

INTRODUCTION

This *Review* presents results of research by the Cambridge Economic Policy Group into the effects of economic policy, as part of a programme which has been in existence for five years. Each year the Group has published assessments of medium-term problems confronting the UK as they appear at the time. The result has been not only a running series of analyses of specific problems and prospects, but also the development of a detailed model of the main aspects of the UK economy, as well as the formulation of more general theoretical propositions and principles for economic policy.

Chapter 1 of the *Review* presents an analysis of problems of economic management in recent years and for the future up to 1985. Part I of the chapter examines events since 1972, to show the impact of world events on inflation and unemployment in Britain and to assess policies adopted by the government in the light of these events. It continues with a statement of principles by which policy for managing the economy should be conducted, before setting out the main strategies which could be adopted in future and their likely results. Part II provides the detailed assessment of main aspects of economic structure on which policy analysis depends, including detailed tables with explanations of the assumptions and uncertainties involved. The whole chapter draws on CEPG's model of the UK economy, which predicts the relationship between policy instruments and economic performance, conditional on assumptions about external events. Full sets of tables for the past since 1961 and for alternative future strategies up to 1985 are provided, together with notes and definitions, in the Statistical Appendix at the end of the *Review*.

Chapter 2 presents a formal analysis of the short-run effects of devaluation, tariffs and direct restrictions on imports, which demonstrates why the former is a difficult and inflationary method for adjusting external trade propensities as compared with the two latter instruments.

Chapter 3 disentangles the complexities of the Common Agricultural Policy and shows that on the evidence available the net effects of all the arrangements (including the 'green' pound) on Britain's payments for imported food, so far from amounting to a subsidy from the rest of the EEC, are a payment by Britain, which may be as large as £600 million a year extra on food imports as the price of membership and £900 million if present proposals are put into effect.

Chapters 4 and 5 consider the role of monetary policy and the effects of growth of money supply on inflation. The former provides a general model for the monetary sector in relation to the rest of the economy and shows that the role of monetary instruments controlled by the government must still be the tradi-

tional one of regulating interest rates and credit; management of the economy according to predetermined targets for growth of money supply or domestic credit expansion is at best an irrelevance and at worst an obstacle to appropriate fiscal policies. Chapter 5 presents historical evidence on movements in the money supply, costs and prices which shows that growth of money supply has not been a significant cause of inflation and, indeed, that apart from a chance coincidence in recent years, the two have not been at all closely correlated.

Chapter 6 reviews trends in competition between the main industrial countries in world markets over the past twenty years, to see how far changes in the relative cost competitiveness of different countries have been able to modify changes in market shares which are the main cause of unequal growth rates. It demonstrates that very large, and continuing, effective devaluations or revaluations would have been necessary to offset trend gains or losses in the market share of most countries.

Chapters 7, 8 and 9 deal with important accounting issues concerning the North Sea and public expenditure and revenues. Chapter 7 provides accounts for public expenditure, public sector receipts, the financial deficit and the PSBR up to 1981, with variants to indicate the effects of different rates of inflation and economic growth. The consolidated accounts show that on present plans there is a substantial surplus of revenue relative to requirements in future years. Chapter 8 explains how the definition of public expenditure has been changed by the Treasury and questions whether the concepts now used are as informative as they might be. Chapter 9 remedies a major gap in official statistics and projections by providing year-by-year accounts for North Sea transactions since 1966, projected into the future up to 1985, on definitions which are consistent with national income and balance-of-payments statistics.

Chapter 10 provides a retrospective assessment of five previous annual exercises published by CEPG, which includes a *post mortem* on the accuracy of conditional forecasts of unemployment, the balance of payments and resources available for consumption; the predictions are shown to have been sufficiently accurate over a medium-term horizon to provide a good guide to future problems, with the exception that the impact of the world economic crisis was not foreseen in 1972 and 1973. The main policy diagnosis provided since the beginning of 1972 is shown *ex post* to have been consistent from year to year. Chronic balance-of-payments problems leading to a rise in unemployment, the inadequacy of devaluation as a remedy and the inflationary consequences of attempting to rely on it, were all identified from the outset.

The inflation of over 20%, which resulted in 1975 from the threshold scheme in combination with a huge increase in import prices, was forecast and correctly analysed in January 1974, as was the world recession, together with the need for large public sector deficits in the UK and other industrial countries if it were to be prevented.

The early assessments of the group were not based on a model of the fiscal system and for this reason judgements about fiscal policy are not covered in Chapter 10. But we recognise very clearly that our fiscal recommendations have sometimes been seriously wrong. The main errors are described in the first part of Chapter 1.

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