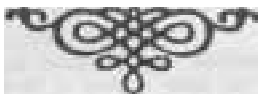
SPOTLIGHT ON THE CITY

One year into the Big Bang, and the City remains a place where much of the Left fears to tread. Yet, as the impact of the financial institutions on the economy grows, and as the rash of privatisation spreads shareholding across the social map, an understanding of the City and all its works must become an ever-more critical component of the Left's new economic strategy. Marxism Today looks at some of the issues and talks to some of the personalities.



City Strategies

Lord Bernard Donoughue describes himself as the 'acceptable face of labourism in the City'. He was a key figure in the Wilson and Callaghan kitchen cabinets (1974-1979) and is now head of international research (and a director) at the merchant bank Kleinwort Grieveson. He also takes the Labour whip in the House of Lords. His name has been mentioned as a possible governor of the Bank of England if Labour ever forms another government. Here he speaks to David Goodhart.

Despite the higher political profile of the City, and some of the negative aspects of Thatcherism that it has come to symbolise, Labour has found it difficult to make much impact on the issue. The party appears caught between trying to learn to love the City and providing a credible critique of its excesses.

It seems to me that it is not possible for Labour to ignore the City, nor is it sensible to take the conventional approach of both disapproving of its huge influence and yet not understanding anything about how it exercises it. The City is one of the most rapidly-expanding parts of our economy and, given the internationalisation of markets, no future Labour government can control or direct the economy without the City's co-operation since national boundaries no longer exist for finance, and since a draconian siege economy is no longer conceivable.

But this transfer of power from politicians to financial markets is precisely what many people find objectionable, especially as the markets usually dislike governments of the Left.

Look, it is just a reality, I am not interested in whether it's a good or bad thing. One of the troubles with the Labour Party is that it spends too much time denouncing bad things and too little time understanding how things work. The City as a powerhouse of the international economy is an inescapable fact of modern life, and to the younger generation it's an attractive fact. I'm an honorary fellow of an Oxford college and dining there recently the fellows told me of the dramatic rise in the number of their best students who want to go into the City. If Labour is seen to be hostile to the ambitions of the most talented youth it will either not be elected or fail when it is. In any case, there isn't really such a thing as a socialist approach to the City, it's like defence policy in that respect.

Is the City playing the game?

It is unusual for a former academic and adviser to Labour governments to end up with a senior post in a City firm. How did it happen?

In the 1960s I was lecturing at the LSE and became interested in financial markets. I found it impossible to fill my week with the two days' work they then handed out to university teachers and I had four small children under the age of five, so I set up a portfolio management company and handled the personal investments of people I knew. That kept me interested and the children in shoes. At the end of 1972 I thought the market was dangerously high and sold out. Grieveson Grant, the broker I used, noticed that this was rather good timing and offered me a job as a consultant. I went to Downing Street in 1974 and after the defeat in 1979 I went back to Greiveson as a part-time consultant until Murdoch sacked me from *The Times* and then I went into the City full-time.

Do you feel any tension between your political values and your job?

For 25 years I have been a market socialist - I learnt the idea from the Hungarians. I have always genuinely believed in the mixed economy, and I don't just mean expanding the public sector and punishing the private. I only describe myself as a socialist very loosely because I'm not sure what the word means in the UK today or what it has ever meant in the Labour Party. I was born into the party, my father was a factory worker, and I joined as soon as I could. After reading PPE at Oxford I was secretary of the Campaign for Democratic Socialism in the early 60s and worked quite closely with Hugh Gaitskell, so I know what it's like for Kinnock. Many of the things he is trying to do we were talking about 25 years ago. My basic position is to support the greatest efficiency in generating resources compatible with decent treatment of people and fair distribution of wealth. For that reason I think the City can contribute more to a Labour society than Camden council or the nationalised gas industry.

As far as Labour has a distinctive set of financial policies they seem to cluster round three ideas: the belief that regulation of City institutions must be tightened up, the desire to direct capital through subsidy, and a continuing attachment to some form of foreign exchange control, however modified. Do you think any of these policy areas have much life left in them?

The Labour position on regulation is broadly right, but we're almost there. In fact we're in danger of going too far. The prevailing atmosphere in the City is becoming dangerously bureaucratic. Some of the documents on regulation are immense and unintelligible. The Secur-

ities and Investment Board ought to have laid down general principles and then built up case law. We should certainly not be outbidding the Tories on regulation, we should simply say we are the more natural regulators, we enjoy it.

What about foreign exchange controls?

In the modern world foreign exchange controls are bound to fail and to hinder efficient trade relations. They should not be an objective of policy - what's so left-wing about import controls or foreign exchange controls? They may be desirable at certain times in certain countries but if they are not necessary, why make a virtue out of them? Labour should, however, preserve the ability to reimpose them if necessary, but make it clear to the City that they would only be used as an instrument of last resort. As for the existing repatriation policy I think it's fair to say it was really just a clever wheeze.

In relation to whom?

Both the party and the City. Repatriation of capital meets an emotional need. If it ever came to be implemented it would provide some money for the national investment bank, and that is helpful, but it should not be pushed too far, just used as a cap on foreign investment. It should also not apply to unit trusts.

But isn't the channelling of some of that foreign investment into the investment bank one aspect of Labour's financial strategy that potentially chimes with popular sentiment?

Certainly, but the bank is not going to be that important. It could have some uses if it is run by sensible people; but as for this gut feeling that all our savings are draining out of the country, the fact is firms and individuals are increasingly unaware whether they are borrowing from foreign or UK savers anyway, and I think the nation gains if invested funds seek the best return. Someone has to suffer a lower return to pay for subsidised capital, I do hope that supporters of the investment bank will hold their deposits with it and then not complain if the returns are less good than the building society. Having said that, I don't think there is any good argument against a bank supported out of tax revenues which could be a useful focus for targeted capital subsidies. That would avoid the need for wasteful general subsidies which - because enshrined in national law - have to apply to leafy Hampstead as much as to a depressed northern town. Much more important than the investment bank, however, and much more lucrative for a Labour government would be a pledge to end the various savings tax breaks. We should not subsidise mortgages and we should not subsidise the collective forms of investment like pension funds. Insurance company performance would be awful without those tax benefits.

But that would provide a tremendous boost to individual share ownership and given the way it has been promoted as a form of no-lose gambling, that could have serious consequences for public companies.

This is nonsense. People view investing in shares as a way of pulling in a bit of extra money. It's silly of Labour to say this is the wrong attitude towards share ownership. I agree Labour should try to give share ownership a more wholesome image. But I fear that every time someone gets up to denounce the casino society the man in the street thinks: 'I want a bit of that.' Personal equity plans, employee share ownership plans and unit trusts are all positive things and Labour must find a way to associate with them. Mrs Thatcher's apparent monopoly in this field has been another populist masterstroke, it is also another example of her taking up positions that Labour could have seized. She is a populist, not a Tory.

But is it really feasible for Labour to become the party of financial consumerism, to support both more regulation and more competition on behalf of the small investor?

Labour must certainly try to pick up the ball and run with it. Consumerism in finance ought to be a natural issue for us. After all, we don't have to worry about harming our own constituency in the City like the Tories. As for the specific policies, well I think they're pretty self-evident really, any group of experts could sit down and agree on the areas where Labour could tighten up consumer rights in the City. But to be convincing, the party will have to change its attitude. It will have to relinquish this combination of inertia - which means it does too little - and envy - which means it does the wrong things.

How has the ethos of the City changed?

The old conventions have gone, of course, and so has the social underpinning of self-regulation. The new City is much more of a jungle and individuals are far more mobile. That said, I think City professionals are more honest than any other group of people I have worked with. The work ethic is also much stronger than it used to be. The highly paid kids we're always hearing about are getting used to working some long hours and are developing a wide range of skills. Those skills will be very useful in business or government when the shake-out comes.

Has the year since Big Bang worked out much as you expected?

Yes. It is clear, as most people thought, that to survive as a successful operator in the new financial markets you either have to be very big indeed or successfully specialist. So what I'm really saying is that there is not much future for British merchant banks. One hopes that the Bank of England or Treasury thought about how to preserve a successful British section of the City when they unleashed Big Bang, but unfortunately we cannot be sure.

But if this was so obvious to everybody why is it that banks like your own - Kleinwort Grieveson - did not prepare themselves better? Is Kleinwort not guilty of lack of foresight in only very recently expanding its capital base?

Yes. But in their defence I would say that things have been imposed on them very fast. It's this naive free-market belief that if you are thrown in the deep end you will not only learn to swim, you will almost instantly become an Olympic contender. We will eventually emerge with only about half a dozen firms: two based on the big clearers, NatWest and Barclays, SG Warburg, and a couple more based on conglomerates like BAT or British & Commonwealth.

Does this not rather limit the case **for prioritising financial services? If our comparative advantage disappears, and the foreign firms repatriate their profits, invisible earnings will become far less significant.**

The invisible earnings from the financial services industry are important and are growing in importance, and although it would still be an important employer and foreign exchange earner even if foreign-owned, it would certainly reduce its value to the economy.

Haven't the earnings of the 'new' City in any case been rather overdone? The real money spinners are insurance and the clearing banks; securities trading is puny by comparison.

But insurance is partly as powerful as it is because it's integrated into the rest of the City. Securities may get publicity out of all proportion to their significance as earners of invisible earnings, but if we lose them we will be in danger of losing our comparative advantage and a British City. This is the really big issue.

The other big issue of the past year has been the alleged short-termism of the large investment institutions. This should have been a subject tailor-made for Labour to exploit, and yet the people who have really made an impact are Nigel Lawson and David Walker at the Bank of England, who are both arguably responsible for exacerbating the problem in the first place.

Yes, Labour has been absent from the short-termism debate. Of course we should have been proselytising to the institutions about the importance of proper long-term active commitments to efficient companies, but that means viewing the institutions as friends not as enemies. I certainly think it is important to protect companies from Hanson Trust without cossetting managements. However, I don't think you can just borrow wholesale from the relationship between finance and industry in countries like Germany and Japan. These things don't usually travel very well.

Finally, do Mr Lawson's recent comments on exchange rates represent a significant shift away from the trend to financial de-regulation and complete dependence on market forces in international financial flows?

It is certainly true that while initially most people could see the logic and benefit of some deregulation, we are now focusing more on the disadvantages, such as volatility, and that is causing a bit of a nudge in the opposite direction. •

Most people find pensions a complicated and depressing subject. But there are big changes coming in the system for both state and private pensions next year, and we need to understand them.

At present, there is a state basic pension, which keeps one at no more than subsistence level. It is currently £39.50 a week.

On top is the State Earnings Related Scheme, usually abbreviated to SERPS, which has been running since 1978. The pension here is based on PA YE earnings between lower and upper limits. The lower limit, the 'LEL', is roughly linked to the state pension, and in this tax year it is £39 a week. The upper limit, the 'UEL', is £295 a week. For each year in SERPS, up to 20 years at most, you get a pension of one-eightieth of your earnings between those limits.

Many people's best earnings, in real terms, come well before retirement. SERPS takes account of this. Each year's earnings are recorded, and at retirement they are *revalued* in line with the rise in national average earnings since they were earned. Then the figures are averaged.

So someone retiring this year would have their 1978-9 earnings revalued by a little over 150%, to bring them up to a figure that makes sense in 1987 terms.

However, when the scheme started in 1978 there were already millions of people building up pensions in 'occupational' schemes run by their employers. They were allowed to 'contract out', so long as the employer's scheme would guarantee a pension at least as good as SERPS. The rules about this guaranteed minimum pension, or GMP, have to override any other rules for the scheme. In return, the employer and employee would pay a lower National Insurance contribution.

SERPS is a modest scheme, and employers' schemes are often providing a much better pension, and getting huge amounts of tax relief for doing so.

But the government has decided that we 'cannot afford' what was promised when SERPS began in 1978. Because people are living longer, and families are smaller, there will be a higher ratio of pensioners to workers in the next century, and they would also have been better off.

Originally the government wanted to abolish SERPS, and make everyone take out insurance policies. They were surprised to find opposition from the insurance companies themselves, who did not want to take on millions of low paid people. There wasn't the profit in it. So instead the Tories have cut the value of SERPS by about half in the long term, and created a new sort of private scheme.

People retiring in the years up to 1998 will get what was originally promised, but, after that, SERPS will be phased down. After the year 2008 the maximum pension will only be a fifth of the relevant band of earnings, and there won't be any system of picking out the best years' earnings. Widows' pensions are also being cut.

The Tories also think pension schemes run by employers are 'pseudo-socialist', as one representative of a far-right think tank put it. So, from next April, it will no longer be possible to make membership of a scheme a condition of employment. And from July onwards, there will be heavy official encouragement to walk out of such schemes and buy 'personal pensions' - your own little pot of retirement gold.

Personal pensions are a very different package either from SERPS or from the normal employer's pension scheme. They **are based on the *money purchase*** idea. This means that the pension you get bears no relation to your earnings while at work. Instead, your contributions are invested to build up a fund, which buys you an annuity at retirement. -

The size of the annuity will depend on how well the investments do, and on interest rates at the date when you retire.

If you buy what is called an Appropriate Personal pension (APP), it replaces your entitlement both to SERPS and to the GMP in an employer's scheme, but without putting any guarantees in their place. These APPs are the minimum; all that has to go in is the National Insurance contribution that would otherwise go to SERPS. For the first few years the DHSS is adding 2% of your earnings as an 'incentive' - more accurately a bribe - to boost the performance of these schemes. This could cost the National Insurance fund up to £1 billion.

You should be very cautious about taking out personal pensions. No-one over the age of 45 for a man, 40 for a woman, should be tempted. These figures are only guesswork, and take no account of inflation. For younger people, if things go well, you could do better than SERPS; but you could also do a lot worse.

Anyone who leaves an employer's scheme to buy a PP is likely also to be giving up death benefits and disability cover, which will need replacing privately at extra cost.

If you're in a good employer's pension scheme, stay there. If you're in a poor one, then negotiate to make it better. Employers' schemes have traditionally treated badly anyone who left, though that's now improved a bit. That will be one of the big sales pitches for the new 'portable' PPs. But it is much better to get the employer's scheme put right. Better still would be decent state pensions for all, but over the next few years that is not on the cards.•

Sue Ward

The Price Of Lunch

Monday lunchtime, and a journalist is hurrying to his next appointment. When he arrives, a PR rep greets him like an old friend, although he's only met her once before, and can't remember her name. Into one hand goes a brimming glass of Piper Heidsick champagne, into his other a copy of the company's interim results.

He glances down the page. The results are good - naturally - no-one would spend this amount to give the press bad news.

Lunch arrives and the select group of journalists, City analysts and senior management settle down. 'Oh I almost forgot,' the chairman waves one of his juniors into action. 'Have one of our pens.'

Afterwards, the journalist goes back to the office, and writes the story up for tomorrow's City pages. The comment will probably be good, because the company seems to be doing well. For the company this makes the whole operation worthwhile. If its share price rises by just a penny or two on the back of the comment, the £1,000 lunch will have been cost effective.

Financial public relations is a growth industry. With the rapid increase in stock market activity in the last few years, competition between companies has grown for the limited amount of press space allotted to them. Sending out press releases, buying lunch or treating journalists to a visit to one of your factories is a way of shouting 'look at me' to the newspapers.

A company in which investors lose interest is in trouble. As the money moves towards more exciting prospects, its share price slips. A low rating makes the company unable to fund acquisitions or make a rights issue. It also makes it a target for takeovers. So most companies have recently engaged PR firms to make sure that people remember who they are.

There is a darker side where the give-aways get just too extravagant. There is no such thing as 'free lunch' and its recipients become uncomfortably aware of it.

The greatest extravagance on record has been generally condemned as crossing this line. Last March, Allied Lyons chartered Concorde to fly analysts to Canada to visit its new acquisition, Hiram Walker, and then to Scotland to see other distilleries. En route, unlimited alcohol and lavish food was *de rigueur.* The whole thing was estimated as costing up to£1m.

The trip failed because the bad press it received was too widespread, and the slap-up treatment alienated more people than it pleased. Several City firms demanded they should pay for their own tickets to demonstrate independence. So now, while trans-Atlantic trips still abound, they are a little more-discreet.

PR agencies won't lie for their clients - there is a blurred code of honour about what is ethical PR - but they will certainly make them look as good as possible. As a brochure from Broad Street Group, another agency, puts it: 'We will develop a credible story for the market.'

In many ways, PR makes the financial journalist's job easier. Company chairmen are more open once they have been trained by agencies about what they can reveal and what to refuse to discuss at all. The journalistic handed a complete story package, often very difficult to pick holes in. Because of time pressures it often gets served up straight for the readers. One agency is called Good Relations; and that's just what its clients are paying for. •

Neil Bennett

'Small shareholders are just a pain.' Give or take the odd expletive, that is how most stockbrokers view the five million or so investors that the huge government sell-off campaigns have persuaded into the shareholding ranks.

While investors who buy government stocks do so in the expectation of an automatic profit, the stockbrokers who have to sell the shares for them do so in the certainty of an equally automatic loss.

The result is a thinly veiled stand-off between the stockmarket and the government. Treasury ministers think that stockbrokers whinge too much. The government exhorts the City to pull its fingers out, take its losses smiling and build on this army of new shareholders.

In September, Sir Nicholas Goodison, the gaunt Stock Exchange chairman, asked the Treasury to ensure that the minimum allocation in the BP issue was set at a level which would discourage millions of tiny investors. And that was the 'on-the-record' end of the dialogue. He was ignored and, very much off the record, he was told that the wider share ownership policy was responsible for the return of the Tory government and the 1987 share price boom.

It was not always like this. Just a year ago, stockbrokers were predicting a new dawn for the small shareholder. They wanted the small shareholder back. Small shareholders were loyal, bought and sold when they were told and did not demand those hugely expensive research departments needed to win and retain business from the insurance companies, pension funds and other investing institutions.

The stockmarket's Big Bang at the end of October 1986 was to be the catalyst that restored the private investor to a place in the sun. Big Bang abolished the set scale of commission charges. Brokers were free to undercut each other. The old fixed minimum commission of £16.50 (plus VAT) went.

One medium-sized broker, Charles Stanley, introduced the £10 (plus VAT) deal. And many others, including leading names such as Hoare Govett and Kleinwort Grieveson, were not much more pricey.

Those who were not caught up with the euphoria ahead of Big Bang voiced objections and pointed to the experience of the United States and Australia.

The fixed commission scale had been abolished in both countries leaving powerful large share purchasers able to negotiate lower rates while the small client saw services decline and prices rise.

The free-market objection to the rigid commission scale, argued doubters, centred on cross subsidy. Someone buying £1,000 of shares under the old system paid £16.50 before stamp duty, VAT and other add-ons. The big investor with £100,000 paid £584.50 (or around two-thirds less per £1,000). Nevertheless, the big deal cost 35 times as much.

It did not cost the stockbroker 35 times as much to process the deal. Much of the cost was identical. Share transactions involve a lot of paperwork whatever the amount. The big buyer was evidently subsidising the small.

Remove that cross subsidy and the cost to the smaller client should go up. But the stockmarket argued that Big Bang coupled with the growing interest of the general public in shares would create so much extra business that rates could come down across the board. The euphoria lasted around three months.

Crisis point arrived with the British Airports sell-off. Investors ended up with £100 of shares, and while that £100 was worth around £145 on paper in the first hours of dealing, after charges punters were lucky to collect a £15 profit.

Stockbrokers did everything they could to turn this business away as their systems started to break down. Some, who were singled out in newspapers as charging below average, immediately increased their charges. Stockbrokers who reduced their minimum charges from £16.50 to £15 after Big Bang now charge £25 or £30 for small deals.

And bigger private investors have also found life getting tougher. Before Big Bang, most big London stockbrokers were happy to have private clients with no more than £75,000 in shares and unit trusts. Now £250,000 or even £500,000 is a typical minimum.

But the wider share-ownership movement has had some support. Building societies based in affluent areas such as the Bristol and West and the Cheltenham and Gloucester have finalised tie-up deals with stockbrokers in selected branches. Stockbrokers Quilters has a branch in London's Selfridges store while the Burton Group - no stranger to stockmarket controversy - has opened two in-store share shops and joined the Stock Exchange. Forty more store sites are on the way if the experiment works.

Now that the leading banks all own stockbrokers, there are plans to offer simplified over-the-counter transactions on every high street. NatWest has introduced 'touchscreens' which print out a cheque on the spot, while Barclays is still working on its much-heralded Barclayshare.

But no matter how sophisticated the electronics, all the attempts to put the retail end of share dealing into the high street environment run into two stumbling blocks.

One is the British obsession with share certificates and registration of ownership. It adds several layers of paperwork to each transaction.

And the other is that, so far, no one at the retail end has found a way of smoothing out the business and activity peaks which follow a privatisation and the troughs which occur at other times. For the new army of shareholders has been reticent to buy anything that does not carry the instant promise of a risk-free tenner. •

Tony Levene

The rash of new unit trusts which have splashed the country's billboards in search of people's cash and conscience signals the coming of age of ethical investment.

Among the new products are ethical funds from NM Schroder, Abbey Life, Dominion and a personal equity plan from Buckmaster and Moore. Friends' Provident has also spun off a North American version of its successful 'Stewardship Trust'.

Cynics would suggest that the raging bull market has reached new peaks of decadence - it can even afford morals. The new products have the appearance of some marketing man's latest hype desperate to get the units rolling in.

Ethical investment is still a certain shade of 'pink' in this country but in the US it has the power to move markets. Wall Street brokers estimate that around 10% of all money invested in US mutual funds, their equivalent of unit trusts, is in ethical funds. The current value of such investment is around $100 billion.

The US movement first saw light during the Vietnam war when investors in Dow Chemicals voiced concern that their money should not finance napalm.

Heather Swailes of the Ethical Investment Research & Information Service (EIRIS) says that the UK is lagging. 'It is only in the past few years that ethical investment started losing its crank's image.' She expects it to grow rapidly. 'It will grow, not because there is a sudden crisis of ethics in the City but because they are beginning to realise that money can be made from ethics with a whole market of caring investors yet to be tapped.'

Britain has lacked a national crisis such as Vietnam - perhaps the only correlation is the wide coverage given to investment in the South African regime. Yet the UK still lags behind, with total direct investment in South Africa totalling £6 billion compared with the US figure of £1.3 billion.

The criteria applied to socially responsible investment extend beyond South Africa and can take in alcohol, tobacco, arms manufacture and nuclear power.

Friends' Provident also looks at a company's employment practices, pollution control and attitudes towards the local community. It argues that this positive discrimination tends to produce good performance results - companies which meet the criteria often have above average management.

Indeed the established ethical unit trusts, such as Friends' Provident, have performed particularly well. Over three years, it claims sixth ranking out of all unit trusts.

The reason for their success is their principles. Electronics have been avoided because of their defence connections and most oil companies have been left out because of their South African connection. Both sectors have under-performed on the stock market.

The ethical blacklist also tends to rule out a disproportionate number of large companies and so the funds have reaped the rewards of the generally superior share price rises displayed by smaller companies. How ethical unit trusts will fare is yet to be seen - the oldest is only three years old*

Susana Antunes