**BALANCE-OF-PAYMENTS THEORY
AND THE UNITED KINGDOM EXPERIENCE**

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Balance-of-Payments Theory and the United Kingdom Experience

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To Merlyn Rees, M.P.,
who first taught me to think and write

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Preface

This book has two main purposes: first, to provide an elementary exposition of the balance of payments and of balance-of-payments adjustment theory; and second, to challenge the relevance of conventional adjustment mechanisms as solutions to the United Kingdom's weak balance of payments.

Even before I started to do my own research and thinking about the balance of payments I was sceptical of the view that countries' balance-of-payments problems are primarily a function of adverse relative price movements which can be rectified by adjustments to the exchange rate. Where the scepticism originates I am not sure but it has spilt over into dissatisfaction with most of the textbooks on the balance of payments, and with their treatment of balance-of-payments adjustment theory, which more or less take for granted, with various degrees of qualification, that relative price adjustments through a change in the exchange rate will secure for a country simultaneous internal and external equilibrium. This was the driving intellectual force in fashion when the world moved to floating exchange rates in 1973.

My scepticism has been most acute in the case of the United Kingdom, which has experienced persistent difficulty in reconciling balance-of-payments equilibrium with full employment and a higher growth rate, and where, as it turns out, devaluation and currency depreciation have been singularly unsuccessful in reconciling the conflict.

My dissatisfaction is not confined to traditional neoclassical price-adjustment theory. It extends to the more recent monetary approach to the balance of payments which gives the impression, whether it intends to or not, that all balance-of-payments difficulties have their origin in monetary disequilibrium and that monetary correction is a sufficient condition for internal and external balance.

It is argued strongly in the book, particularly in Chapters 10 and 11, that the balance of payments must be viewed in a growth context, and that at the heart of the United Kingdom's economic difficulties is the slow rate of growth of exports, which cannot be raised permanently, if at all, by exchange-rate depreciation, and is not amenable to monetary manipulation. The problem requires real economic policies of a structural nature related to the wider characteristics of goods, such as their quality, design and reliability, marketing and delivery. Exchange-rate depreciation simply ossifies the industrial structure and makes manufacturers temporarily more competitive in the export of goods with given characteristics which were the source of the payments weakness in the first place. As I argue in Chapter 10, I am convinced in my own mind that the United Kingdom's inferior economic record in relation to other industrialised countries, particularly since 1950, is largely a function of its balance-of-payments strait-jacket caused by the slow rate of growth of exports relative to other countries, and until this underlying weakness is rectified the United Kingdom will be condemned to a low growth rate and the spectre of rising unemployment whatever other domestic policies are pursued.

Apart from being an unusual (but I hope appealing and convincing) mixture of textbook and polemic, the book has two other features which distinguish it from traditional texts. First, it is argued strongly that the focus of balance-of-payments policy ought to be on the current account. To focus elsewhere, as the new monetary approach to the balance of payments urges, can store up trouble for countries in the future by delaying the real economic adjustments that a country must make ultimately. Second, for the first time in a textbook, the foreign-trade multiplier is presented relating imports to expenditure - this is obviously more realistic than relating imports to income if the import coefficients of various components of domestic expenditure differ.

Finally, an attempt has been made to organise the book in such a way that it can be used both as a preliminary text on balance-of-payments theory and also as a source of reference on the performance of the U.K. balance of payments which can be updated in subsequent editions if the book proves useful to students.

In writing the book I am in debt to a number of organisations and individuals. The Social Science Research Council financed my research on labour-market bottlenecks and the balance of payments. During the project several other ideas were developed. The Treasury and the

Department of Trade and Industry provided me with statistics. Mr John Goy and Mrs Julia Stevens of the University of Kent Library obtained and checked references for me. The editors of *Banca Nazionale del Lavoro Quarterly Review*, *Applied Economics*, the *Oxford Bulletin of Economics and Statistics* and the *National Westminster Bank Quarterly Review* gave me permission to reproduce certain material which first appeared in their journals. Mrs June Harrison typed the manuscript with superb efficiency. Finally, my colleagues Richard Disney, John Craven, Charles Kennedy, Bob Dixon and Thea Sinclair, helped to improve the book with their constructive comments on various chapters. To all these I am deeply grateful, but they bear no responsibility for the deficiencies which remain.

A. P. T.

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