy. It was this sorry situation which caused Prime Minister James Callaghan to tell the Labour Party conference in September 1976:

> 'We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you, in all candour, that that option no longer exists; and that insofar as it ever did exist, it only worked by injecting bigger doses of inflation into the economy followed by higher levels of unemployment as the next step. That is the history of the past twenty years.'[7]

Lessons unlearnt

There are, in 1993, two questions at the heart of the Keynesian conundrum:

(i) Given the disastrous experience of 1972-76 and the appalling record on inflation since the 1960s, why are so many economists and policy-makers still wedded to Keynesian theory?

(ii) How can one explain the errors of Keynes himself, who had shown so many flashes of brilliance before writing *The General Theory*?

Neither of these questions is easily answered, but perhaps we can move towards an answer to the first by considering the outcome of admitting that there is not very much that governments can do to alleviate unemployment. Immediately the discipline of economics, which is sometimes regarded as providing a cure-all for economic problems, loses some of its charisma. And this applies also to economists who are sometimes regarded rather as witch-doctors are in a primitive society. Such a reduction in status would not suit many who call themselves economists today, and practically idolize Keynes as the man who had an answer for every problem.

There may be some clues to the answer to the second question in a short pen-portrait by Keynes' close friend and fellow-member of the Bloomsbury group, Clive Bell, written in 1956. On the concluding page, Bell refers twice to Keynes' cleverness, and states bluntly that he 'was the cleverest man I had ever met'[8]. Earlier he referred to 'that cocksureness which was his most irritating characteristic' and 'his besetting sin'[9]. It sometimes led Keynes to speak with authority on matters about which he was woefully ignorant, and Bell gives several examples of stupid mistakes by Keynes which a less clever but wiser man would never have made.

No-one can doubt that in his earlier years Keynes made some very positive contributions to the discipline of economics. But is it not possible that urged on, or misled, by some of his Cambridge colleagues like Richard Kahn and Joan Robinson, he claimed altogether too much for that discipline in *The General Theory*? That the British economy has been suffering from these exaggerated claims ever since? And that the most obvious symptom of this disease is inflation?

3. What Does Price Stability Mean?

Inflation may be defined as an increase in the general level of prices. That level is usually measured in Britain by the Retail Prices Index (RPI), and the measure which most people are interested in is the change in that index over the previous 12 months. If the RPI shows no change over the previous 12 months the rate of inflation will be zero, and we could say with some confidence that price stability prevails. Such a claim would certainly not be justified if retail prices had risen modestly -- say by one or two per cent -- even if the rate of inflation had fallen considerably over the year -- say from seven to two per cent. Price stability is an absolute, not a relative, term.

However, it might be argued that something else is necessary to achieve *full price stability*. People are concerned about the present and the future as well as the past. The experience of the past fifty years suggests that any drop in inflation is likely to be very short-lived--a brief lull before the next burst of inflation. So full price stability might be defined as a state of affairs in which (a) the RPI has remained constant over the past year and (b) there is confidence that it will remain constant in the foreseeable future. In other words, full price stability requires that the inflationary (Keynesian) psychology is broken. It is, perhaps, unlikely to be achieved until the RPI has been constant for at least two years.

Price stability does not mean that all prices remain stable, and still less does it involve direct controls by the government to prevent price increases for particular goods and services. The general level of prices remains stable in the context of a market economy, in which practically all prices are determined by supply and demand. And some economists would argue that price stability is a pre-condition for the effective working of a market economy, and that without it money cannot fulfill its key functions.

Where price stability prevails, it might be expected that the price of a commodity which suddenly comes into short supply, for whatever reason, would rise. Consumers of this commodity would either buy less of it or switch expenditure from other items. If they chose the latter option, demand for these other items would fall and so would their price. So changes in the price of particular commodities are fully compatible with overall price stability. In fact they should be expected in a market economy.

The measure of inflation

In most industrialized countries today the general level of prices is measured and published monthly. In Britain the accepted RPI measure was initiated in 1914 and is monitored by an independent committee, so it is not susceptible to manipulation by politicians. It includes all the goods and services which ordinary people buy over the

course of a year, including food, clothing, housing and so on. As expenditure patterns change, so does the weighting system of the RPI, which is updated annually. The rate of inflation in the UK is the increase in the RPI over the preceding 12 months. At the time of writing (March 1993) this was 1.8 per cent. In other words, it might be argued that people needed to have increased their incomes by 1.8 per cent to be as well off as they were in March 1992. Not surprisingly the increase in the RPI is mentioned more frequently than any other factor during pay negotiations.

General criticism of the RPI, sometimes called 'the headline rate of inflation', is conspicuous by its absence, but a question has been raised about the inclusion in the index of mortgage interest rates. Currently in Britain nearly ten million households are buying a house with the help of a mortgage, and a significant part of their monthly payment is the interest on the loan. For example, in January 1993 on a 25-year endowment loan of £30,000 the monthly repayment was £203, of which £160 was interest at 8.55 per cent. It will be readily seen that changes in interest rates have a large impact on housing costs for ten million households, and consequently some economists have taken these interest charges out of the RPI to produce what they call 'the underlying rate of inflation'. However, this measure of inflation has not proved generally acceptable. Housing is a basic necessity and most people in Britain acquire their housing through a mortgage loan. It would, therefore, be wrong to remove the biggest part of the cost of housing from the RPI, even though changes in interest rates produce major changes in housing costs.

For example, from October 1990 to the present the base rate of interest fell from 15 to 6 per cent, as inflation fell from 10.9 to 1.8 per cent. This meant that the monthly mortgage payments for homeowners fell by about one-third. Conversely, if inflation and interest rates started to rise again, so would mortgage payments. It is clear that the trend of interest rates is an extremely important factor in the inflation rate. Just as rising interest rates increase inflation, so do falling interest rates reduce it. And a reduction in inflation can quickly produce a virtuous circle with falling interest rates. The two interact strongly with each other.

The price stability target

The above definition of price stability shows that it includes an inflation rate of zero, or no change at all in the RPI over the previous 12 months. As an item of policy, this may be thought to be a pipe-dream, but in fact there is much evidence to show that it is achievable in Britain by the end of 1994.

For example, the inflation rate has been reduced from 10.9 per cent in October 1990 to 1.8 per cent today. That is a reduction of 9.1 percentage points in two years and fivemonths. Thus a further reduction of 1.8 percentage points over the next eighteen months is entirely possible. Indeed, over the nine month period May 1992 to February 1993 the RPI actually fell from 139.3 to 138.8. So by March 1993 the UK was very close to price stability as defined above.

In recent years the British government has frequently talked about low or zero inflation, but ministers have been altogether too reluctant to spell out the aim of price stability. Perhaps they should refer to the first report of the Cohen Council on Prices, Productivity and Incomes, published in 1958. Those 'three wise men' stated categorically that

4. The Cost of Inflation

> 'We conclude that alike on internal and external grounds our objective should be to stop the inflation, not merely to moderate its course'.[1]

The thesis of this Paper is not only that inflation can be stopped by the end of 1994, but that price stability must be achieved by that date and maintained thereafter. The next two chapters sets out the cost of failing to achieve that aim and the tremendous benefits which would flow from its achievement.

By the 1960s a large majority of (Keynesian) economists thought that an increase in the rate of inflation was the best way to stimulate economic growth and reduce unemployment. Following the debacle of the Heath/Barber boom of 1972-73, by the end of the 1970s a growing number of (monetarist) economists were coming to the contrary view that, except in than the very short-term, an increase in the rate of inflation would *increase* unemployment. The leaders of this school of thought were Professors Friedrich Hayek and Milton Friedman, and their views found acceptance by Mrs. Thatcher and her government which had been elected in May 1979. In the *Conservative Manifesto* of April 1979 the control of inflation was given absolute priority in the initial summary of the Party's five tasks, and time and again ministers have insisted that it remains the key economic objective.

Officially, then, Keynesian economics died in Britain in May 1979. However, it is one thing for government ministers to state a policy. It is quite another to change the minds and attitudes of the numerous open and crypto-Keynesian economists still beavering away in the Treasury, the Bank of England, academia and other places. Nevertheless, the Thatcher government, after an awkward first year, had considerable success in achieving their primary economic aim. From a peak of 21.9 per cent in May 1980, inflation fell steadily to 2.4 per cent in August 1986, but thereafter the general trend was upwards to 10.9 per cent in October 1990. Certainly the average annual inflation of 7.3 per cent in the 1980s, when the price level doubled, was an improvement on that of the 1970s average annual inflation of 12.5 per cent, when the price level rose 3.3 times. But surely the 1980s record should be described as bad, compared with that of the 1970s which was appalling. The truth was that the Thatcher government, after seven years of hard slog and all the unpleasantness of high unemployment (which the electorate had accepted), almost had the inflationary cat back in the bag. But two years of over-expansionary budgets in 1987 and 1988 and lower interest rates in 1987 and early 1988 let the cat out of the bag again, with disastrous results both economically and politically.

The political costs

After insisting for more than eleven years that the control of inflation was her government's over-riding economic priority, could it have been a coincidence that Mrs. Thatcher was forced to resign three months after inflation reached double figures? Of course there were the problems of: the unpopularity of the poll tax and her aggressive attitude towards Euro-federalism; but perhaps she could have ridden out the two problems, had not the economic crisis, with very high interest rates and rising unemployment, finally convinced too many Tory MPs that she had become an electoral liability. The Prime Minister -- who also rejoices in the title of First Lord of the Treasury -- has the primary responsibility for the management of the nation's economic affairs. It is surely not unreasonable to argue that it was the failure of the Thatcher government to

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maintain control over inflation which was the main cause of Mrs. Thatcher's demise.

The economic costs

By July 1986 inflation was 2.4 per cent. Instead of insisting on the economic imperative of eliminating inflation by 1988, Mrs. Thatcher and her Chancellor, Nigel Lawson, took their eyes off the inflationary ball. The result was the Prime Minister's forced resignation in October 1990 and economic misery for millions of people over the period 1990-93. It is not just desirable but absolutely essential that present and future governments avoid a repeat of that error, and a consideration of the economic effects of the mistake should encourage them to do better. This requires some study of the chief economic variables between January 1987 and January 1993, and the interplay between them.

Chart 2

Inflation unemployment and base rates 1987-1993 (Jan)

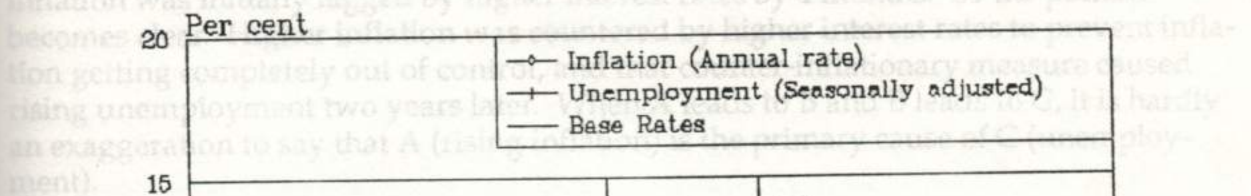

Chart 2 above shows the trends of inflation, unemployment and base rates over the period January 1987 to January 1993. It will be remembered that over this period the government's main, not to say only, weapon against inflation was higher interest rates. The connection between these three series is of crucial importance for the management of the economy.

As has been mentioned, inflation reached a low point of 2.4 per cent in the late summer of 1986. It then rose to nearly 5 per cent in late 1987 before subsiding again to 3.3 per cent in January 1988. From that point it rose quickly and remorselessly to 10.9 per cent in September 1990, before the fall to the present level of 1.8 per cent in March 1993.

The increase in interest rates followed closely (but not closely enough) the rise in inflation. In fact the chart shows that during the period February to May 1988 inflation was beginning to rise but interest rates were actually cut (from 9 to 7.5 per cent). Once the authorities realized their mistake, interest rates were raised rapidly to 12 per cent by August, but the damage had been done. By then inflation was at 5.7 per cent and rising strongly, and all the success of the anti-inflation policies of 1980 to 1986 had been thrown away. Interest rates had to be raised further to 15 per cent in October 1989 and left at that excruciatingly painful level for a year before inflation began to fall again. The lesson is simple: once an inflationary boom has developed, it can be stopped by an increase in interest rates. But the increase must be quick and substantial. Between May and early August 1988 all of the seven increases in interest rates were of 0.5 per cent, but this kind of piffling increase is counter-productive because it seems to indicate that the authorities have no stomach for the fight against inflation.

The most obvious side-effect of counter-inflationary measures is rising unemployment, and this is the third series plotted on the chart. It will be seen that the time-lag between higher interest rates and higher unemployment is almost exactly two years, and higher inflation was initially lagged by higher interest rates by 4 months. So the pattern becomes clear. Higher inflation was countered by higher interest rates to prevent inflation getting completely out of control, and that counter-inflationary measure caused rising unemployment two years later. When A leads to B and B leads to C, it is hardly an exaggeration to say that A (rising inflation) is the primary cause of C (unemployment).

Sadly, this pattern does not reverse itself symmetrically when inflation and interest rates fall. If it did, we could expect unemployment to be falling sharply now two years and five months after interest rates and inflation began to fall. Certainly the March 1993 unemployment figures showed a welcome modest fall (the first for 34 months) but the after-effects of stagflation are less easily cured than a severe hangover. The lesson is that stagflation must be avoided at all costs, and this lesson becomes even more painfully obvious when the detailed effects of the recent recession are considered under four headings.

1. Economic Decline

The change in gross domestic product at factor cost, measured in constant prices, is usually regarded as an accurate indication of economic growth or decline. This shows that the British economy was in continuous decline from the second quarter of 1990 until the middle of 1992. The index fell from 117.6 to 112.8, a decline of 4 per cent. It could be that the decline bottomed out in the second half of 1992, but at that time there was no sign of the recovery which had officially been predicted to start many months earlier. Naturally this decline had some extremely unpleasant repercussions.

2. Employment and Unemployment

As the economy declined, so did the number of people at work, between the middle of 1990 and 1992. Most of these joined the ranks of the unemployed, but a minority who were not entitled to unemployment benefit disappeared from the statistics. As employment fell, so unemployment grew -- from 1,606,600, or 5.6 per cent, in March 1990 to 2,995,100, or 10.6 per cent, in January 1993. The workforce was virtually static over this period, so it cannot be argued that high and rising unemployment was a consequence of a growing workforce. Instead, it was the most obvious and unpleasant result of the economic mismanagement of 1987-88.

A disturbing aspect of this wave of unemployment was that it affected regions of the country (especially the South-East) and groups of people, including accountants, lawyers and other professionals, who had previously been thought to be recession-proof. For many redundant and unemployed men and women the shock of their new status was the worst part of it.

3. Housing Re-possessions and the Construction Industry

The government chose to use high interest rates as their main counter-inflation weapon, and the part of the economy most affected by interest rates is property and the construction industry. Base rates were held at 15 per cent for a year from October 1989 and the effect on this sector of the economy was devastating. Homeowners who had previously thought of their house as a one-way bet, economically speaking, had their illusions rudely shattered as property prices fell by 25 per cent or more in some areas. Soaring interest rates meant soaring monthly mortgage payments, and some families, who had accepted the government's encouragement to become part of a property-owning democracy and bought a modest property (perhaps a council house), found themselves unable to keep up the payments. Some of this misery can be seen in the figures for houses re-possessed and mortgages in arrears for 1987-92.

Table 1

	Properties Re-Possessed	Mortgages More Than 6 Months in Arrears at End of Year
1987	26,390	70,450
1988	18,510	53,090
1989	15,810	80,640
1990	43,890	159,210
1991	75,540	275,350
1992	68,540	

Source: Council of Mortgage Lenders, press release, and *Financial Times* article 9/10 January 1993.

If we take the average of 1987-89 as a 'normal' year we arrive at annual figures of about 20,000 for re-possessions and 68,000 for mortgage arrears. That means that about 128,000 re-possessions were caused by the recession in the three years 1990-92 and that

by the end of 1991 about 207,000 extra households were badly in arrears with their payments.

Home ownership in Britain is a serious matter. It is not something entered into lightly. Each one of those additional house re-possessions will include a tale of misery, despair and enormous family stress. And many of the families involved were not speculators but people who bought a modest (council) house and subsequently lost it.

The consequences of high interest rates were equally serious for the construction industry, which plays a key part in the British economy. Work simply dried up for architects and builders. Large and small firms, some of them well-established, went bust. The state of the industry at the end of 1992 can be summed up easily: 'bombed-out'. There is no need to say any more.

4. Business Failures

While construction was perhaps the industry worst affected by the recession, all other sectors of the economy were damaged in one way or another. In his 1991 article 'How Inflation Undermines Industrial Success' Walter Eltis described some of inflation's malign effects on the business community as a whole and argued that:

> 'inflation creates a possible inhibition against investment. This arises because when inflation increases, company profits rise far less than the rate of interest, so interest costs increase enormously more than profits in the early years of investments'.[1]

This is just one of the ways in which inflation damages a nation's productive capacity. But perhaps the most telling evidence is the figures for business failures, which reached record levels in 1992. Business failures are of two kinds. Where limited companies cease trading they go into liquidation, but sole traders and partnerships go bankrupt. Together liquidations and bankruptcies give us a figure for the total number of business failures, and the series for 1987-92, provided by Dun and Bradstreet International, paints a dismal picture.

Table 2

Year	Business Failures in England and Wales
1987	17,045
1988	16,652
1989	18,163
1990	24,442
1991	39,827
1992	51,947

If we take the average of 1987-89 (17,300) as the norm, it can be seen that the recession caused about 64,000 super-normal business failures during the three years 1990-92. Like the house re-possessions, every one of these business failures meant unimaginable misery and distress for the proprietors and workforces of the businesses concerned. In some cases the proprietors would have lost their homes, which had been pledged as security for loans, as well as their livelihood.

Political consequences

Enough has been said about the particular costs of an inflation-induced recession. But one further comment is necessary. The Conservative government had consistently advocated home-ownership and an enterprise economy since 1979. Many of that government's most loyal supporters could reasonably feel betrayed by the effects of the post-1990 recession, which destroyed all or much of what they had worked for.

So how can the Conservative election victory of April 1992 be explained? Only in two ways. First, the Conservatives had changed their leader, and there was some optimism that Mr. Major had learned a hard lesson from the misguided policies of 1987-88. And second, since the opposition had not only endorsed those misguided policies, but would have taken them further, the alternative would have been worse. Economic events have political repercussions, and by 1992 the credibility of both the government and the opposition, indeed of parliament itself, was at a very low ebb.

5. The Benefits of Price Stability

The benefits of price stability are, of course, the counterpart of the cost of inflation. There is a natural business cycle which cannot be completely eliminated, but the primary aim of government policy must be to smooth out the humps and the troughs as far as possible. A determination to achieve and maintain price stability should be at the centre of such a policy.

The achievement of price stability would mean the end, once and for all, of policy-induced recessions like that of 1990-93, with all the accompanying misery described earlier. This would be an incalculable benefit. But there would be other benefits too.

If money retained its value over long periods of time-up to and beyond a lifetime - people would be able to stop worrying about the problems of inflation, which have meant that cash they save at the age of 30 has lost nearly nine-tenths of its value by the time they want to retire at 60. To be realistic, inflation makes personal pension planning impossible. Yet the government has now encouraged millions of people to take out personal pensions.

Not only that, but interest rates could fall considerably further, to the great benefit of all borrowers, including those buying a house on a mortgage. Base rates are currently 6 per cent. The achievement of price stability would allow them to be cut to 4 per cent. Once confidence had grown that price stability would be maintained (after, perhaps, a further 12 months) base rates could be cut to 3 per cent or even less. The property market would be rejuvenated and a property-owning democracy would become a source of pleasure instead of pain.

There is no need to labour the point. The benefits of price stability would be just as great as the cost of continuing inflation.

Of course, this is an academic paper, and academics are rightly expected to be objective. It might be argued, therefore, that this chapter should be followed by another which puts the case for inflation or against price stability. However, readers who have followed the reasoning so far will understand that such a task presents this author with great difficulties. Therefore, instead of making up a case which lacks conviction, he prefers to risk the accusation of partiality and to leave readers who wish to do so to construct that case for themselves.

6. The New Zealand Example[1]

Inflation has been endemic in the British economy since 1939. Until 1979 it was accepted and even encouraged, but for the past thirteen years the government has made strenuous efforts to bring it completely under control, without success. In these circumstances it may be that the biggest barrier to achieving price stability is psychological -- the feeling that it is an impossible objective. The situation might be similar to that over the reform of trade union law in 1979, after it had remained unchanged, despite the strenuous efforts of both Labour (Harold Wilson) and Conservative (Edward Heath) Prime Ministers. Most people had given up hope. And yet, fourteen years later, the law has been reformed and in 1992 fewer days were lost through strikes than at any time since statistics were first collected in 1893.

Given this psychological barrier to the achievement of price stability, it could be helpful to consider the recent experience and policies of a country whose inflation problem was worse than the UK's in the 1980s but is now almost cured. That country is New Zealand, whose annual inflation rate averaged 11.4 per cent in the 1980s compared with 7.3 per cent in Britain. It has been stated on good authority that by the mid 1980s 'inflation expectations were deeply entrenched in New Zealand society'[2] and the following figures support that statement.

Table 3

Annual Increase in the Consumer Price Index in New Zealand

	Per Cent
September 1985	16.3
September 1986	11.0
September 1987	16.9
September 1988	5.6
September 1989	7.2
September 1990	5.0
September 1991	2.2
September 1992	1.0

Source: OECD, *Main Economic Indicators*, Issue for November in the relevant year.

Since early 1990 the Reserve Bank of New Zealand has been operating under a new Act which gave it greater independence, and it is clear from the above figures that this, together with other policies, has had the dramatic effect of almost eliminating inflation in 30 months. It seems that there are four key elements to the new monetary policy in New Zealand.

1. The price stability goal is now entrenched in law. The statute says that 'the primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices'. That would surely be a revolutionary and desirable innovation for the Bank of England.

2. Price stability as a concept is defined in quantitative terms. The definition is not embodied in the statute, but the Act requires the Governor of the Bank and the Minister of Finance to agree on the definition and to set it out publicly in a Policy Targets Agreement. This Agreement defines price stability as 0-2 per cent annual increases in the Consumer Price Index. To allow for improvements in quality and for other reasons it has been decided that 1 per cent inflation is consistent with price stability. It will be seen from Table 3 above that by late 1992 the Reserve Bank had hit the bull's-eye of its price stability target by getting inflation down to 1 per cent. This was an astonishing success.

3. A time period was set for the achievement of the 0-2 per cent inflation target. The initial Policy Targets Agreement was signed in March 1990 and called for achievement of the target by December 1992 and maintenance of price stability thereafter.

4. Provision has been made for inflation rates outside the target range in certain special cases, such as the occurrence of large exogenous supply shocks, and the extent of variation is prescribed.

The transparency of any departure from the objective of price stability makes it almost impossible for such a departure to occur, and any substantive modification of the objective must be done in writing and in public.

A key benefit of this new policy was a fall in interest rates of 7 percentage points in the two years to May 1992, usually with financial markets leading and the Reserve Bank accommodating. In addition trade unions have moderated their pay claims and pay increases have fallen. But Nicholl and Archer tell us that:

> 'by far the most significant and important behavioural change has taken place inside the policy making machine. The announced downward path for inflation has provided a structure for internal discussions and debates within the Reserve Bank about the appropriate stance of policy. It has also provided the impetus for a number of politically sensitive decisions, notably the tightening of policy in May and August 1990 (in the run-up to the 1990 New Zealand election), a reluctance to accelerate the market-led loosening in monetary conditions through 1991, and the willingness explicitly to ease policy in September 1991. In each case the critical deciding factor behind the tightenings, and the more recent eventual acceleration of the loosening trend, was the outlook for inflation relative to the way-point target ranges over the 1-2 years ahead'.[3]

Surely there are some very important lessons here for monetary policy in the UK, as well as proof that a determined government was able to reduce inflation from 6 per cent in the spring of 1990 to 1 per cent by September 1992, that is by 5 points in 30 months.

Does this not suggest that if the British government was equally determined it could reduce inflation from the present level of 1.8 per cent to zero by the end of 1994, and maintain it at that level? However the way in which the British government has recently addressed the problem do not provide many grounds for confidence that this objective will be achieved.

7. A Policy for Price Stability in Britain

'The Conservative Government will continue to put the conquest of inflation as our first objective. We will not be content until we have stable prices, with inflation eradicated altogether.'
-- *Conservative Manifesto,* May 1987.

'We have got the scourge of inflation under control... Membership of the ERM is now central to our counter-inflation discipline.'
-- *Conservative Manifesto,* March 1992.

The two statements above do not bear comparison with the recent New Zealand policy for price stability discussed in the previous chapter. Neither of them contains a definition of price stability or a timetable for achieving it. And the forced exit of the pound sterling from the Exchange Rate Mechanism on 16th September 1992 (Black Wednesday for some, White Wednesday for others) means that the government now has no proper counter-inflation strategy. Since that day there has been a major vacuum of economic policy, and for an economy which is prone to stagflation and slumpflation, that is an extremely dangerous situation. The vacuum must be filled in the near future and it is perfectly reasonable to argue that a clearly set out programme for price stability should be the centrepiece of the new policy.

At this point it needs to be said that no great originality is claimed for some of the policy recommendations in this concluding chapter. They are very similar to those contained in Professor Tim Congdon's 1991 paper *For a Stable Pound*[1]. No apology is needed for putting forward similar proposals, because those who think carefully about Britain's inflation problem might be expected to come to similar conclusions. And the justification for repeating some of those proposals is that, for nearly a year after they were published, the Prime Minister and the Chancellor of the Exchequer were obsessed with maintaining Britain's membership of the ERM, even though it was patently damaging the British economy. Now we are free from that ligature, but freedom requires the rapid development of a more effective substitute.

A proper policy for price stability in the UK would be based on the understanding:

(a) that previous policies over the past 14 years have failed, and
(b) that price stability, given sufficient determination, is achievable by the end of 1994.

It follows from (a) that the new policy requires some radical elements, and the key ones would be:

1. A greater degree of independence for the Bank of England.

2. A definition of price stability which was widely understood and accepted, not just by economic experts in the Treasury and Bank of England, but also by ordinary people.

3. A clear timetable for the achievement of price stability.

4. Allowance for some deviation from the target in a few, special cases.

5. Suitable fiscal and monetary policies which avoided increases in indirect taxation as far as possible.

6. Whole-hearted backing for the policy by the Prime Minister and Chancellor of the Exchequer. This should include an understanding that the heads of senior civil servants and economic advisers at the Treasury and Bank of England would roll if the target was not achieved by the set date.

7. Acceptance by the public, including top business executives, that pay restraint will be necessary in the foreseeable future and that pay increases need to be much more closely linked to performance and productivity.

In other words, the policy would be similar in some respects to that so successfully operated in New Zealand since March 1990. It would require a parliamentary Bill to provide more independence for the Bank of England, and such a Bill would probably take at least a year to become law. That is too long, and there is no reason why most of the main elements of the new policy should not come into effect within the existing framework. All that is required is determination in Downing Street and backing from the cabinet.

Some comments must now be made about these seven key elements of the new policy.

1. More Independence for the Bank of England

There is widespread support for this innovation, based on the failure of Treasury economic policy in the post-1945 period and especially in the recent past. One genuine concern is that it might undermine democratic accountability for economic policy. There appears to be an inconsistency between central bank independence and parliamentary sovereignty. However, if West Germany and New Zealand have overcome this problem, so can the United Kingdom.

2. A Definition of Price Stability

This is an essential part of an effective counter-inflation policy, and the unwillingness of the government to publish such a definition until October 1992 must have been a major reason for the failure of their policy since 1979.

However, the Chancellor of the Exchequer announced in October 1992 that the UK's target range for inflation (otherwise his price stability target) was 1-4 per cent for the twelve month change in the RPI excluding mortgage interest payments. A few words of comment on this target range are desirable.

First, there is a marked contrast between the way in which this target range was suddenly announced by the Chancellor and the New Zealand approach described earlier, where the price stability target is published after agreement between the Governor of the Central Bank and the Minister of Finance. Mr. Major has recently called for more open government. But there may be some senior officials in the Treasury who are reluctant to respond to this call. To change the habits of a lifetime is not easy.

Second, the Chancellor has chosen an arcane measure of inflation which means nothing to most people, and especially to those who are buying a house on a mortgage. Between early 1988 and late 1989, as base rates rose from 7.5 to 15 per cent, many households faced a large increase in their monthly payments to a building society. It is, of course, ridiculous to try to tell these people that the cost of living has not increased. The choice of this measure of inflation suggests that the Chancellor and his advisers are ignorant of the attitudes to inflation of most ordinary people, who regard the RPI as the key measure.

Third, and most seriously, there is no indication that the Chancellor sees his chosen inflation range as an interim target. No mention has been made of a date by which inflation will be completely eliminated from the UK economy. In other words, the Chancellor's policy assumes that inflation will continue almost indefinitely at about 2.5 per cent. Or, to put it another way, his so-called policy for price stability is no such thing.

In this Paper it has been argued that price stability means what it says: no increase in the retail prices index for at least a year. But of course it is unreasonable to ask policy makers to hit a single point. Instead, they should be asked to hit somewhere within a narrow band, and in New Zealand the band is 0-2 per cent, with a centre point of 1 per cent. Admittedly, an increase in quality does occur over time for some goods, so that a small upward drift in the index might simply reflect the price of such quality improvements: but nevertheless there are good reasons for choosing a band of -1 to +1 per cent instead of 0-2 per cent. An inflation of 2 per cent is not price stability, and over time it leads to a significant increase in prices as the following table shows:

Table 4

Year	Price Index With Inflation at 2 Per Cent Per Annum
0	100
10	122
20	149
30	181
40	221
50	269

However, once it has been agreed that a clear and widely accepted definition of price stability is required, the detail of such a definition will soon fall into place.

3. A Clear Timetable for the Achievement of Price Stability

This element of the programme has hitherto been conspicuous by its absence. It should consist of two parts. First, a single target date by which price stability is to be achieved, and second, intermediate targets and dates.

In March 1993 the UK rate of inflation was 1.8 per cent, having fallen from 10.9 per cent, or by 9.1 points, since October 1990. And over the 9 months to February 1993 retail prices were stable. It is, therefore, entirely feasible to aim for price stability by the end of 1994. In fact to set a later date would show a lack of nerve by the government. Intermediate targets could be 1 per cent by December 1993 and 0.5 per cent by June 1994.

4. Exceptional Cases

Britain, like New Zealand, has an open economy. It is, therefore, susceptible to exogenous shocks caused, say, by a sudden increase in the price of an essential import. At the moment this seems unlikely, but it is desirable to provide for the unexpected. The oil price rise of 1973-74 came out of the blue.

5. Suitable Fiscal Policies

Emphasis on 'monetarism' since 1979 might have led some people to suppose that fiscal policy is unimportant. On the contrary, as every first-year student of economics should learn, a sound macroeconomic policy requires appropriate fiscal and monetary policies working in harmony. A lax fiscal policy can undermine a tight monetary policy and vice versa. Perhaps the key difference is in flexibility. Interest rates can be changed daily, but more than one budget year can quickly cause administrative chaos.

It follows from the above that however desirable more independence for the Bank of England may be, unless the Bank's anti-inflation monetary policy is backed up by an appropriate Treasury fiscal policy, it will be in vain.

Those who see Keynes as the architect of 'the great inflation' do not necessarily recommend a return to the rigid pre-Keynesian Treasury dogma of balanced budgets. The business cycle requires some increase in welfare payments (eg, unemployment benefit) in the trough, and when this is combined with reduced tax receipts, a deficit will occur. The question is not *Is a deficit acceptable in the trough of the cycle?*, but *How large a deficit is acceptable in the trough?*.In his budget statement of 16th March 1993, the Chancellor forecast a deficit of £50 billion, or 8 per cent of Gross Domestic Product (GDP), in fiscal 1993-94, with some reduction in later years. Those who wish to see price stability in the near future would argue that this deficit is distinctly too large and must be reduced. In other words, either an increase in taxation, or a reduction in government expenditure, or both, are necessary.

In the *Autumn Statement* of November 1992, which outlined the government's expenditure plans for fiscal 1993-94, it was stated that general government expenditure, which had been 42 per cent of GDP in fiscal 1991-92, would rise to 45.5 per cent in 1993-94. But any government which maintains, as the Conservatives do, that consumption and

investment decisions are better made by individuals than by politicians and civil servants, should find this kind of ratio totally unacceptable and want it reduced quickly. Thus it should want increases in taxation to be avoided as far as possible, including increases in indirect taxes which inevitably push up the RPI. In reality the Conservative government is committed to reducing direct taxes, but at the same time it has had an almost manic enthusiasm for increasing indirect taxes, which are usually regressive. It is surely desirable that tax increases of *all* kinds should be avoided, and not just increases in direct taxes.

This leaves cuts in government expenditure as a fiscal necessity. Such measures always provoke howls of outrage, but the howls must be disregarded. If a policy for price stability is to have credibility, the Chancellor must cut public expenditure for fiscal 1994-95 by several billion pounds. These cuts would be announced in the budget statement due in November 1993. Of course the existence of low inflation and the prospect of price stability would make these cuts less painful than they otherwise would be.

6. A Suitable Monetary Policy

Monetary policy has been hamstrung for seven or eight years by a desire to maintain the pound sterling at some (usually unsuitable) rate on the foreign exchanges. The lesson of all recent economic history is that countries which put their own house in order by achieving price stability can leave the value of their currency on the foreign exchanges to look after itself. To give primacy to the foreign exchanges, as 'Black Wednesday' showed, is disastrous. But once price stability is accepted as the overriding objective of the Bank of England, everything else falls into place.

The Bank would then increase the money supply to allow for growth in the economy (usually 1-3 per cent per annum) and adjust interest rates in line with the inflation trend. If inflation began to move up, so would interest rates, and vice versa. Currently, base rates (at 6 per cent) are 4.2 percentage points above the inflation rate of 1.8 per cent, and that is a more than adequate gap. If inflation remains below 2 per cent it should be possible for the Bank to cut interest rates further. This would reduce mortgage interest payments and assist economic recovery. In turn, economic recovery would help to reduce the huge budget deficit.

7. Backing from Downing Street

Backing for the policy from the Prime Minister and the Chancellor of the Exchequer is, of course, crucial to the policy's success but it does not necessarily mean that the launch of the policy should be accompanied by a large propaganda campaign. It is noteworthy that in New Zealand there did not seem to be a large 'announcement effect' on the passing of the legislation, and indeed:

> 'Ultimately, credibility is derived from results -- and particularly from results in relation to publicly advertised intentions'.[2]

In fact, because the economic credibility of the Prime Minister and the Chancellor have been so low since 16th September 1992, propaganda would be pointless. Words, as well

as the pound, were devalued on that day. Only results will lead to a revaluation of the credibility of the government and the currency.

8. General Acceptance of the Need for Pay Restraint

In some quarters there seems to be a view that economic policy, even in a democracy, is solely a matter for a small clique of politicians and advisers who work in and around Westminster and the City of London. No doubt the decisions which these people take are important, but the decisions taken by millions of ordinary people and households, especially with regard to pay, may be equally important.

For much of the period of 'the great inflation' most people at work expected and received annual, inflation-plus pay awards. This occurred even when the economy was declining, as in 1990 - 92. Probably the worst offenders during this recession were senior business directors of UK quoted companies, whose pay showed a mean annual growth of 16.6 per cent over the three years 1989 - 91. The authors of the research project which produced this result commented that:

> 'Considering data on almost 300 large quoted companies, we were unable to detect any important relationship between directors' compensation and the performance of their companies. The failure to identify any such relation is particularly marked in the recessionary period 1989-91'.[3]

The truth is that a greater degree of self-discipline in pay by everyone, but especially by senior business directors, is an essential pre-condition of price stability and economic recovery. Without it, the best fiscal and monetary policies are useless. It seems that the cabinet recognize this, because in late 1992 they accepted a policy of severe pay restraint for themselves and announced that all public sector pay increases in 1993 would be limited to 1.5 per cent. The policy was spelt out in paragraph 2.44 of the *Autumn Statement* where we were told that:

> 'Without pay restraint, there would be less room for programmes, including the provision of services and capital projects, to help promote recovery and longer-term prosperity, within an overall total for public expenditure that the country can afford'.[4]

The evidence of the past thirty years suggests that any policy for pay restraint in the UK is doomed to failure. Occasionally it has worked in the short-term, but that has been followed by a surge in pay awards which more than wiped out all of the earlier gains. If full price stability is to be achieved, this must change; but there *are* reasons to suppose that change is possible.

First, the Thatcher government's trade union reforms, coupled with a severe decline in trade union membership since 1979, have made trade unions more cautious about threatening or taking industrial action. Second, an authoritative survey reported recently that:

> 'The cost of living was by far the most frequently mentioned consideration in pay settlements. This was the case for both manual and non-manual employees, whether their pay was negotiated with trade unions or determined unilaterally

by their employer. Around a half of all managers mentioned the cost of living. And for about a quarter of all managers it was the only influence upon the size of the settlement that they mentioned'.[5]

Thus it can be seen that the lower rate of inflation which now exists should help to encourage low pay settlements. A commitment to achieve price stability, backed up by appropriate policies, would strengthen that encouragement, and the government should do three things in this specific area of pay discipline:

(i) It should be made clear that a policy of public sector pay restraint will have to continue well beyond 1993, with no catching up when it ends.

(ii) To avoid the possibility of a repetition of the winter of discontent the remaining trade union immunities should be abolished. This is the only way of preventing the new, all-embracing, public sector trade union 'Unison' from causing chaos in that sector.

(iii)To compel senior business directors to set a good example in this matter of pay restraint, company law should be changed to make them more accountable to their shareholders. This would mean making the pay of the Boards of Directors of publicly quoted companies the subject of a separate vote at the annual general meeting of shareholders.

These three measures, taken together, would provide firm support for self-discipline over pay. Without them the policy could soon disintegrate, with serious consequences for the achievement of price stability.

Conclusion

The object of this Paper has been to show that price stability should now be at the centre of British economic policy, and that it can and must be achieved by the end of 1994. If the paper has helped to convince some sceptics and doubters that such a target is indeed attainable and should be attained, then it will have served its purpose.

Notes

NOTES TO CHAPTER 1

1. *Bank of England Quarterly Bulletin*, November 1992, p. 447.

NOTES TO CHAPTER 2

1. R.F. Harrod, *The Life of John Maynard Keynes*, Pelican Books, 1972, p. 332.

2. J.M. Keynes, *The General Theory of Employment, Interest and Money*, Macmillan, 1936, p.3.

3. *Ibid*, p. 378.

4. Quoted in S.R. Dennison and J.R. Presley (Eds.), *Robertson on Economic Policy*, Macmillan, 1992, p. 41, and in J.R. Presley (Ed.), *Essays in Robertsonian Economics*, Macmillan, 1992, p.91.

5. HMSO, Comnd. 6527.

6. M. Friedman, *Money Mischief*, Harcourt Brace, Jovanovich, 1992, p. 233.

7. Quoted in M. Friedman, *op. cit.*, p. 208.

8. Clive Bell, *Old Friends*, Chatto and Windus, 1956, p. 61.

9. *Ibid*, pp. 47 and 48.

NOTES TO CHAPTER 3

1. HMSO, 1958, p. 31.

NOTES TO CHAPTER 4

1. *National Westminster Bank Quarterly Review*, February 1991, p11

NOTES TO CHAPTER 6

1. For this chapter the author has drawn heavily on an essay by Peter W.E. Nicholl and David J. Archer 'An Announced Downward Path for Inflation', published in R. O'Brien (Ed.), *Finance and the International Economy*, Oxford University Press, 1992. He gladly acknowledges his debt to these authors.

2. R. O'Brien (Ed.), *Finance and the International Economy*, OUP, 1992, p. 118.

3. *Ibid*, p. 126.

NOTES TO CHAPTER 7

1. Centre for Policy Studies, *Policy Study No. 128*.

2. R. O'Brien (Ed.), *Finance and the International Economy*, OUP 1992, p. 122.

3. P Gregg, S. Machin and S. Szymanski, *The Disappearing Relationship Between Directors' Pay and Corporate Performance*, British Journal of Industrial Relations, March 1993,

4. HMSO, Cm 2096, 1992, p. 17.

5. N. Millward et al, *Workplace Industrial Relations in Transition*, Dartmouth, 1992, p. 239.