

# 7

## FLOW OF FUNDS, PRICE CONTROL AND RESOURCE ALLOCATION IN THE U. K.

### Introduction

Based on our analyses and discussions in previous chapters, the conclusion has been reached that during Stages 2-4 of the Price Control, corporate earnings measured on a cash flow basis were reduced to negative amounts. That is, during these periods companies failed to generate sufficient cash from their production and trading activities to cover compensation for the money capital that was required after paying for replacement investment. This condition of financial non-viability was caused by the inter-related effects of high inflation and a regime of price control and taxes based on historic cost accounting. Effectively it represented a situation in which income or resources had been transferred out of the company sector in favour of personal incomes.

As indicated earlier, reduction in prices consequent upon the control reduced profit incomes *pro-tanto* and also reduced them as a proportion of total national income. Therefore the deficits in cash flow earnings of companies should be reflected in a personal sector surplus with the benefit of lower prices. At sector level the flow of fund statistics published by the Bank of England provided a convenient means to trace the movement of resources as well as their magnitude between the various sectors of the U. K. economy. Besides showing the extent to which the financial deficit of the company sector (which with certain limitations comes closer to the definition of cash flow earnings used by us) increased during the period of con-



trol, the problem of company finance and its relationship with real activity is also discussed in the following sections.

### Flow of Funds

“Flow of Funds” is short for an approach to economic analysis which is becoming fashionable in Britain. It was pioneered in the United States in the late 1940’s and early 1950’s and was taken up mainly by the Bank of England in the early 1960’s following the Radcliffe Report’s call for more detailed monetary statistics. Flow of funds analysis, like national income accounts, is presented not in terms of individual decision making units but for a few consolidated sectors. In most published flow of funds statistics the U. K. economy is divided into five sectors : public, personal, industrial and commercial companies, banking and other financial institutions, and the accounts are completed by the addition of the overseas sector. This link is derived from the circular nature of economic flows underlying the basis of national income accounts. “That is, output on the one hand generates income for each of the factors of production, while on the other hand it is used to meet the final demand generated by various forms of expenditure. In the process financial surpluses and deficits arise for each of the sectors”<sup>1</sup>. A sector is said to have a financial surplus if it spends less than its total income on goods and services. This surplus must necessarily be used in the acquisition of financial assets or in repayments of existing debts. Likewise, a sector with a financial deficit must find finance by borrowing, or by selling existing financial assets. In other words, the net financial balance for real activities measuring the difference between income and expenditure of each sector is closed by net acquisition of financial assets or liabilities, i. e. financial activities in the money and capital markets. This explains the existence of financial institutions and means that finance has a crucial role in determination of income and expenditure by channelling funds from those who save to those who think it profitable to invest<sup>2</sup>.

The flow of fund framework presented above is used jointly by the Treasury and the Bank of England for the purpose of financial forecasting as the counterpart of a macro-economic forecast for the short term—covering one to two years. It is prepared in conjunction with other forecasts and is based on the same assumption ; its parti-



cular aim is to exhibit the possible implications of other forecasts for monetary policy, and to provide a plausibility and consistency check which might cause those forecasts to be modified. Financial forecasting has assumed relatively more emphasis for policy making purposes since the adoption by the authorities of specific targets for the growth of monetary aggregates<sup>3</sup>.

Although the Bank of England has been publishing the sectoral flow of funds for a number of years, it was Godley and his associates (known as the "New Cambridge School") who used the framework to present their criticism of official forecasting of national expenditure before the Expenditure Committee in 1974<sup>4</sup>. They based their argument on an estimated equation which would have been fairly successful up to 1972 in predicting a small surplus for the private sector—the personal, industrial and commercial, and financial sectors combined—as a function mainly of disposable income, but also of bank advances and stocks<sup>5</sup>. The other two sectors—public and overseas—would between them have a deficit corresponding to the private sector surplus. In view of the predictability of the private sector surplus, it was argued, the overseas sector surplus (balance of payments deficit) must vary directly with the public sector deficit, and the best policy to reduce the balance of payment deficit was to cut the budget deficit. The supposed (ex ante) proof of this proposition stems from the necessary arithmetic identity that (apart from residual errors) the net acquisition of financial assets by the public, and private and overseas sector<sup>6</sup> must sum to zero. Ex post forecast based on the econometric equation provided a good fit with the actual surplus for the private sector up to 1972, after which it was shown that the model had broken down massively from 1973 onwards<sup>7</sup>. The model was predicting deficits for the combined private sector while surpluses had actually been realised.

### Supply and Price of Funds

It was not our intention to engage in the debate on macro-economic policy-making based on the behaviour of aggregate sectoral financial balances. However, the somewhat stable relationship observed between total private sector income and expenditure provided a basis for the argument that the financial viability of the corporate sector did not require it to be in financial surplus within the total private sector, so long as its other elements (household) were willing



to lend at a price, and that financial deficits of the corporate non-financial sector was a commonplace thing in other industrialised countries, like Germany, Japan and the U. S. A<sup>8</sup>. While statistically this was true, there was a significant difference between the financial deficits arising out of a growth and profitable situation, and those deriving from a state of no or less growth and an unprofitable condition such as produced the financial deficits in the U. K. However, it must be pointed out that the financial viability condition used for this thesis is based on sound economic principles of wealth creation and consumption in which borrowing and lending were not precluded. At sector level it was the real return to capital—irrespective of its ownership characteristic—which was wiped out by the operation of price control based on historic cost accounting and effectively redistributed the same to other factors of production, viz. labour. This created a condition of financial non-viability in which the high cost of borrowing also made its contribution, although its supply remained less of a problem for the sector as a whole. For individual companies it is well known that in profitable trading conditions, increased gearing, i. e. a high proportion of debt to equity capital pays only to a certain extent, but in unprofitable condition gearing not only has negative effects but could prove to be disastrous. Even in Germany where the rate of inflation was the lowest among the industrialised countries, it was observed that a switch in leverage effect occurred, i. e. leverage now operated to cause negative impact on the rate of return on equity<sup>9</sup>.

Our analysis of company accounts in the previous chapter showed that companies could not generate enough cash from their basic operations to cover all their current outlays. If trading and production in the company sector could not generate enough cash to cover the capital expenditure incurred in maintaining the current productive base then it indicates that either capital was being distributed effectively or external subsidisation was needed to maintain the real capital base. While the choice between present and future consumption really depends on *social time preference*, for any positive social rate of discount (however low) the existence of a positive cash flow on the capital stock is a necessary precondition. Therefore, the deficits in the industrial and commercial companies' financial balance, as shown in the following table, to a large extent represented the "refinancing



gap" created by the underpricing of sales due to the use of historic cost accounting for price control and taxes in inflationary conditions, and was not associated with any increase in real activities, which in general was the underlying cause of such deficits in countries like Germany and Japan. However, it is argued subsequently that the deficits in the industrial and commercial sector would have been different, possibly smaller for the given level of capital expenditure, if price control and taxes had not shifted income or resources out of the sector. On the other hand, the recorded deficits would be higher if capital outlays on account of *trade debtors* were also accounted for.

TABLE 1 : SECTOR FINANCIAL BALANCES\*

£ million

Year	Public Sector	Overseas Sector	Personal Sector	Industrial and Commercial Sector	Financial Sector
1964	-1004	+355	+592	-126	-23
1965	-853	+22	+920	-62	-21
1966	-963	-100	+1090	-94	-72
1967	-1690	+298	+970	+211	-112
1968	-1048	+288	+739	+279	-197
1969	+365	-440	+938	-142	-336
1970	+714	-735	+1284	-899	-332
1971	-314	-1058	+911	+75	-152
1972	-1721	-131	+1210	+533	-150
1973	-2768	+901	+2009	-418	-266
1974	-5390	+3725	+4824	-3259	-410
1975	-8184	+1702	+6185	-336	-292
1976	-8569	+1476	+7617	-658	-1012

Note : (Deficits and surpluses do not cancel out, because of residual errors, omissions and unidentified transactions ).

Source : \*Bank of England Quarterly Bulletin, NIESR No. 74, 1975.

As will be observed from the table, the combined net financial balance of the private sector—personal, companies and financial, is positive in all of the years. According to the prediction of the New Cambridge model the net balance should have been deficit for years 1973-74 and 1975. Although the balance for industrial



and commercial companies and financial sector were negative it was the large surplus in the personal sector which swamped the deficits in those two other elements in the total private sector. The public sector which, with the exception of 1969 and 1970, had invariably been in deficit since 1952, piled up massively increased deficits in the 1973-76 period much more than the increased surpluses accruing to the overseas sector.

### Limitation of Flow of Funds Analysis

In stating the object of the flow of funds analysis it was emphasized that "it is not the size of the surplus or deficit which lies at the centre of interest so much as the interaction between financial conditions on one side of the line and general economic activity on the other"<sup>10</sup>. Size is less emphasised possibly because there remain a large number of unidentified items in sectoral accounts. In addition to unexplained errors or omissions, these items reflect changes in trade credit between sectors. The largest unidentified entries are usually a *positive* figure for the company sector and a *negative* one for the personal sector<sup>11</sup>. It should perhaps be explained that for reasons mentioned above and also because of other allocational problems, the sectoral surpluses/deficits do not sum to zero as theoretically they should. The estimates of the financial transactions do, however, add to zero, because they all involve two sectors and are entered twice with opposite signs—every financial asset is a financial liability somewhere else. The difference between the surpluses and deficits of the sectors and their identified financial transactions show up as "unidentified financial transactions". As we have observed in the previous chapter, both debtors and creditors increased significantly during recent years of inflation and it was argued that as elements of working capital they are determined by the rates of relative price changes and/or growth. It was also observed that for companies in manufacturing and distribution, trade creditors increased more than trade debtors. But for the flow of funds analysis it is the increase in trade debtors which was important because for the company sector as a whole ultimately it had flown from this sector to the personal sector. On the other hand it was only the fund associated with net increase in trade creditors for the sector, which had flown in from the rest of



the other sectors, excluding the personal sector. The upshot of this discussion was that leaving changes in trade debtors out of flow of funds analysis resulted in consistent overstatement of financial surplus or understatement of financial deficits of the company sector, with correspondingly opposite effects on the personal sector. If the flow of funds on account of trade debtors were accounted for then the 1973-76 deficits of the corporate sector would have been larger and the surplus of the personal sector (and to some extent the overseas sector) would also have been larger.

### Changing Financial Behaviour of Households

Having described the limitations of financial surplus or deficits, we should resume discussing the main theme of flow of funds, i.e. the interaction between sectors and also between financial conditions and real activities. It may be observed in the flow of funds table that the speed with which the public sector's deficit increased in the last few years was matched by an even more unexpected rise in the personal sector's surplus at a time when rapid inflation was generally expected to make consumers opt for 'jam today' instead of saving<sup>12</sup>. Two arguments were put forward for the increasingly large surplus in the personal sector. One tended to relate the increasing surplus of the personal sector with financial factors arising from the perceived need of households to maintain the real value of their financial wealth which was being eroded by rapid inflation. It was argued that as the economy began to move into a period of faster inflation, households started to save more as a percentage of their disposable income. During the comparatively stable environment of the mid-fifties and sixties, "it was generally accepted that persons' saving was determined by 'real' factors and that most financial decisions were made separately. But developments since then had drawn attention to the way in which real transactions (the saving ratio) might in turn be influenced by financial factors....<sup>13</sup> It was further observed that as a proportion of personal disposable income, the main form of contractual saving (contribution to life insurance and pension funds, mortgage debts and hire purchase obligations) remained fairly stable while the overall saving ratio had risen sharply since 1972. Therefore it might be argued that the significant increase in non-contractual savings was



an attempt by households to protect themselves from the effect that negative real interest rates were having on their past savings. The other argument was related to 'real' factors, and maintaining that the increased surplus in the private sector was due to relatively higher levels of subsidisation received by the personal sector especially from price restraint in both the public and corporate sectors<sup>14</sup>. Until the end of 1975, average earnings increased at a higher rate than consumer prices and the increased saving ratio of households might have been associated with the increasingly large combined deficits of the public and corporate sectors. This argument was related to the issue of utilising subsidies in order to reduce inflation. Subsidies which reduced cost of living by reducing prices paid by the personal sector increased the deficit of the public<sup>15</sup> and corporate sectors with a corresponding increase in the surplus of the personal sector.

The following table shows the combined deficit of the public and company sectors as the ratio of personal disposable income and also the ratio of personal saving to disposable income.

TABLE 2 : FINANCIAL DEFICITS

Annual	Public Sector	Industrial and Commercial Sector	Total	As per cent of Personal Disposable Income	Personal Saving as per cent of total personal Disposable Income*
	£m	£m	£m	(%)	(%)
1966	963	94	1057	4.0	9.2
1967	1648	211	1437	5.2	8.5
1965	1136	-279	857	2.9	8.0
1969	-335	142	-193	-0.6	8.1
1970	-715	899	184	0.5	9.0
1971	313	-75	238	0.6	8.6
1972	1737	-553	1184	2.7	10.2
1973	2768	418	3286	6.3	11.6
1974	5390	3259	8649	14.3	14.2
1975	8184	336	8520	11.6	14.3
1976	8569	658	9227	10.8	14.2

\* Bank of England Quarterly Bulletin, March 1977, and Economic Trends, CSO.



The comparison was made with personal disposable income because the main source of finance for the public sector and industrial and commercial companies should be the savings of the personal sector (although the deficit on the current account of the balance of payments also provided finance). It could be observed from the table that over the seven year 1966-72 inclusive, the deficits of public and company sectors averaged 2.2% of personal disposal income and the corresponding saving ratio was 8.8%. Over the four years 1973-76 inclusive, the corresponding magnitudes were 10.8% and 13.7% which showed a jump of 8.6% points in the former and 4.9% points in the latter. These figures gave a very broad indication of the possible relationship between price restraint and increased savings ratio in the U.K.

Although public sector deficits were affected by increases in oil and commodity prices and increased public expenditure, there were reasons to believe that underpricing of sales due to price control, especially in the company sectors, might have contributed largely to the increase in the savings ratios because real earnings were rising even at higher levels of inflation. Uncertainty of the future level of inflation might have brought some reduction in consumption relative to increase in disposable income, but its contribution to the increase in the savings ratio would be relatively less. Financial factors alone could not possibly have brought such a big shift in real behaviour of households.

### **Impact of Public Sector Deficit Financing**

Large subsidies help to reduce inflation in the short run but, unless those subsidies are financed properly, inflation is likely to accelerate in due course, i.e. if the cost of subsidies leads to excessive growth of money supply. The money supply will increase if either the public or the corporate sector finances a subsidy by borrowing from the banking system. In cases where the public sector bears the cost of this subsidy the future inflationary consequences could be avoided if the government either raised taxes or reduced other public expenditure to compensate for the cost of subsidy, i.e. the financial deficit of the public sector does not necessarily increase as a result of subsidy. Even where the financial deficit of the public



sector does increase, the money supply would not be affected if the government financed the subsidy by deliberate additional borrowing from the non-bank private sector. Such borrowing from persons was, in fact, undertaken both indirectly in the selling of government stocks through other financial institutions and directly through selling gilt-edged, national savings and other bonds and deposits<sup>16</sup>. Where the corporate sector's deficits are increased due to controls and taxes inflationary consequence would depend on whether or not the corporate sector financed its additional deficit by borrowing from banks, the banking system being the residual source of finance for the corporate, as well as the public sector. In the period under review, the necessary additional finance was not forthcoming in the capital markets, the corporate sector was forced to increase borrowing from the banking system. The following data shows the use of bank financing by both the public and company sectors. The table shows the net flow of funds of the banking sector to the public and corporate sectors. Massive increases in the net cumulative flows indicate that the money borrowed by these two sectors, after a series of transactions appeared as bank deposits for the personal and foreign sectors.

TABLE 3 : NET FLOW OF FUNDS OUT OF THE BANKING SECTOR

( increase + decrease— )

£ million	Public Sector	Cumulative	Industrial and Commercial	Cumulative
1972	—946	—946	+1091	1091
1973	+1895	949	+2224	3315
1974	+720	1669	+4701	8016
1975	+3083	4752	—686	7330
1976	+247	4999	+1457	8787

Source : Bank of England, Quarterly Bulletin, June 1977, Table F.

It may be observed that although the authorities sought to obtain as much finance as possible from outside the banking system to finance public sector deficits in a non-inflationary way, there was substantial net bank borrowing. As for the company sector, over and above the prevailing unfavourable conditions in the capital market, the Price Code rules also discouraged obtaining funds from share issues, because dividend was not an "allowable cost", whereas in-



terest on borrowed money was. However, it may be argued that since interest was an allowable cost, based on the flow of funds frame of analysis, there was no apparent justification for financial constraints to affect real activities in the company sector. It was true that at aggregate level there was no shortage of finance, as surpluses and deficits must cancel each other out. But the price at which this finance was available exceeded the rate of return which would have justified such borrowing. Besides the bank borrowing by the government the remaining deficits of the public sector were financed through both long term and short dated instruments<sup>17</sup>. The rates of interest which were offered to obtain this sum provided an attractive alternative for the deployment of the personal sector surplus. The fact that in real terms interest rates had been negative since 1971, external account pressures arising out of the reserve role of sterling pushed it much above the rate of return in money terms. Therefore, it was suggested that no viable borrowing could occur and the industrial sector was effectively unable to respond to growth opportunities<sup>18</sup>.

### **Impact of Deficits in the Company Sector**

U. K. companies traditionally made less use of loan capital than their continental competitors. "Average gearing (borrowing, less cash, as a percentage of total funds employed) is now 26%, and tending to fall, compared with 45% in France and Germany. The real deterrent to issuing fixed interest securities in the U. K. is the high rate of interest which, for industrial prior charges, is currently about 14½% and compared with an average of around 8½% on the continent"<sup>19</sup>. As a result there was virtual absence of fixed interest issues by industrial borrowers during 1973-76. Traditionally also U. K. industry derived a small proportion of its funds from the stock market, which in general is attributed to a failure of institutional investors, such as pension funds and insurance companies to channel sufficient new money into industrial companies<sup>20</sup>. But this, on the other hand, was as much due to shortage of demand for funds as shortage of supply<sup>21</sup>. For example, in 1975 the government had little difficulty in raising some £5000 million of new monies, five times as much as was raised by industry. It was, therefore, suggested that industry was not demanding funds because they were producing far below their existing plant capacity<sup>22</sup>. It



seemed that the need to finance working capital investment and replacement expenditure which was reflected in the deficits of the corporate sector did not form part of the demand for funds as indicated above. In a sense this might be accepted because these were operational deficits in cash flows resulting from under-pricing of sales. But given the deficits it did not seem right to argue that there was no demand for fund. Institutional structures were such that the company sector was not able to meet rates comparable to those at which the government borrowed. This was due to sharply reduced low profitability and financial viability as was observed in the previous chapter. Therefore, it might be concluded that although there was no shortage of funds, the existence of a dominant public sector which was interest-insensitive created a condition in the money and capital markets where the company sector could not obtain fund at low cost to match with still lower real profitability.

In a situation when the financial viability of on-going operations was increasingly threatened from the impact of high inflation and price controls, it was quite reasonable to expect that company financial behaviour had a real effect on economic activity. "Companies clearly do eventually have control over investment in both fixed assets and stocks"<sup>23</sup>. The corporate sector cut its expenditures on both fixed assets and stocks in 1975, and as a result its financial position was much improved, along with some improvement in earnings due to relaxation in the Price Code in December 1974. But from the first quarter of 1975 real personal disposable income started to decline and reached the level of 1973 by the second and third quarter. Therefore, it was argued that companies' economic behaviour was influenced more by the onset of adverse trading conditions rather than financial stimuli to move towards an optimum balance sheet structure. The weight of evidence tended to support the proposition that industrial and commercial companies when forced into financial deficits attempt to restore their financial position by reducing capital formation and stock-building. "Inevitably, however, there is a time lag before they are able to achieve this retrenchment. During the three cycles since 1960 the time lag has averaged six quarters for stockbuilding, and eight quarters for capital formation because of the latter's long gestation period"<sup>24</sup>. It was shown that the two lagged series fluctuated together in line with



industrial and commercial companies' financial surplus/deficit<sup>25</sup>. Given the magnitude of the cash flow crisis experienced, especially in 1974, the extent to which financial conditions might have adversely affected real activities of the company sector could be very significant.

Britain's record of low investment and low profitability was widely known and various proposals were being put forward by way of improving the effectiveness of investment—by increasing its quality as well as quantity<sup>26</sup>. It was true that higher investment would bring higher levels of profit by increasing the efficiency of production and reducing cost. But investment was not a free variable, it was related as much to demand factors as it was to supplies. With respect to demand, export led growth had been emphasised for U. K. The profitability argument could as well be important. Since the sole end of economic activity is consumption and it is only individual who can consume, not entities, like companies, it is one individual or group which gains at the expense of others. To the extent that prices paid by the personal sector failed to reflect true cost, including the cost of capital, this increased the surplus of the personal sector, but within the sector it amounted to a redistribution of income from the share of capital to the share of labour. Low investment might have been associated with the inability of the company sector to generate sufficient cash flows from operations, such that after paying taxes at effectively higher rates, not enough was left in the form of distributable income to maintain the real consumption of investors as a class.

An extended discussion on the causes of low investment was beyond the scope of this thesis. However, it would be worthwhile to examine the data presented in the following table which showed distribution of proprietary income and financing between debt and equity capital. These data relate to Table 5 in Chapter 6 in which the deteriorating cash flow performance of a large number of listed companies was analysed. The breakdown of the result of that analysis in the following table indicates that in view of the low real profitability, growth however low this might have been, was being increasingly financed from debt capital, possibly due to its tax advantage. Indeed, as it was suggested, a substantial portion of the investment would not have been there had it not been for the most generous fiscal incentives in the world<sup>27</sup>. As there was little real



TABLE 4 : DISTRIBUTION OF PROPRIETARY INCOME &amp; FINANCING BETWEEN DEBT AND EQUITY

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
new equity finance $B_j$	48	-16	45	167	160	54	106	170	56	79	715
dividends paid $D_j$	651	607	913	952	957	953	999	802	870	981	946
equity cash flows $D_j - B_j$	+603	+623	+870	+785	+797	+899	+893	+632	+834	+902	+231
new debt finance $N_j + M_j$	667	707	540	480	674	723	288	585	1864	1852	466
interest payments $F_j$	142	178	206	247	282	306	355	395	480	525	576
Debt proprietorship flows $F_j - (N_j + M_j)$	-525	-529	-334	-233	-392	-417	+67	-190	-1,384	-1,327	+110



growth in investment taking the 1973-75 period as a whole, sharply increased borrowing, not only represented cross-substitution of equity capital by debt capital, but as indicated, was needed to meet the "refinancing" gap created from the shifting of resources due to the use of historic cost accounting for the purpose of price control and taxes. It might as well be construed that companies maintained the payment of dividend and interest at least in monetary terms through a process of chain borrowing mostly from banking sources, particularly in 1973-74. In general, only a smaller proportion came from long term sources, both debt and equity, opposites of which had been the more common form of financing in high growth and more profitable economies<sup>28</sup>. The upshot of this discussion was that the use of an inappropriate accounting measure for the purpose of price control might have contributed to a significant increase in the volume of financial transactions which was not matched by increased levels of real activities<sup>29</sup>. Therefore, it was concluded that although price control reduced the level of inflation, operation of the policy on the basis of conventional accounting was not helpful to achieve the other objective of the Price Code, i.e. to maintain growth in output and investment. Financing growth under inflationary conditions would have required much larger quantities of resources than was available to the company sector at comparable low cost.

### Summary

Analysis and discussion in this chapter has centred around three main points. First, the flow of funds analysis indicated that the personal sectors' surplus increased sharply in recent years of high inflation and price controls, with correspondingly increased combined deficits of the public and company sectors. This was reflected in higher savings ratios, which might also have been influenced by the desire of households to maintain the real value of their financial investments in the face of rising inflation. Second, although there was no shortage of finance, high rates of interest paid by the government, partly from external accounts pressure and partly to finance huge public sector deficit in a non-inflationary way, i.e. from non-bank private sources, raised the cost of capital of the company sector much above the rates of return on existing capi-



tal stock as well as on investment. Funds, however, were not demanded in the traditional sense, i.e. for increasing capacity in the face of existing excess capacity. High and accelerating inflation brought in a greater need to finance working capital investments and depreciation shortfall for replacements, for which the company sector was almost entirely dependent on the banking sector. The higher cost of this floating debt in times of rising interest rates might have precipitated or intensified recessionary activities. Finally, sharply reduced profitability and financial viability of the corporate sector seemed to have accelerated the process of cross substitution of equity capital by debt capital which had been going on for a long time in the U.K. As indicated, a greater proportion of the increased debt capital comprised short term debt; unlike other high growth and more profitable countries, low real profitability and low growth in the U.K. economy might have made the company sector unattractive for both long term debt and equity capital, given the relatively higher level of inflation experienced.

#### Footnotes

1. An Introduction to Flow of Funds Accounting : 1950-70, Bank of England, December 1972.
2. *Ibid.*
3. Bank of England, Quarterly Bulletin, June 1977.
4. Ninth Report, HC-328. 1974, H. M. S. O.
5. The New Cambridge equation estimated over the period 1954-72 is :

$$P_x_t = 0.533(Y-T)_t^1 + 0.416(Y-T)_{t-1}^1 + 0.899 HP_t^1 + 0.790 BA_t^1 + 0.962 S_t$$

Where  $P_x$  = total private expenditure on consumption, fixed investment and stockbuilding;  $Y-T$  = total private disposable income  $HP$  = change in personal hire purchase debt outstanding.

$BA$  = change in personal bank advances (excluding advances for house purchase)  $S$  = Change in the book value of stocks refers to time in years. A prime denotes real values—that is current price magnitudes deflated by the national income implicit price deflator of private consumption plus fixed investment.

6. The balance of payment on current account (plus net capital transfers) with the sign reversed.



7. J.A. Bispham, "The New Cambridge... Policy Making", NIESR, No. 74, 1975.
8. OECD, Economic Outlook, December 1976.
9. W. Koll. "The Real Rate of Return of German Corporations 1963-74". Presented in London at a meeting of the MIT-Project "Rate of Return", April 13th-15th, 1977.
10. Bank of England, An Introduction to Flow of Funds Accounting : 1952-70, December, 1972.
11. *Ibid.*
12. C. Johnson, Anatomy of U.K. Finance, 1970-75, *The Financial Times*, June 1976.
13. Bank of England, Quarterly Bulletin, March 1977.
14. Greenwell & Co. Monetary Bulletin, No. 46, December 1975.
15. The other important reason is increased public expenditure and balance of payments deficits on capital accounts.
16. Bank of England, *op. cit.*
17. *Op. cit.*
18. D. Wood, "Forecasting and Planning National Industrial Strategy", MBS, Seminar papers.
19. M. Gibbs, "Company Finance in Europe". Phillips & Drew, Market Review, Feb. 1976.
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21. Martin Gibbs *op. cit.*
22. *Ibid.*
23. Barclays Bank Review, Company Financial Behaviour, February 1976.
24. G.T. Pepper and G.E. Wood, 'Keynesian' and 'Monetarist' Indicator of the U.K. Economy : in Resource Allocation and Economic Policy, ed. by M. Allingham and M.L. Burnstein. The Macmillan Press Ltd. 1976.
25. *Ibid.*
26. Beddow, R. and Boyle, D. "Britain's vital investment lag". *Management Today*, July, 1977.
27. A. Harris, "Nostalgia and the profit argument". *The Financial Times*, 9th June, 1977.
28. C. Johnson, "Anatomy of U.K. Finance 1970-75, *The Financial Times*, 1976.
29. *Ibid.*