

# **THE ECONOMIC SYSTEM IN THE UK**

**SECOND EDITION**

**Edited by  
DEREK MORRIS**

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# THE ECONOMIC SYSTEM IN THE U.K.

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DEREK MORRIS

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# Preface

This book is mainly, though not exclusively, intended for non-specialist and certain specialist students in economics (see p. 5). It attempts to explain the general principles underlying both the working of the U.K. economy and Government economic policy whilst meeting two other objectives. These are, first, that it should be intelligible to the introductory reader who is prepared to study it carefully, whether he or she is a student or a member of the general public, and, second, that at the same time, the book should examine at least some of the complexities which are frequently excluded in introductory texts but which cannot be avoided in the day-to-day management of the economy. (See section 1.2 of Chapter 1 for further discussion of these objectives.)

Some of the chapters are based on pamphlets which have been used for teaching applied economics to students over a number of years. But these pamphlets, and indeed part of the rationale for this book, arose out of a rather unusual and possibly unique form of economics teaching that has been developing in the last two decades.

In 1953 a group of industrialists and academics from Oxford University met with the intention of establishing a permanent vehicle for mutual discussion on the state of the economy, its impact on industry, the development of management techniques, and other related economic matters. A precedent existed for such contact in an earlier series of interviews with businessmen conducted by several economists from the University which had been designed to explore the validity of current economic theory as it applied to the industrial sector.

This meeting resulted in the formation of the Oxford University Business Summer School which has now been held every July for twenty-three years. It is of four weeks' duration and has developed into an intensive course in economics for middle-level managers from the public and private sectors, primarily those who are regarded by their companies or departments as likely to reach board level or its equivalent and who are therefore likely to require a good understanding of how the economy works and how it impinges on companies' behaviour, objectives, and performance.

The school is staffed by a number of academic economists, all of whom are involved in direct application of economic analysis to practical problems either in the private or public sector, and all of whom therefore have an interest in regularly exploring and developing the usefulness of economic theory when applied to the real world. In addition, there are lectures by the tutors and by outside economists, leading industrialists, politicians, and others.

Lack of satisfaction with the economics books available to back up such a course led to the writing of internal pamphlets which subsequently, with some modification, were also found to be useful for certain students. The

format and perspective, which were rather different from most textbooks, appeared to have certain advantages but the range and cohesion of the pamphlets taken together were not always adequate or appropriate. This book developed from the attempt to overcome these drawbacks. The range of economic policies discussed was extended, the level of detail increased, and a section added to provide a necessary basic introduction to the operation of the economy. It is hoped that the resulting book provides a series of useful articles on specific issues, but also a coherent introduction to the working of the U.K. economy as a whole.

Most contributors are past or present tutors of the University Business Summer School. Most have written on a topic of particular interest to themselves and in areas where they are heavily committed to extensive advisory work on top of their academic commitments. This naturally leads to difference of viewpoint and emphasis. In certain cases contributors have strong opinions which may or may not concur with the prevailing orthodoxy. A certain amount of editorial licence has therefore been used, not to remove such differences, but to present as far as possible a framework within which different schools of thought can be described, compared, and evaluated. Unnecessary duplication has been avoided where possible, but different chapters have occasionally required re-presentation and development of earlier points to preserve the sense or flow of argument.

Several contributors have offered comments and criticism on other chapters, and the editor is indebted to them for this. Similarly, a number of anonymous reviewers have provided detailed comments and criticisms on early drafts, and suggestions for the final one. This has proved extremely helpful. The assistance of various students in reading and commenting on several chapters has likewise proved invaluable. All remaining errors of fact, argument, or judgement are of course our responsibility alone. The contributors' thanks are also due to those who cheerfully helped to type both early and final drafts: Pip Bevan, Jean Brown, Angela Fawsett, Clare Jones, Peggy Smith, Joe Wilkins, and typists at the Oxford Institute of Economics and Statistics.

Finally, because of the very heavy commitments each contributor already faced, both within the University to teaching and research and frequently outside it in an advisory capacity, most of the work of writing this book has had to come out of already greatly squeezed leisure time. We would all like to thank very much those in our personal lives who have borne the brunt of this pressure.

DEREK MORRIS

*Oriel College, Oxford*  
*21 March 1976*

# Preface to the Second Edition

While much has happened in the U.K. economy since the first edition of this book was written, the main economic forces which underlie and determine the changing economic conditions in the U.K. remain relatively stable. In focusing on these forces, the first edition was primarily intended to provide a basis for understanding and assessing the U.K. economy not only in the mid-1970s but over an extended period of the U.K.'s economic development. Reference to the then current economic situation was made for illustrative purposes rather than to provide a recent economic history of the U.K.

For this reason we have not thought it necessary to make many major changes in this second edition despite the passage of nearly three years since the first edition was written. However, the emphasis placed on different economic issues by those concerned to analyse, forecast, and control the economy changes over time, and there is value in illustrating the economic forces at work by reference to recent events. This clearly serves to explain current events better, but also permits better understanding of likely trends in the future and perhaps makes the useful application of economic theory more immediately apparent to students of the subject. Therefore, as the only recurrent change in the second edition we have included, where relevant, tables, charts, or text to bring the reader up to date with developments that have affected the U.K. economy since 1976, and we have interpreted these developments in the light of the analysis which precedes them. This mainly applies to Chapters 4, 7, and the policy chapters of Part IV. In addition Chapter 14 covers the developments to date on the international front which have been central to the U.K.'s position, and Chapter 20, which in the first edition was no more than a postscript on policy options, has been lengthened to include an assessment of what has in fact occurred and, given the analysis of the previous chapters, what 1979-80 is likely to hold for the U.K.

In addition many chapters have been subject to minor revision and several amended more substantially to allow new analysis or evidence to be incorporated.

Finally, one other change since the first edition is worth noting. Although chapters have been prepared by the same contributors, the responsibilities of several of them have changed. Hywel Jones is now Director of Henley Forecasting, Michael Surrey became Editor of the *National Institute Economic Review* and is now Professor of Economics at Leeds University, Andrew Graham is a member of the Wilson Committee on the Financial System, and Christopher Allsopp is Chairman of the St. James's Forecasting Group run by the Economist Intelligence Unit with the aid of the Treasury Macroeconomic forecasting model. Derek Robinson has been Chairman of the Social Science Research Council, Richard Smethurst is now Director of the External Studies Department of Oxford University, Jeremy Hardie is a

member of the Monopolies Commission, and David Stout is Economic Director of the National Economic Development Office. The editor much appreciates the willingness of the contributors to find time under such circumstances to prepare chapters for the second edition.

DEREK MORRIS

*Oriel College, Oxford*

*17 November 1978*

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## PART I



# I

## Introduction

D. J. MORRIS

### **1. Background to the Book**

#### *1.1. The Performance of the U.K. Economy*

The impact of the economy on all aspects of life has never been more evident. Governments, politicians, and civil servants are more preoccupied with economic performance both domestically and internationally than ever before; company sales, costs, and profits are increasingly determined more by the general level of activity in the economy than by the efforts and ability of the companies themselves to improve their performance. At both managerial and shop-floor level the number of jobs available as well as the incomes received are often seen as more dependent on the state of the national economy and nationwide policies on employment and incomes than on the decisions of the particular company concerned. Most important of all, individual living standards are seen as determined by factors which lie far beyond the ability of the individual to influence, and this is true whether the individual is an employer or employee, a housewife, pensioner, student, or child.

This impact would have been less worrying and indeed less noticed or emphasized if it had in general been viewed as a beneficial one. In fact, the performance of the U.K. economy has been almost universally regarded as poor, if not disastrous. Three distinct, though not necessarily unrelated, aspects of this performance can be identified. First, in the recent past both unemployment and inflation hit record levels; the economy ceased to grow, at least temporarily, and real living standards on average actually fell for the first time since the war; the balance of payments was in record deficit and the value of the pound internationally fell very heavily. These have all served to emphasize the dependence of individuals on the performance of the national economy and on the economic actions of other countries, to which this recent performance is partly attributable.

Second, and looking over a somewhat longer period, the U.K. economy has been subject to almost continuous cyclical fluctuations in the general level of activity. These, together with the changes in economic policy associated with it, have created great difficulties for those in the public (government) and private sectors who are attempting to plan for and achieve sustained long-term economic growth and development.

Third, and probably most serious of all, is the poor performance of the U.K. economy over thirty years when compared to nearly all other developed countries in the world. The level of output per man (labour productivity) is relatively low and has increased at a slower rate than in other countries. Living standards have consequently grown at a slower rate than elsewhere. The competitiveness of British goods abroad has been inadequate and has only been temporarily sustained through successive depreciations of sterling.

The general result is that while both the causes of, and solutions to, this poor performance are a central topic of discussion and dispute in industrial, academic, and government circles, there is little disagreement with the judgement that the economy has failed to behave as it should. Consumer prices are thought too high, wages too low, production costs too high and profits too low, taxation is frequently regarded as excessive not only by those paying the highest levels, and the provision of goods and services by private companies, nationalized industries, and government agencies is often regarded as inadequate in terms of quantity and quality, or both.

### *1.2. Purpose of the Book*

Two very important repercussions of this situation may be noted. First, there is an increasing need for all those involved in any way in the economic processes of production, distribution, and sales, or in the management of the economy as a whole, to have a good grasp of the fundamentals and some of the complexities involved in the operation of the economy. This includes managers, civil servants, union representatives, and politicians. Many of them feel, in a way which they did not several years ago, that they need the economic training necessary to understand what is happening in the economy, to assess its likely behaviour in the future and to recognize the limitations which interdependence of unions, management, and government places on all three. Their difficulty is the limited time available for this purpose, and it was with this in mind that the Oxford University Business Summer School (despite its somewhat inappropriate title) developed into an intensive one-month course in economics. This book arises out of some of the written material used on the course and therefore retains some of the characteristics of a crash course and, as one objective, the provision of an introduction to economics for those who will have little or no opportunity to pursue an extended course in the subject.

A second repercussion has been a rapidly growing interest in economics on the part of students. This arises partly because it is recognized that the tendency for economic aspects to dominate issues will probably increase, and be reinforced by an ever more rapidly increasing interdependence of the different sectors of the economy on each other in the future economic development of the U.K. This will place ever greater demands on the economic literacy of the future managers, civil servants, and trade unionists which many of today's students will become. In addition, however, it arises from a general and very sensible desire to comprehend the economic issues that constrain and determine so many human activities in all walks of life. An understanding of the very powerful, but often unanalysed, forces at work



in society is seen more and more as a central factor in the process of education, and economic forces represent some of the most powerful ones. This book is therefore very much directed at students, and both the original summer school pamphlets and drafts of various chapters have been found useful for student teaching purposes.

As this book is very far from being a conventional introductory textbook it is advisable to be explicit about the two particular types of student for whom it is intended:

First, there is an increasing number of students at universities, polytechnics, business schools, and many other institutions who, though not specializing in economics, nevertheless wish to study it to some extent, so that they will be better informed about their economic environment and better equipped to judge the performance of economists and politicians in the attempts they make to manage the economy. There are all too many cases, however, where the course for such non-specialists has been little more than the introductory work of those doing specialist courses in economics. This is unfortunate as the demands of the two groups are quite different. There are many aspects of economic analysis (often abstract, rigorous, and complex) which are appropriate for a three-year course because there is sufficient time available to reach a relatively high level of sophistication. The introduction to a specialist course therefore rightly emphasizes the tools of analysis, starting with the simplest, most basic ones, and building up gradually. Initially, therefore, it makes sense to abstract from the economic environment and its complexities until the modes of analysis have been grasped. If the non-specialist is provided with only the first part of such a programme he can easily end up with a few pieces of simple deductive theory, little evidence on how to apply them (or even on whether they are applicable at all as they stand), little understanding of the economy, and the misguided belief that economic theory and the real world have little connection.

In fact, the needs of the non-specialist are much closer to those of management, civil servants, etc., namely an introduction to economics which reduces technical analysis to the minimum necessary to understand the systematic forces at work in the economy; which avoids the elaborations required to understand detailed problems that the student will never face, and which are not central to general economic activity; but which nevertheless brings out the complexity of the central issues, permits assessment of the controversies existing in the area of economic policy, and assists the formation of his own judgement on the vast literature on economics poured out each week in newspapers, journals, and all manner of government publications.

Second, some of the later chapters (mainly Parts III and IV) look at difficult, controversial, and often not easily understood areas of economics. These chapters, which are the core of the book, will stretch non-specialists, but should be quite intelligible to them given that they have read the more basic economics in Part II. In addition, however, specialists, for whom Part II would be unnecessary, may well find the later chapters useful material as an introduction to the applied side of their course. These chapters summarize particular areas, identify the main issues and problems, and give some