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UNDERSTANDING THE UK ECONOMY

Third Edition

Edited by

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To Benjamin and Alexandra

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List of Abbreviations

ACT	Advance Corporation Tax	EEA	Exchange Equalisation Account
AD	Aggregate Demand	EEC	European Economic Community
AFBD	Association of Futures Brokers and Dealers	EER	Effective Exchange Rate
AMS	Aggregate Measure of Support	EFF	Extended Fund Facility
APC	Average Propensity to Consume	EFL	External Financing Limit
AS	Aggregate Supply	EFTPOS	Electronic Funds Transfer at Point of Sale
ATM	Automated Teller Machine	EMCF	European Monetary Co-operation Fund
BBC	British Broadcasting Corporation	EMI	European Monetary Institute
BES	Business Expansion Scheme	EMS	European Monetary System
BIS	Bank for International Settlements	EMTNs	Euromedium-term Notes
BoP	Balance of Payments	EMU	Economic and Monetary Union
BTEC	Business and Technician Education Council	EPU	European Political Union
CAP	Common Agricultural Policy	ERI	Effective Exchange Rate Index
CBI	Confederation of British Industry	ERM	Exchange Rate Mechanism
CCC	Competition and Credit Control	ESCB	European System of Central Banks
CD	Certificate of Deposit	ET	Employment Training
CET	Common External Tariff	EU	European Union
CFSP	Common Foreign and Security Policy	FES	Family Expenditure Survey
CGT	Capital Gains Tax	FIMBRA	Financial Intermediaries, Managers and Brokers Regulatory Association
CR	Concentration Ratio	FIS	Family Income Supplement
CSE	Consumer Subsidy Equivalent	FMI	Financial Management Initiative
CSO	Central Statistical Office	FRN	Floating-rate Note
CTT	Capital Transfer Tax	FSBR	Financial Statement and Budget Report
DCE	Domestic Credit Expansion	GAB	General Agreements to Borrow
DHSS	Department of Health and Social Security	GATT	General Agreement on Tariffs and Trade
DIB	Defence Industrial Base	GCSE	General Certificate in Secondary Education
DM	Deutsche Mark	GDFCF	Gross Domestic Fixed Capital Formation
DTI	Department of Trade and Industry	GDP	Gross Domestic Product
EAGGF	European Agricultural Guarantee and Guidance Fund	GEMM	Gilt-edged Market-maker
EAP	Enlarged Access Policy	GGE	General Government Expenditure
EAS	Enterprise Allowance Scheme	GNP	Gross National Product
EC	European Community	HBAI	Households Below Average Income
ECB	European Central Bank		
ECU	European Currency Unit		
EDI	Electronic Data Interchange		

HMSO	Her Majesty's Stationery Office	NDP	Net Domestic Product
IBELs	Interest-bearing Eligible Liabilities	NHS	National Health Service
ICCs	Industrial and Commercial Companies	NI	National Income
IDC	Industrial Development Certificate	NICs	National Insurance Contributions
IFA	Independent Financial Adviser	NIESR	National Institute for Economic and Social Research
IFS	Institute for Fiscal Studies	NNP	Net National Product
IGA	Inter-governmental Agreement	NSB	National Savings Bank
IGC	Inter-governmental Conference	OECD	Organisation for Economic Co-operation and Development
ILO	International Labour Office	OFGAS	Office of Gas Supply
IMF	International Monetary Fund	OFT	Office of Fair Trading
IMRO	Investment Management Regulatory Organisation	OFTTEL	Office of Telecommunications
IPD	Interest, Profits and Dividends	OMO	Open-market Operation
IPR	Intellectual Property Right	OPEC	Organisation of Petroleum Exporting Countries
ISDA	International Swap Dealers Association	OTC	Over the Counter
JA	Jobseeker's Allowance	PAYE	Pay As You Earn
LA	Local Authority	PDI	Personal Disposable Income
LASFE	Local Authority Self-financed Expenditure	PEP	Personal Equity Plan
LAUTRO	Life Assurance and Unit Trust Regulatory Organisation	PIA	Personal Investment Authority
LDC	Less Developed Country	PIBS	Permanent Interest Bearing Shares
LDMA	London Discount Market Association	PPP	Purchasing Power Parity
LFS	Labour Force Survey	PPS	Perpetual Preferred Stock
LIBOR	London Inter-bank Offered Rate	PRT	Petroleum Revenue Tax
LIF	Low Income Families	PSBR	Public Sector Borrowing Requirement
LIFFE	London International Financial Futures Exchange	PSDR	Public Sector Debt Repayment
LSE	London Stock Exchange	PSE	Producer Subsidy Equivalent
LTOM	London Traded Options Market	R&D	Research and Development
MCA	Monetary Compensatory Amount	RDG	Regional Development Grant
MFA	Multi-fibre Arrangement	REG	Regional Enterprise Grant
MIPs	Mortgage Interest Payments	RER	Real Exchange Rate
MIRAS	Mortgage-interest Relief at Source	RPI	Retail Prices Index
MLR	Minimum Lending Rate	RPIX	Underlying Retail Prices Index
MMC	Monopolies and Mergers Commission	RPM	Resale Price Maintenance
MoD	Ministry of Defence	RSA	Regional Selective Assistance
MPW	Marginal Propensity to Withdraw	SB	Supplementary Benefit
MSC	Manpower Services Commission	SDR	Special Drawing Right
MTFS	Medium Term Financial Strategy	SEA	Single European Act
MTN	Multilateral Trade Negotiations	SEAQ	Stock Exchange Automated Quotation
NAIRU	Non-accelerating Inflation Rate of Unemployment	SEM	Single European Market
NBFI	Non-bank Financial Intermediaries	SERPS	State Earnings Related Pension Scheme
NCT	New Control Total	SFA	The Securities and Futures Authority
		SFF	Supplementary Financing Facility
		SIB	Securities and Investments Board
		SMU	Support Measurement Unit

SRO	Self Regulatory Organisation	YTS	Youth Training Scheme
TB	Treasury Bill		
TDI	Total Domestic Income		
TEC	Training and Enterprise Council	Countries are abbreviated in tables and figures in accordance with the originals. The following abbreviations are used:	
TESSA	Tax Exempt Special Savings Account		
TFE	Total Final Expenditure		
TPI	Tax and Price Index		
TRS	Transitional Reduction Scheme		
TSA	The Securities Association	Belgium	B
TSB	Trustee Savings Bank	Denmark	DK
UAA	Utilised Agricultural Area	France	F or FR
USM	Unlisted Securities Market	Greece	GR
VAT	Value Added Tax	Ireland	IRL
VER	Voluntary Export Restraint	Italy	I or IT
VSTF	Very-short-term Financing	Luxembourg	L
WIRS	Workplace Industrial Relations Survey	Netherlands	NL
YES	Youth Employment Subsidy	Portugal	P
YOP	Youth Opportunity Programme	Spain	S or E
		United Kingdom	UK
		West Germany	FRG or WG or D

Preface to the First Edition

We very much hope that the justification for writing a book of this kind is self-evident. If this is not the case, then we simply wish to point out that economic literacy remains at far too low a level in the UK. In seeking to enhance this literacy we like to think that this book will be of interest to a very wide-ranging audience, but we recognise that, in practice, almost all those who read it will be studying a parallel course in economic principles, either at A-level or as undergraduates, or will already be acquainted with economic issues either through their work or their reading of the financial press. We hope that the book is sufficiently challenging to interest readers who are already conversant with economics, but not so challenging as to prevent readers who are not conversant with economic theory from following the discussion.

We have tried to strike an acceptable balance between **analysis** and **description**. It is obviously necessary, in a book of this kind, to describe how the UK functions at the present time, and also how it has functioned in the past where this has been different. It is, however, unilluminating simply to explain what is done in policy terms without simultaneously explaining why, and the reasons why are also to be found in the book where appropriate. It should be noted that the kinds of models to be found in textbooks may often fail to explain why many policies are being pursued, because the real world may be evolving very rapidly and be using fairly crude rules of thumb whilst coming to terms with these changes. It is accordingly our intention to concentrate upon the real world, and to give short shrift to textbook models which cannot shed much light upon it.

Most readers familiar with economics will have been taught the subject as a succession of separate boxes labelled 'employment', 'inflation', and so on. There is, as a consequence, a preference for

applications to be organised into similar boxes, to be dipped into one by one as appropriate. We do not care for this approach because, first, it fails to emphasise the **fundamental linkages** between the various parts of the economy; secondly, it fails to deliver a satisfactory **historical perspective**; and thirdly, it permits the authors covering the content of separate boxes to offer a **subjective interpretation** of events which conflicts with that to be found in other boxes. Rather oddly, some books consider this latter point to be a virtue, and express distaste for the imposition of monolithic structures. Our view is that this is very much a vice, and indicative of lack of editorial control. This book is accordingly approached from precisely the opposite viewpoint – namely, that individual authors should work to a carefully predetermined structure and that stylistic differences should be kept to a minimum. In particular, each author has been asked to set out the pros and cons of every policy debate without prejudice. This does not mean that the authors do not have strong preferences concerning the conduct of policy, nor indeed that they have refrained from expressing them, but rather that they do not seek to persuade by omitting to mention what the counter-arguments are.

The issue concerning the need to provide a framework which integrates individual sections has been difficult to resolve. One innovative feature in this respect is the introductory chapter which seeks to provide both a philosophical basis and an historical perspective for all that follows. A second innovation is to set the discussion of fiscal and monetary policy at the end of the book, in Chapter 12, so that it draws together the macro-economic threads from previous chapters, with Chapter 11 doing the same for the microeconomic threads. The early chapters presume least prior knowledge, but when necessary they are exten-

sively cross-referenced to later points in the text where the missing information is to be found. Issues which can be broadly be said to concern welfare have been allocated a chapter of their own (Chapter 10), rather than ignored altogether or dispersed in brief and unrelated sections throughout the text.

Certain themes inevitably appear under several chapter headings – for example, the development of the Single European Market (SEM). Generally speaking they are left dispersed, but cross-referenced to other parts of the book where the same themes recur. However, in certain cases – for example, agriculture – it has made more sense to collect the themes together under one heading in order to avoid duplication and the loss of continuity in the discussion. For these reasons, the structure of the book may at first sight appear unusual, but we firmly believe that it does, in fact, make better sense than the structures to be found in other texts, and we leave it to the readers to judge for themselves (and hopefully to let us know their opinions on the matter in due course).

While the book is essentially about the UK economy, it has a stronger international flavour than is commonly associated with books on this topic. This reflects a whole host of developments, such as the SEM and deregulation in general, which are making it increasingly inappropriate to view policy within the physical confines of the UK alone. Since this is very much a feature of ongoing policy we have deliberately set up our discussion so that it offers clear pointers towards the future, and we have chosen to compensate for this by saying much less than is usual about the more distant past.

In our opinion the election of the current government was a significant watershed in policy terms, for reasons set out in the Introduction. Each chapter is accordingly structured to say relatively little about the period before 1969; to provide a fairly detailed review of the decade 1969–79; and to focus primarily upon the decade 1979–89 and especially upon how it has compared with the decade which preceded it.

All this places great demands upon the handling of data. We have tried to introduce as much data as possible, and to locate it all within the appro-

priate context rather than relegate it to appendices. Equally, we recognise that tabular material can be boring – and, at times, a poor means of communication – so where appropriate other methods of presentation have been used. A point to be emphasised is that data are expressed in the form normally used by government and reported in the media. Thus, for example, the Public Sector Borrowing Requirement (PSBR) is not simply stated as an absolute number but as a percentage of gross domestic product (GDP). Much of the data is adjusted for inflation, and whenever space permits the comparable data for other countries are also included.

The contributors to this book (other than the editor) have been chosen because they are knowledgeable in their fields. However, too much knowledge can be a vice as well as a virtue when it comes down to the need to compress a great deal of information into a small space, and the authors are commended to you not so much because they are ‘specialists’ but because they have proved in their previously published work that they have the facility to communicate to the target audience for this book. We hope that it makes enjoyable reading. No doubt you will let us know if that is not the case. One way or the other the editor is more than happy to accept ultimate responsibility for the entire finished product, although individual authors are responsible only for the chapters which bear their name.

Finally I would like to thank Gordon Hughes and the other five anonymous reviewers for their thorough dissection of the text in its varying stages of completion. There is a myth – propagated, one suspects, by those who write only short articles – that textbooks are not refereed adequately, but that has been far from the reality in this particular case. Whilst some suggestions for improvements have been set aside for this edition, it is anticipated that they will be incorporated in the second edition.

Any restructuring of the text in subsequent editions will be determined entirely by the suggestions of users, and these are accordingly welcomed by the editor.

PETER CURWEN

Preface to the Second Edition

Armed with reviews and a large number of questionnaires completed by teachers, we have set out to revise the text significantly for this second edition. While not every suggestion for improvement has been adopted on this occasion, we are already considering how best to manage the book's evolutionary path.

It is important to begin by clearing up one particular misunderstanding. Although it is hoped that many readers will be able to enjoy the text without having previously learned economics in a formal way, we anticipated that most readers would use this book in conjunction with a basic text on economic theory, thereby allowing us to concentrate upon its applications in the real world. The text contains such models as are essential to assist both the general reader and students of economics who are reading ahead of their main text to understand the issues which we address, which can be very complicated, but it is simply impractical to try to combine detailed theory and applications in a single text.

We have attempted to keep the text as up to date as is humanly possible. To this end we have introduced a large amount of new data, particularly in the form of Figures, whilst removing a much smaller amount which appeared in the first edition. We believe that this database provides a truly comprehensive overview of the workings of the UK economy. In recognition of recent developments we have included a good deal of additional

material on the European Community, and have sought wherever possible to draw comparisons between the performance of the UK and other member states.

The editor has chosen in this edition to take over responsibility for writing all of the first nine chapters in the book, two of which have been divided compared to the first edition as a result of the addition of much new material. This should ensure greater uniformity of approach, and also ease the burden of revision for future editions. The new material is generally intended to introduce developments which have taken place over the past two years, but completely new sections have also been added where it was thought that they would enhance the discussion in a material way. For example, there is a new section devoted to the housing market in Chapter 3, which is accompanied by a fuller discussion of the link between wealth, consumption and saving, and Chapter 2 contains a completely new version of the overall model of the economy.

It is hoped that these, and other, improvements have enhanced the usefulness of the text for a wide variety of readers. As before, the text has been thoroughly reviewed in draft form in order to ensure that this is so, and we would like to thank the reviewers for their extensive and helpful comments.

PETER CURWEN

Preface to the Third Edition

Only two years have passed since the publication of the second edition, but events have, as ever, refused to stand still, necessitating some significant revisions to parts of the text. Looking back at what was written two years ago, the analysis appears to have held up well and we see no need to retract anything of substance, but there can be no doubt that two years of recession oblige us to rethink the probable course of the UK economy during the rest of the decade.

When the second edition was at final proof stage it proved necessary to insert a substantial section relating to the Maastricht Treaty. At the time it was assumed that it would be signed and sealed before 1992 was out, with member states if anything moving closer together in the narrow band of the Exchange Rate Mechanism (ERM). In the event, the outcome has been rather different, so this edition contains a good deal of analysis of what went wrong and where it is taking the UK.

In this, and other respects which reflect, for example, the official creation of the SEM on 1 January 1992, the text is increasingly seeking to examine the role of the UK as part of a wider political/economic system. Nevertheless, the UK has recently been affected by the consequences of some of its own peculiar structures, and of these

the housing market is clearly the most prominent. For this reason, the discussion of the role of the housing market has been greatly extended in this edition.

In most other respects the primary task has been, as usual, to update the database so that it provides a meaningful picture of the current state of the economy; in effect, that prevailing at the end of 1992 or some months into 1993, but any significant turns in events at the end of 1993 have also been integrated into the text. We therefore trust that this new edition will continue to provide teachers and students alike with an invaluable insight into the workings of the UK economy.

One final change of practice needs to be noted. Whereas in previous editions we referred to the European Community (EC), throughout this edition we refer to the European Union (EU), or occasionally simply to the Community, in line with current practice in the majority of governmental and media commentary. In practice, insofar as the terms EC and EU relate to the subject matter of this book, they can be treated as interchangeable.

PETER CURWEN

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