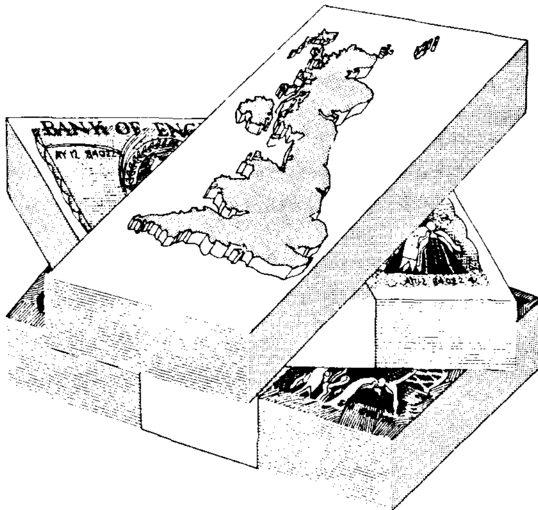
The British Economy

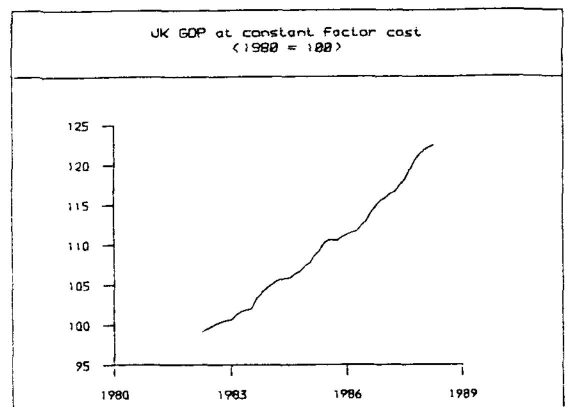


OVERVIEW

Earlier prognostications of a slow-down in the rate of growth of output in the British economy have been confounded by recent evidence. Continuing high levels of output growth are a reflection of rapid growth in domestic - and particularly consumer - demand. But domestic demand is growing at a much faster rate than output and there are indications that the differential increased during the second quarter and middle of the year. The inevitable result has been a marked deterioration in the balance of payments. The government's use of interest rate policy as the sole instrument regulating the expansion of domestic demand leaves much to be desired.

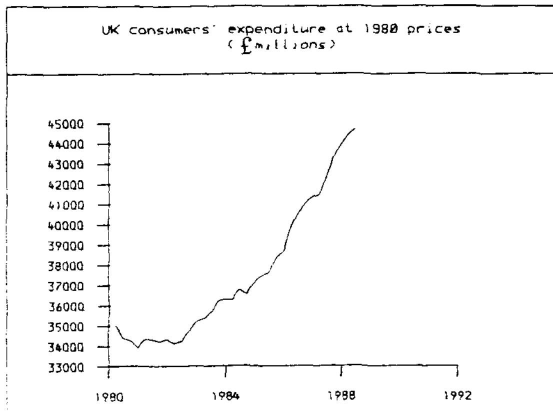
MACROECONOMIC TRENDS

The average measure of GDP at current market prices, nominal or 'money' GDP, rose by 1.3% between the final quarter of 1987 and the first quarter of 1988 to a level 9.5% higher than in the first quarter of 1987. After allowance for inflation, the average measure of GDP at constant market prices, 'real' GDP, rose by 0.6% between the two consecutive quarters to a level 4.2% higher than in the first quarter of 1987. The output based measure of GDP, which is conventionally regarded as the most reliable indicator of short-term change, recorded an increase of 0.7% during the first quarter of 1988 to reach a level 5.2% higher than a year previously. Both the average measure of 'real' GDP and the output based measure therefore recorded a lower rate of growth in the first quarter of 1988 than the quarterly rate averaged during 1987. However, preliminary estimates suggest that output rose by 1.3% in the second quarter of the year - an annual rate of 5.3%. Although the level of output was 5.1% higher than a year previously, and therefore little different from the annual change to the first quarter, the most recent data cast some doubt on the view that growth in the economy is quickly reducing to more sustainable levels. The behaviour of the CSO's coincident cyclical indicator would appear to reinforce the doubts. This indicator, which attempts to show current turning points in the business cycle around the long-term trend and contains retail sales, production output and CBI survey information, as well as GDP data, among its component series, fell slightly during January and February of this year but resumed an upward path from March.



Real consumers' expenditure rose by nearly 1.5% between the fourth quarter of 1987 and the first quarter of 1988. This can be compared with a rate of change of 1% between the final two quarters of 1987. In the year to the first quarter of 1988 expenditure had risen by 7%. In this latest quarter, expenditure on most categories of goods and services increased,

although spending on clothing proved to be an exception. Within the consumer durables category, expenditure on vehicles grew by 11.5%, on furniture and floor coverings by 9.5% and on other durables by nearly 12%. There is therefore little evidence from these data of any moderation in the upward trend of consumer spending. The Department of trade and Industry's (DTI) retail sales volume index rose, in seasonally adjusted terms, by 2.4% in July, suggesting that, if anything, spending was accelerating. In the three months to July, the index was 1.5% higher than in the preceding three months and sales were 7% higher than in the same period a year earlier. Sales in the household goods category were particularly strong, with volumes 4% higher than the preceding three months. The CBI/FT distributive trades survey for August also provided little comfort for those wishing to see a downturn in the rate of growth of consumer demand. In the retail sector, a balance of plus 59% reported an increase in sales compared with the same month in 1987. This balance was the highest since January and comes after strong positive balances in May, June and July. Moreover, a balance of plus 70% expected sales volumes in September to be greater than in September last year. It therefore seems clear that the 4.5% point rise in interest rates since May has yet to affect consumer demand.



The underlying determinants of the growth of consumer demand continue to be buoyant. The rate of growth of average earnings was 8.5% in June, having remained at this level since December last year. Provisional estimates for July indicate that the annual rate has now risen to 9%. Real personal disposable income (RPDI) has also increased at a brisk rate. Between the fourth quarter of 1987 and the first quarter of 1988 RPDI rose by 2.5%, to sand at a level 5.5% higher than the first quarter of 1987. However, the saving ratio is estimated to have risen to around 5.5% from the historically low level of 4.5% recorded in the fourth quarter of 1987. The rise reflected the slower growth in consumer expenditure compared to RPDI. In July consumer credit rose again by £300 million to stand at a record £25.4 billion.

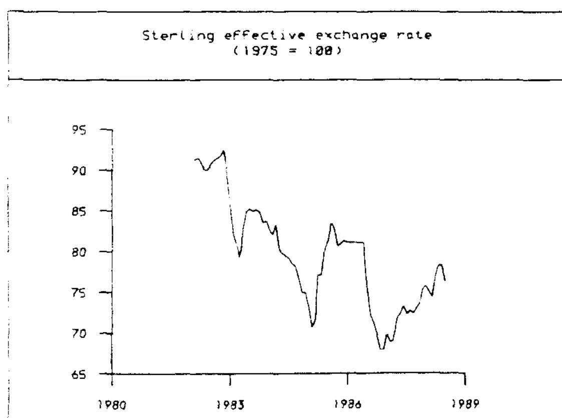
General government consumption fell by nearly 1.2% during the first quarter of 1988. As a result real government spending stood at 0.6% above the level attained in the first quarter of 1987.

Gross fixed investment increased by 3.5% during the first quarter of 1988, rising to a level 10.8% above that attained in the same quarter of 1987. The growth in investment in the year to the first quarter 1988 is accounted for largely by spending in the private sector which rose by 14.5%. Investment by public corporations fell by 11% while general government investment spending rose by just 1.7%. By type of asset, investment in dwellings displayed the greatest increase in the year to the first quarter, rising by 22.2%, reflecting private sector expenditures which increased at a rate of 28.7%. Investment in Vehicles, ships and aircraft, Plant and machinery, and Other new building and works, rose by 11.4%, 9.4% and 5.6%, respectively, during the same period. The June DTI survey of investment intentions forecast an increase of 16% in manufacturing investment during 1988. Investment in the other key sectors of the economy: construction, distribution and services, is forecast to rise at the lower, but still significantly positive, rate of 10%.

The trade accounts continue to deteriorate and are symptomatic of the concern about the growth of demand pressure in the economy. The visible trade balance recorded a deficit of £4.0bn in the first quarter of 1988 which represented a further deterioration from the £3bn recorded in the preceding quarter. Provisional figures for the second quarter indicate a further significant deficit of £4.4bn. The non-oil trade deficit rose again to £4.9bn in the first quarter from the £4.1 bn recorded in the previous quarter. Both export and import volumes fell in the first quarter of the year but at 5.5% the fall in exports was markedly greater than the 2.2% fall in import volumes. The oil surplus fell back to £0.9bn after the £0.1bn increase recorded in the fourth quarter of 1987. The deterioration in the

oil surplus can be clearly seen by comparing the surplus recorded in the first quarter of 1986 with the current figure. In that quarter the surplus stood at £1.9bn, around a billion more than the current figure. The current account moved further into deficit in the first quarter of this year, rising to £2.9bn. Further revisions to the trade accounts have now produced an estimated deficit on this account for 1987 of £2.5bn, compared with the previous estimate of a £1.6bn deficit. And the estimate for 1986 has now been revised downwards from a £0.1bn surplus to a £0.2bn deficit. Provisional estimates for the second quarter of 1988 suggest that the deficit was again £2.9bn, so that up to June the deficit was averaging almost a billion a month. However, in July the deficit deteriorated further to an estimated £2.2bn.

In the second quarter of 1988, the output of the production industries is provisionally estimated to have increased by 1.5% compared with the previous quarter. This reverses the estimated decline of 1% recorded in that quarter and suggests that growth may not be moderating to the degree expected in the last quarter's Commentary.



By June output was 4.5% higher than in the second quarter of 1987. Manufacturing output also rose by 1.5% in the most recent quarter to a level 7% higher than a year earlier. By market sector, the output of the consumer goods industries rose by 1%, compared with the 0.5% increase recorded between the preceding two quarters. Increased investment demand also appears to have had a favourable impact on the output of the investment goods industries where output rose by 4% between the latest two quarters. This stands in marked contrast to the 3% fall experienced in the previous quarter.

In the second quarter there was the usual variation in the output performance of individual sectors. The output of the energy sector continues to fluctuate (see June Commentary). The change in this quarter was favourable, with output rising by 0.5% to a level 1% below that of a year earlier. Within manufacturing, the principal increase recorded was in metals, and engineering and allied, where output rose by 4% between the latest two quarters. In chemicals, food, drink and tobacco, and other manufacturing, output remained largely unchanged. The output of other minerals and the textiles and clothing industries fell by 2% and 1%, respectively. In construction, output was 10% higher than in the first quarter of 1987. Overall, output in the production and construction industries rose by 1% in the first quarter of 1988 to a level 4.5% higher than in the first quarter of 1987.

THE LABOUR MARKET

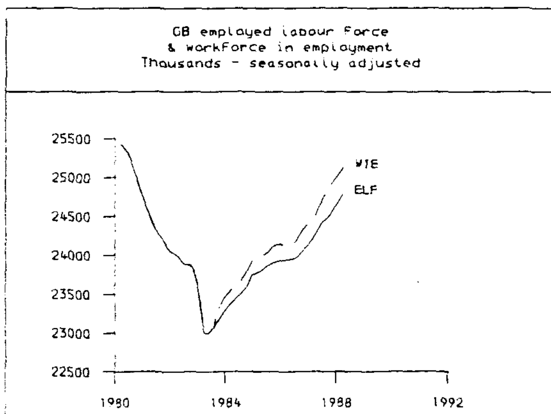
EMPLOYMENT AND UNEMPLOYMENT

In July, the Department of Employment introduced a new employment series workforce in employment. This replaces the employed labour force series in future monthly press releases on the state of the UK labour market. The 'employed labour force' constitutes the sum of employees in employment, the self-employed and HM Forces. The 'workforce in employment' includes the employed labour force plus participants in "work related government training programmes". This latter group consists of "those participants in programmes and schemes who in the course of their participation receive training in the context of a workplace but are not employees, self-employed or HM Forces". This revised presentation is in line with International Labour Organisation(ILO) guidelines. Estimates of the workforce in employment have been provided back to 1983 when YTS was first introduced.

The workforce in employment is estimated to have risen by 119,000 in the first quarter of 1988. In the year to March 1988 the series is estimated to have risen by 618,000 and to have increased by 2,140,000 in the five years since March 1983. The comparable figures for the employed labour force are 141,000, 529,000 and 1,806,000, respectively.

Employees in employment rose by 111,000 in the

first quarter of 1988 and the composition of the change broadly corresponded to the established pattern. The number of employees in the service sector rose by an estimated 113,000 compared with revised estimates of 130,000 and 74,000 in the preceding two quarters. Manufacturing employment actually rose by an estimated 1,000, following reductions of 6,000 and 22,000 in the previous two quarters and another small increase of 3,000 in the second quarter of 1987. In other sectors, the energy and water supply sector continued to lose jobs with a 15,000 fall recorded, compared with reductions of 8,000 and 3,000 in the preceding two quarters. The other industries category, on the other hand, increased its employment by 13,000 after a drop of 3,000 in the preceding quarter.



Productivity - output per head - growth continues to be high. In the first quarter of 1988 output per head in the whole economy was 3% higher than a year earlier. In manufacturing, the high rates of productivity growth experienced from the second half of 1986 have continued into 1988. In the first two quarters of the year the percentage increases on a year earlier were 7.6% and 7.2% respectively. The underlying increase in average weekly earnings in the year to June was provisionally estimated to have been 8.5%. This rate has continued since the 0.25% point increase in the rate which first occurred in the year to last December. However, provisional estimates for July suggest that the rate has now risen 9%. The growth in unit labour costs reflects the relative growth of earnings and productivity. In the whole economy, the percentage increase on a year earlier rose to 5.9% in the first quarter of 1988, compared with increases of 4.8% and 4.2% in the preceding two quarters. In manufacturing, the faster growth of productivity has resulted in the growth of wages and salaries per unit of output remaining relatively low in recent quarters. In the first quarter of 1988 the percentage increase on a year earlier stood at 0.5% and this was followed by a 1.4% increase in the second quarter. With increasing pressures for higher wages, unit labour costs have tended to edge up during the first six months of this year despite the good productivity performance in manufacturing.

Seasonally adjusted unemployment continues to fall with some evidence of a slight slackening in the rate of decline. In the six months ending July, the reduction is provisionally estimated to have averaged 41,800 per month. In the preceding six months the average change over six months has averaged 40,300 in June, 39,400 in May, 43,400, in April, 44,700 in March, 48,800 in February and 51,400 in January. By July, seasonally adjusted unemployment stood at 2.314 million, or 8.2% of the workforce, down 58,500 on the previous month.

INDUSTRIAL RELATIONS

Relations between the EEPTU and the trade movement figured prominently in British industrial relations. From the early part of the year it had been clear that the expulsion of the EEPTU would take place at the Trades Union Congress in September.

These events prompt three questions: first, were there particular developments and changes which made the expulsion almost inevitable? Secondly, will the EEPTU be successful outside the TUC? Thirdly, what are the implications and consequences for the trade union movement.

Increased tensions between trade unions have been a feature in recent years, due largely to the continuing decline in trade union members. Trade union membership is down a further 1.3% over the past year and now represents 9,126,911 employees, or 41.5% of the labour force. Many of the inter union disputes as well as differences over policies arise from the increased competition between union for members. This competition is further exacerbated by technological changes blurring the traditional demarcational lines between trade unions, and by the emergence of differing policies, such as single union and no strike arrangements with employers.

The TUC's proposals, to tackle the twin issues of union relationships and the decline in union

membership, were published before the expulsion of the EEPTU. These suggested: first, a new code of practice on inter union relations. Secondly, unions would be required to notify TUC of planned single union deals for TUC scrutiny before signing. Thirdly, unions would not be permitted to conclude no strike deals. Fourthly, there were to be new measures designed at enhancing contacts with employers' organisations on industrial relations issues. Fifthly, there would be a pilot scheme for providing labour market intelligence and union membership. Finally, the TUC should adopt a new role in co-ordinating union services, eg financial and legal, and the promotion of trade unionism especially amongst women and young people.

However, pressures to maintain membership levels exerts considerable pressures on trade unions to pursue individual, rather than collective, interests and hence to conclude single union deals and agreements which breach traditional recruitment boundaries. Whilst the EEPTU has some twenty single union agreements both the TGWU and AEU have been criticised over issues of union poaching and single union deals. The TGWU plans to widen its recruitment base by a series of measures including mergers, improving services for members and, interestingly, by improving links with employers, especially those on greenfield sites.

It is unlikely that either the traditional union machinery for dealing with inter union membership disputes, the Bridlington principles, or new policies will be able to cope with these pressures coupled with new employer demands as to patterns of recognition. New methods - possibly along the American practice of agency arrangements - will be necessary. Union agency arrangements allow for an employee to be a member of a particular union, but to be represented, for bargaining purposes, by another union. An agency fee is paid to the union which represents the employee to the employer. American practice allows for periodic elections to establish whether employees wish to change their bargaining union.

Whether the EEPTU will be successful is more difficult to assess. Undoubtedly, the union will face a number of inter union disputes some of which it has generated. There is the possibility of conflict with ACTT over recruitment in the satellite broadcasting industry. The EEPTU has won negotiating rights in the Docklands light Railway and may use this as a springboard to win recognition rights with the operators of the Channel Tunnel. The union has been involved in merger discussions with the AEU. If this were to be successful the resultant union would represent more than a tenth of all unionists. One development has been EEPTU moves to use COMPS (the Council of Managerial and Professional Staffs) as a base for extending its white collar membership. The success of such developments would make the EEPTU the core of an alternative TUC, this would be much more attractive to those unions, including: UCATT, IPCS, PAT and RCN, with whom the EEPTU has sought discussions. A key factor will be the number of electricians and electronics workers in ten years time. The Henley Centre predicts a rise to some 700,000. Such an expansion, coupled with employer support, might herald a reasonably secure future for the union.

There are implications and consequences of this split in the union movement. First, it highlights a divide as to the directions for future trade union policy. Eric Hammond, the EEPTU general secretary, described his union's policy as 'competitive business unionism'. Such policies have been long held in the United States and imply a much reduced political commitment, a greater competition for members, and a focusing of union power on the economic objectives of their members, rather than the social aspirations which have long been a feature of British trade unionism. As such it represents a philosophy more in tune with Thatcherism than that held by the majority of the movement. 'Evidence' to support the relevancy of such a philosophy can be drawn from the results of a recent MORI survey of trade union members. This found that a greater proportion supported the actions of the EEPTU than the TUC. Some 58% favoured single union deals, but 60% were against a widespread adoption of 'business unionism' as key to success in the future.

Business unionism weakens the rank and file vitality of a trade union movement and tends to lead to greater central control and less democracy within the union. It stresses the very cosy relationships and arrangements between employers and trade unions which Norman Fowler, the employment secretary, has argued should end. He has called on employers to establish individual relationships with their employees, arguing that the revolution in the labour market is that 'the individual will want to negotiate his own terms

and conditions of employment including his own pension arrangement. He will want to reflect his own skills, efforts and capacities, not the outcome of some distant negotiations between employers and trade unions. But business unionism can stress relationships between the union and employer which do not reflect the members' interests'.

Others who see the Electricians as the vanguard of the new trade union realism have based their arguments on a reworking of the What do unions do? arguments of Freeman and Medoff (Basic Books, New York, 1984). However, as Professor Metcalf noted, in his well publicised article comparing productivity rates in unionised and non-unionised firms, there are major problems in assessing the economic impact of unions, let alone the value of their social functions. More significantly he argues that both the vanguard and the traditional philosophies will face difficulties in maintaining union membership levels.

A review of the central organisations of tradeunion movement in other countries gives some indications as to the likely implications for the British movement of a continued split between unions. Sweden has separate central organisations for white collar and manual employees. In Germany the three central organisations represent the interests of manual, civil service and salaried employees. Both have well organised and powerful union movements, Sweden with 94% of employees in union membership and Germany with 42%. The divisions between the central organisations are logical. By contrast France has evolved a union movement with five overlapping and competing confederations, divided on political and religious lines, a fragmented and weak movement. Trade Unions in Japan are similarly divided. The structure of enterprise, or company unions, leads to both a large number of trade unions, more than 74,000 in the 1980s and to very weak confederations. Both Sohyo and Domei have few powers over individual unions. A division in the movement along blurred and indistinct lines, where unions compete for members, is likely to lead to a further weakening of the movement, a weakening liable to be exploited by some employers. Such a pattern could lead British trade unions to resemble their French counterparts with considerable implications for the pattern of industrial relations.

Such considerations tended to obscure the other issues at the TUC, most notably the decision concerning the government training plans. Popular concern did not focus on the motion in support of the restoration of union recognition at GCHQ nor on NUM's loss of its seat on the General Council as its membership had fallen below 100,000.

The future pattern of industrial relations within the education sector remains unclear. Unions representing secondary teachers have considered binding pendulum arbitration - where the arbitrator can only decide for one side or the other, there is no scope for compromise - in return for the government restoring negotiating rights. However, the government appears to seek a negotiating body on which it constitutes the majority on the employers side, and in which arbitration can only be used when both sides agree. Other features of the emerging system can be gleaned from developments in CTCs. The city colleges plan no strike clauses in agreements, performance related pay schemes and either no union or recognition of PAT. Birmingham CTC, for example, has indicated a preparedness to pay 5% above normal rates with performance related pay.

In the Health Service the issues of pay and funding of the costs of pay increases surfaced. The costs of the pay and regarding award were known to be high and problematic. In May the government had sent guidelines to health authorities indicating that for grading purposes only those nursing sisters with a continuing responsibility for running a ward should be put into the higher grade (Grade G). This meant that only one sister per ward would be graded in Grade G, the others would be located in Grade F and as such would receive an increase of only some £20 per year. Such a guideline would appear to have ignored the need to run wards continuously for 24 hours per day and seven days per week. Where work is continuous few, if any, enterprises pay those responsible for work on shifts less than their day time counterparts - yet this appears to be government policy. If this is not an inept policy it poses questions as to why the government would wish to engender low morale amongst nursing staff.

Elsewhere in the public sector the move towards greater flexibility and a weakening of traditional bargaining arrangements continues. Within the coal industry, British Coal has been extending flexibility and six day working. The agreement with the UDM involves miners working six days a

week for three weeks followed by one week off. This agreement will enable coal production to be increased from 233 days per year to 300. The agreement includes a clause which states that the union signing a local agreement for six day working will be recognised, for collective bargaining purposes, for at least ten years. As such the deal will aid UDM both in its attempts to recruit at new mines and to lessen NUM efforts at encroaching on the UDM.

Management has also re-introduced an old payment method - fix price contracts - under which teams of miners bid for fixed price contracts to complete particular jobs, such as clearing a coal face.

Recent moves to improve flexibility in British Rail have focused on introducing a flexible trainman grade. This combines the existing jobs of assistant driver and guard. It will reduce some of the barriers between the NUR and ASLEF as it provides for guards under the age of 46 to train as drivers (thereby overcoming the shortage of drivers). It introduces new grades of conductor and senior conductor. British Rail has extended performance and merit pay to middle management levels. Pay for middle managers is now firmly linked to performance. Travellers Fare white collar staff have performance related pay schemes based on an annual review of a series of management objectives.

The industrial action in the Post Office stemmed from the introduction of pay supplements for new recruits. The difficult recruitment area supplements were introduced in an attempt to overcome turnover rates of over 50% in some South East areas. However, the difficulty in securing a return to work added credence to other causes; most notably the consequences of devolving negotiations to lower management levels. A further cause appeared to be pressures to improve productivity which have led to accusations of 'hardline' management and undoubtedly a lowering of morale. This may well lead to further industrial action before the end of the year.

Flexibility was also a major theme in LACSAB's review of its operations. In recognising the need for more flexibility in negotiating practices and levels LACSAB pointed out that the current cost per authority for negotiations was £4717. It speculated as to whether if national bargaining were substantially reduced in scope, each authority could conduct its own negotiations for less than £5,000. It noted the recommendations of the Employers' Strategy Document which called for more flexibility for authorities, less national prescription and fewer smaller negotiating bodies. LACSAB's role will focus more on advice for individual authorities and less on bargaining.

Elsewhere, similar moves to downgrade the importance of national bargaining were announced. The Water Boards proposed to end all national deals as from 1989. The Broadcasting industry has reduced the number of items negotiated at national level and has increased the scope for local variations.

In the private sector the move towards derecognition of unions continues to grow at a slow pace and in relatively few industries. The Pontins Holiday group has withdrawn union recognition. Sky television has decided not to recognise trade unions. Over the past four years some 40 companies have withdrawn trade union recognition.

In recent months calls have again been made to abolish wages councils. Few employers seem to fear the implications of national bargaining accelerating pay rates from bottom to top without taking account of firms' needs to structure pay according to performance and profitability. More likely, since it would seem to be large firms that have led the call, the aim is to secure the freedom to relate pay to local labour markets. A number of MPs have argued that Wages Council agreements are cosy arrangements for employer and unions which are bad for the consumer. Such arguments appear to neglect the reasons for the Wages Council legislation, namely the need to protect the employee from exploitation.

One of the consequences of the introduction of local pay in the Civil Service has been a growth in the variation pay supplements in the South East. In the Inland Revenue recruitment grade staff aged 18 or over, with one year's service will get £600 in south east districts outside London. Executive officers in two London offices with recruitment problems will also get £600. Foreign office administrative assistants get £600 on joining; admin officers get £300 on joining and £600 in their second year; secretarial grades get £400. The Department of Energy pay assistants and officers based on seniority £200 after 2

years, £400 after three years and £600 after four years. In the Department of the Environment only personal secretaries in central London receive payments. In the Customs & Excise Department most payment is aimed at executive and higher executive officers in VAT offices in London, but Higher Executive Officers in Reading and Northampton Collection Centres receive £400 and £500 respectively. As yet it is uncertain as to whether such competition between government departments is being exploited by staff in short supply.

PROGNOSIS

Earlier prognostications of a slow-down in the rate of growth of output in the British economy have been confounded by recent evidence. Continuing high levels of output growth are a reflection of rapid growth in domestic - and particularly consumer - demand. But domestic demand is growing at a much faster rate than output. Between the first quarters of 1987 and 1988 total domestic expenditure grew by 6.8% whereas 'real' GDP grew by 4.2%. And there are indications that the growth of domestic demand rose again relative to output growth during the second quarter and middle of the year. The inevitable result has been a marked deterioration in the balance of payments, with the current account recording an unprecedented £2.2bn deficit in July.

There appears to be a consensus that demand in the British economy is growing too rapidly. Despite the buoyancy of demand in the other major OECD countries (see World Economy section) which has had a favourable impact on British export growth, the growth in British demand - by July car imports were growing at an annual rate of 30%, other consumer goods by 14% and intermediate goods by 27% - largely accounts for the recent marked deterioration in the trade position. However, the deficit need not pose much of a problem, in the short run, if it continues to be financed without the need for a significant - and sudden - depreciation of the exchange rate. That could have serious inflationary implications. The British Government's sizeable gold and foreign currency reserves, currently standing at around $50bn, provide considerable scope for manoeuvre. But to retain investor confidence in sterling, either the deficit must be viewed as self correcting and/or policy must be seen to be tackling the causes of the deficit and contributing to the adjustment. The current upsurge in investment is partly responsible for the deterioration in the trade accounts following significant imports of capital goods, which were increasing at an annual rate of 25% by July. However, it appears unlikely that the growth in capacity, and reduction in capital goods imports, will lead to a switch in domestic demand of sufficient size to markedly reduce the trade deficit. That will only be achieved if their is a reduction in the rate of growth of domestic demand.

The progressive increase in base rates from 7.5% in May to 12.5% in August provides a clear signal of the government's desire to moderate the growth in domestic demand. But as we commented in the June Commentary, relying on interest rates alone is an unsatisfactory approach to managing the economy. Higher interest rates will, other things being equal, raise the exchange rate and tend to worsen the deficit. On the other hand, higher rates should brake any tendency for sterling to fall too quickly because of the deficit, and this could minimise the effect of depreciation on inflationary expectations. Higher interest rates could also produce an unsatisfactory balance of demand in the economy if firms' investment plans were more interest sensitive than the spending decisions of consumers. Moreover, to the extent that higher interest rates do affect domestic spending - and the econometric evidence suggests that investment in dwellings, consumer durables and inventories are particularly responsive - there is the question of the time lag before the higher rates have their desired effect. Current building society practices of reviewing interest rates charged to certain borrowers only once a year - currently around 45% of borrowers - imply that lags may be becoming more extended. Faced with this uncertainty and the possible adverse effects on the current account deficit, the Chancellor would have been better advised to have applied other instruments to moderate the growth in demand. That would have reduced the need for such a large increase in interest rates. The most frequently canvassed alternative, credit controls, would under present market conditions, not have the effect its proponents expect and could introduce severe distortions affecting both equity and efficiency. Financial de-regulation and the abolition of exchange control severely limits the degree to which the supply of credit can be restricted to private institutions and individuals. Those who avoid the control may be

the least socially deserving. And economic efficiency would suffer if projects denied access to credit promise a higher rate of return than those obtaining credit through avoidance of the control.

We have argued in previous Commentaries that the appropriate policy response to achieve both external and internal objectives is to use interest rates to target the exchange rate and tax adjustments to moderate the domestic pressure of demand. The Chancellor would have been better served if the direct tax cuts introduced in the last Budget had been at least partially reversed. A step in this direction in the autumn would be welcome. In our view it remains the only hope for lower interest rates by the turn of the year.