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UNDERSTANDING THE UK ECONOMY

Fourth Edition

Edited by

Peter Curwen

Contributors

Keith Hartley and Nick Hooper
Paul Marshall

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Dedicated to the memory of
Thelma Curwen
1920–96

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List of Abbreviations

ACAS	Arbitration, Conciliation and Advisory Service	CSO	Central Statistical Office
ACT	Advance Corporation Tax	CTT	Capital Transfer Tax
AD	Aggregate Demand	CVD	Countervailing Duty
AFBD	Association of Futures Brokers and Dealers	DCE	Domestic Credit Expansion
AIM	Alternative Investment Market	DES	Department of Education and Science
AMS	Aggregate Measure of Support	DHSS	Department of Health and Social Security
APACS	Association for Payment Clearing Services	DIB	Defence Industrial Base
APC	Average Propensity to Consume	DIY	Do It Yourself
ATM	Automated Teller Machine	DM	Deutsche Mark
BBC	British Broadcasting Corporation	DSO	Direct Service Organisation
BES	Business Expansion Scheme	DSS	Department of Social Security
BIS	Bank for International Settlements	DTI	Department of Trade and Industry
BoP	Balance of Payments	EA	Employment Action
BPM	Balance of Payments Manual	EAGGF	European Agricultural Guarantee and Guidance Fund
BSA	Building Society Association	EAP	Enlarged Access Policy
BTEC	Business and Technician Education Council	EAS	Enterprise Allowance Scheme
CA	Community Action	EC	European Community
CAP	Common Agricultural Policy	ECB	European Central Bank
CBI	Confederation of British Industry	ECJ	European Court of Justice
CBoT	Chicago Board of Trade	ECU	European Currency Unit
CCC	Competition and Credit Control	EDI	Electronic Document Interchange
CCT	Compulsory Competitive Tendering	EEA	Exchange Equalisation Account
CD	Certificate of Deposit	EEC	European Economic Community
CET	Common External Tariff	EER	Effective Exchange Rate
CFSP	Common Foreign and Security Policy	EFF	Extended Fund Facility
CGBR	Central Government Borrowing Requirement	EFL	External Financing Limit
CGT	Capital Gains Tax	EFTA	European Free Trade Association
CP	Community Programme	EFTPOS	Electronic Funds Transfer at Point of Sale
CPAG	Child Poverty Action Group	ELs	Eligible Liabilities
CR	Concentration Ratio	EMCF	European Monetary Co-operation Fund
CRT	Composite Rate Tax	EMI	European Monetary Institute
CSE	Consumer Subsidy Equivalent	EMS	European Monetary System
CSE	Certificate of Secondary Education	EMTNs	Euromedium-term Notes
		EMU	Economic and Monetary Union

EPU	European Political Union	IMD	Institute for Management Development
ERI	Effective Exchange Rate Index	IMF	International Monetary Fund
ERM	Exchange Rate Mechanism	IMRO	Investment Management Regulatory Organisation
ESA	European System of Accounts	IPD	Interest, Profits and Dividends
ESCB	European System of Central Banks	IPR	Intellectual Property Right
ET	Employment Training	ISDA	International Swap Dealers Association
EU	European Union	ITO	Industry Training Organisation
FCIs	Financial Companies and Institutions	JA	Jobstart Allowance
FES	Family Expenditure Survey	JG	Jobfinder's Grant
FIMBRA	Financial Intermediaries and Brokers Regulatory Association	JM	Jobmatch
FIS	Family Income Supplement	JP	Jobsearch Plus
FMI	Financial Management Initiative	JRS	Job Release Scheme
FRN	Floating-rate Note	JTS	Job Training Scheme
FSBR	Financial Statement and Budget Report	LA	Local Authority
GAB	General Agreements to Borrow	LASFE	Local Authority Self-financed Expenditure
GATS	General Agreement on Trade in Services	LAUTRO	Life Assurance and Unit Trust Regulatory Organisation
GATT	General Agreement on Tariffs and Trade	LCE	London Commodity Exchange
GCSE	General Certificate in Secondary Education	LDC	Less-developed Country
GDFCF	Gross Domestic Fixed Capital Formation	LDE	London Derivatives Exchange
GDP	Gross Domestic Product	LDMA	London Discount Market Association
GEMM	Gilt-edged Market Maker	LEC	Local Enterprise Company
GGE	General Government Expenditure	LFS	Labour Force Study
GGFD	General Government Financial Deficit	LFW	Learning for Work
GNP	Gross National Product	LIBOR	London Inter-bank Offered Rate
GNVQ	General National Vocational Qualification	LIF	Low Income Families
HBAI	Households Above Average Income	LIFFE	London International Financial Futures Exchange
HMSO	Her Majesty's Stationery Office	LSE	London Stock Exchange
HP	Hire Purchase	LTOM	London Traded Options Market
IBA	Independent Broadcasting Association	MA	Modern Apprenticeships
IBB	Invest in Britain Bureau	MCA	Maximum Commissions Agreement
IBELs	Interest Bearing Eligible Liabilities	MCA	Monetary Compensatory Amount
ICCs	Industrial and Commercial Companies	MERM	Multilateral Exchange Rate Model
IDC	Industrial Development Certificate	MIPs	Mortgage-interest Payments
IEA	Institute of Economic Affairs	MIRAS	Mortgage-interest Relief at Source
IFA	Independent Financial Adviser	MFA	Multi-fibre Arrangement
IFS	Institute for Fiscal Studies	MLR	Minimum Lending Rate
IGA	Inter-government Agreement	MMC	Monopolies and Mergers Commission
IICP	Interim Indices of Consumer Prices	MoD	Ministry of Defence
ILO	International Labour Office	MPC	Marginal Propensity to Consume
		MPW	Marginal Propensity to Withdraw
		MSC	Manpower Services Commission

MTFS	Medium-term Financial Strategy	RPI	Retail Prices Index
MTN	Multilateral Trade Negotiation	RPIX	Underlying Retail Prices Index
NAFTA	North American Free Trade Association	RPM	Resale Price Maintenance
NAIRU	Non-accelerating Inflation Rate of Unemployment	RSA	Regional Selective Assistance
NBFI	Non-bank Financial Intermediaries	RSSL	Recruitment Subsidy for School Leavers
NCT	New Control Total	SB	Supplementary Benefit
NCVQ	National Council for Vocational Qualifications	SDR	Special Drawing Right
NDP	Net Domestic Product	SEA	Single European Act
NES	New Earnings Survey	SEAQ	Stock Exchange Automated Quotation
NHS	National Health Service	SEM	Single European Market
NI	National Income	SERPS	State Earnings Related Pension Scheme
NICs	National Insurance Contributions	SFA	Securities and Futures Authority
NNDI	Net National Disposable Income	SFES	Small Firms Employment Subsidy
NNP	Net National Product	SFF	Supplementary Financing Facility
NSB	National Savings Bank	SIB	Securities and Investments Board
NVQ	National Vocational Qualification	SMU	Support Measurement Unit
NWS	New Worker's Scheme	SNA	System of National Accounts
OECD	Organisation for Economic Co-operation and Development	SRO	Self-regulatory Organisation
OEIC	Open-ended Investment Company	TB	Treasury Bill
OFGAS	Office of Gas Supply	TDI	Total Domestic Income
OFT	Office of Fair Trading	TEC	Training and Enterprise Council
OFTTEL	Office of Telecommunications	TES	Temporary Employment Scheme
OMO	Open-market Operation	TESSA	Tax Exempt Special Savings Account
ONS	Office for National Statistics	TFE	Total Final Expenditure
OPEC	Organisation of Petroleum Exporting Countries	TFW	Training for Work
OTC	Over the Counter	TIFFE	Tokyo International Financial Futures Exchange
PAYE	Pay As You Earn	TPI	Tax and Price Index
PDI	Personal Disposable Income	TRS	Transitional Reduction Scheme
PEP	Personal Equity Plan	TSA	The Securities Association
PFI	Private Finance Initiative	TSB	Trustee Savings Bank
PIA	Personal Investment Authority	TUPE	Transfer of Undertakings Regulations
PIBS	Permanent Interest Bearing Shares	TWS	Travel to Work Scheme
PPP	Purchasing Power Parity	UAA	Utilised Agricultural Area
PPS	Perpetual Preferred Stock	USM	Unlisted Securities Market
PRT	Petroleum Revenue Tax	VAT	Value Added Tax
PSBR	Public Sector Borrowing Requirement	VER	Voluntary Export Restraint
PSDR	Public Sector Debt Repayment	VSTF	Very-short-term Financing Facility
PSE	Producer Subsidy Equivalent	WEF	World Economic Forum
PW	Project Work	WiE	Workforce in Employment
R&D	Research and Development	WIRS	Workplace Industrial Relations Survey
RDG	Regional Development Grant	WP	Workstart Pilot
REG	Regional Enterprise Grant	WT	Work Trials
RER	Real Exchange Rate	WTO	World Trade Organisation

YC	Youth Credits
YES	Youth Employment Subsidy
YOP	Youth Opportunity Programme

YTS	Youth Training Scheme
YWS	Young Worker's Scheme

Countries are sometimes abbreviated in tables and figures, and the following abbreviations are used:

Austria	A
Belgium	B
Denmark	DK
Finland	FIN
France	F
Germany (united)	D
Greece	GR
Ireland	IRL
Italy	I
Japan	JAP
Luxembourg	L
Netherlands	NL
Portugal	P
Spain	E
Sweden	S
United Kingdom	UK
United States	USA
West Germany	WG

The macroeconomic model uses the following abbreviations:

C	Consumption
E	Expenditure
I	Investment (or Income)
G	Government spending
M	Imports
O	Output
T	Taxation
X	Exports
Y	Income

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 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 macroeconomic threads from previous chapters, with Chapters 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 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 Single European Market 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 how it has compared with the decade that 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 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.

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 it 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 Single Euro-

pean Market 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.

PETER CURWEN

Preface to the Fourth Edition

There has been a three-year rather than a two-year gap between this and the preceding edition, and hence there has been somewhat more updating to be done than previously. Like most revised texts, this book has tended to grow modestly larger with each successive edition. It is always easier to add new information than to declare old information to be redundant. This caused the individual chapters to become somewhat unwieldy at the time of the third edition, so for this edition they have mostly been divided into two, roughly equal, parts. However, this has had very little effect upon the overall coverage of the book, and should not cause confusion for those used to previous editions.

Chapter 1 remains as before. The old Chapters 2 and 3 have been divided such that the latter third of Chapter 2 plus the initial third of Chapter 3 now become Chapter 3 in this edition, with the remainder of the old Chapter 3 becoming a new Chapter 4. The old Chapter 4 has been divided down the middle to form two new Chapters, 5 and 6. The old Chapter 5 has also been divided, but in this case it is the central part of the old Chapter 5 on taxation which becomes the new Chapter 7, and the remainder which forms the new Chapter 8.

Both the old Chapters 6 and 7 have been divided in two to form two new chapters, creating new Chapters 9 to 12 inclusive. However, as the old Chapters 8 and 9 were relatively short, they have not been divided and become new Chapters 13 and 14. The old Chapter 10 has been divided in two, forming new Chapters 15 and 16. The major structural revision is in respect of the old Chapter 11 on industry and policy. Here, in addition to a basic division to form new Chapters 17 and 19, a relatively small part of the old chapter has been lifted

out to form, much extended, a completely new Chapter 18 on privatisation. Finally, the old Chapter 12 has become a truncated Chapter 20 in order to reduce the complexity of the discussion.

The new structure is intended to offer coverage at the rate of roughly one chapter a week for a full-year course, or two a week for a semester. We decided not to extend the book by adding any further new chapters at this stage, preferring an incrementalist approach with successive editions, but we feel sure that readers will be more comfortable with the new chapter size.

In addition to the creation of a new chapter, new material has been added where desirable, and in particular the continued development of the European Union, not least its expansion in size, is reflected in an increased emphasis upon events outside the UK.

In political terms, a general election is due fairly soon after this book is published. There is widespread agreement about the probability of a change of government, although it remains unclear whether the winner will obtain an absolute majority or be forced to rule by coalition. Clearly, a change in government has implications for the content of a book such as this, and the authors have sought to signal and/or discuss probable changes in policy direction. However, it is looking increasingly likely that comparatively little will be affected by a switch to a Labour government, so we remain unconcerned that this edition will become dated any quicker than its predecessors.

It is, perhaps, worth noting in conclusion that, although the text is critical of many of the policies pursued over the past decade and a half, the authors remain firmly of the belief that the UK

economy is overall much stronger than it was in 1979. Most of the text is given over to a discussion of the factors underpinning the size of the national 'cake'. However, considerable space is also given over to a discussion of the way in which the 'cake' is divided up, which is widely believed to be done less equally today compared to 1979. The task

facing an incoming Labour government, should that eventuality arise, will be to find a means of simultaneously making the 'cake' bigger and dividing it up more equally. We hope to report on its progress in the next edition.

PETER CURWEN

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