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University of Strathclyde

The Fraser of Allander  
Institute

**Quarterly  
Economic  
Commentary**

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# FRASER of ALLANDER INSTITUTE

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The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short-term movements in economic activity. The results of this work, carried out in conjunction with the Department of Economics, are published in the Institute's Quarterly Economic Commentary. The Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium and long term aspects of the Scottish economy.

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The editor welcomes contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Editor.

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# Outlook and Appraisal

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Growth in the British economy came almost to a halt during the first half of this year. As a result, even a speedy resolution of the coal dispute would be unlikely to push the GDP growth rate this year above 2.5%. Though much of July's interest rate increase has already been reversed, it is likely to prove more difficult to reverse the effects on the retail price index and thus attain the goal of 4.5% inflation at the end of the year. The uncompetitive nature of the housing finance market makes a speedy and full unwinding of the recent rise in mortgage rates unlikely.

The reasons for the slowdown in growth are not difficult to identify. Maintenance of steady growth was dependent on exports and fixed investment compensating for the slowdown in consumers' expenditure and on there being no return to destocking. Fixed investment has played its part, and is likely to continue to do so under the stimulus of the Budget changes in capital allowances. Exports, however, showed little growth during the first half of the year. Net oil exports in particular were markedly lower. The stagnant volume of exports was coupled with continued growth in imports, and there was a further bout of destocking.

Employment, always a lagging indicator of economic trends, continued to increase in the year to March. However, the bulk of the jobs created were part-time and for females. Correcting the official figures to allow for the preponderance of part-time jobs greatly reduces the scale of job creation over the last year. Trends in notified vacancies and numbers of registered unemployed are consistent with continued slow growth of employment over the summer months. The revival in employment has induced discouraged workers to re-enter the labour market and partly accounts for the present conjunction of simultaneously rising employment and unemployment.

There is a dearth of information on trends in the Scottish economy during the first half of this year. It would appear that industrial output grew reasonably rapidly during the first quarter, but may subsequently have stagnated during the second. The results of the April and July CBI Surveys are consistent with this view. Prospects for the third quarter are not bright given the continuation of the coal dispute. The Scottish growth rate for the year as a whole is unlikely to be as high as anticipated in the May Commentary.

The May assessment that the immediate outlook for the Scottish economy was "better than at any time since 1979" is still appropriate. It is important, however, to be quite clear about the meaning of this assessment. While it implies that the growth rate of the Scottish economy this year is likely to be higher than at any time since the onset of recession, it does not exclude the possibility that growth will be somewhat slower than forecast in May.

Recovery in the Scottish economy began late in 1983 and continued into early 1984. It is possible that growth in the industrial sector then slowed during the second quarter. However, since it would appear that the level of output during the first quarter was markedly above the average for 1983, even maintenance of the first quarter level for the remainder of 1984 would lead to a growth rate for the year of about 2%. A return to growth during the fourth quarter would still leave the annual rate somewhat below the 2.5% anticipated in the May Commentary.

The coal dispute continues to cast a long shadow over both the British and Scottish economies and is partly responsible for the unexpectedly poor performance of both during the first half of this year. The dispute has directly depressed the level of industrial output, with particular emphasis on the index for energy and water supply industries, but with spillover effects into

other sectors, such as metal manufacturing, transport and distribution.

The more serious and long-run effects of the dispute are the indirect ones. These are multifaceted. The short term inflation outlook has deteriorated with rises in mortgage rates, falls in sterling's effective exchange rate and prospective increases in energy costs required to cover both the greater use of oil in electricity generation and the increased deficit of the National Coal Board.

The Government's monetary and fiscal strategy have been knocked off course by the direct Exchequer costs of the dispute, with adverse consequences for the PSBR. While the final effects on official borrowing may not be significant, financial markets have been sufficiently unsettled to reverse, at least temporarily, the downward trend in interest rates.

Though the long-run effects of the dispute on both the inflation rate and the PSBR are unlikely to be significant, what is potentially damaging to both the government's strategy and the prospects for sustained recovery is that any perceived acceleration of price inflation makes it increasingly difficult to maintain downward pressure on wage inflation. A strong case can be made that maintaining, and indeed increasing, such pressure offers the greatest prospect of any sustained reduction in unemployment. A reduction of wage inflation has become increasingly important with the marked slowdown in the economy.

There is an accumulating amount of evidence that employment is sensitive to movements in real wages. The case for reducing, or indeed halting, the rate of growth of real wages cannot be dismissed by arguing that it has the undesirable effect of depressing domestic demand. Domestic demand is a function both of numbers employed and of the wage rate. It is quite possible that an increase in the former would more than compensate a fall in the latter.

Even if it did not, aggregate demand comprises not merely domestic demand, but also export demand. While there is a

limit to the extent to which domestic demand can sustain British based industry, export demand is potentially insatiable. In addition, the employment multiplier associated with export demand is greater than that associated with domestic demand, since a much larger proportion of the latter leaks into imports.

It is within this context that the issue of a statutory national minimum wage should be debated at the TUC Congress. The introduction of such a measure would be likely to further increase unemployment. No convincing empirical evidence exists to substantiate the claim that a statutory minimum wage creates jobs. On the contrary a wealth of evidence suggests that such a policy reduces the employment of those whom it is intended to help. Its adverse effects are focussed on the young, the unskilled, and racial minorities, in short on those groups whose employment prospects have deteriorated most during the recession.

The outcome of the TUC debate on minimum wages is most unlikely to have any effect on the policies of the present government. This is fortunate, since introduction of a minimum wage is an irrelevance at the present time. It is regrettable that the TUC does not press with equal fervour for the introduction of measures which are likely to create employment, and which are not inconsistent with the Government's market-oriented rhetoric or its fiscal stance. Such measures do exist, the most obvious being a marginal employment subsidy.

This proposal has hitherto been rejected by the Dept. of Employment on the grounds that it would distort employers' natural preferences and induce them to hire employees whom they would otherwise not have done. A similar objection could be lodged against existing industrial incentives, against the Young Worker Scheme, against the Micro-Electronics Application Programme, in fact against practically all expenditure and taxation measures. All are designed to alter patterns of behaviour. So is a marginal wage subsidy. Since the government believes that wage moderation is the key to reducing unemployment, and since wages adjust only slowly of their own accord, the logic of the government's own position dictates measures to reduce the costs of labour. The most obvious such measure is a marginal employment subsidy.

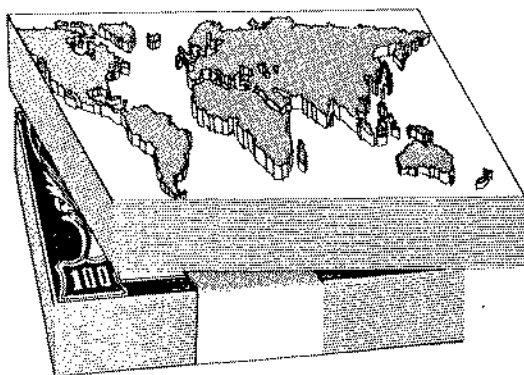
August 20th 1984

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# The World Economy

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coming twelve months are likely to see a greater degree of convergence in the economic experience of the major countries. Growth in the US is expected to slow markedly in the latter half of this year while that in the remainder of the OECD should accelerate.



The strength and likely duration of the upturn are overshadowed by several factors. Firstly, high real interest rates, in large part a consequence of expansive American fiscal policy, threaten the stability of the international financial system. Secondly, persistently high real rates may shortcircuit the investment recovery already under way by channelling corporate profits into the liquidation of debt rather than the expansion of capacity. Thirdly, though the immediate threat to oil supplies posed by the Iran-Iraq war appears to have diminished, world oil markets remain in a state of flux.

The year to date has seen a marked broadening of the geographic base of the recovery which now embraces not just North America, but most of the wider OECD area as well. The generalised expansion in the developed world has in turn been transmitted to developing countries as demand for commodities and semi-manufactures has increased. The volume of world trade, which increased by only 2% during 1983, is likely to increase by 5% during the current year. The stimulus provided by consumers' expenditure and the inventory cycle in the early stages of the upturn is increasingly being supplemented by export demand. The gathering pace of recovery has wrought a turnaround in the finances of the corporate sector, which in turn has contributed to a revival of private fixed investment.

Medium term prospects for oil price remain more than usually uncertain, with little firm information on the volume of OPEC output. This uncertainty was superimposed on financial markets already unsettled by the US budget deficit and contributed to a period of considerable instability on foreign exchange markets in July, culminating in a further upward ratchet of international interest rates. While inflation shows little sign of again becoming a major international problem in the immediate future, unemployment shows every sign of remaining one for at least the duration of this decade despite some evidence that recent quarters may have witnessed a moderate increase in employment.

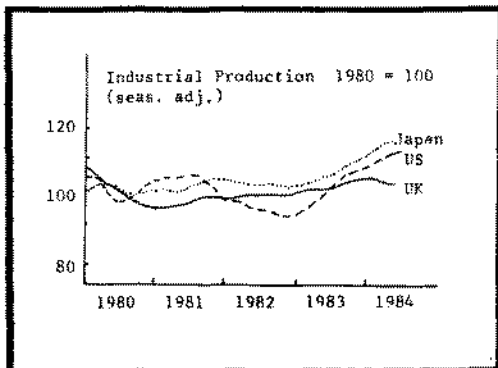
## OUTPUT

Though the recovery outside the US has been slow by historical standards, the

Notwithstanding the broader geographic base of the recovery, growth in the

industrialised world continues to be dominated by the pace of expansion in the US. Revised data for the second quarter suggest that the pace of expansion there was only marginally slower than the exceptionally high 9% rate recorded during the first. The dollar and American nominal interest rates accordingly rose to new record levels as corporate and personal credit demands were superimposed on the already large structural budget deficit.

Rising interest rates should bring some slackening of the pace of US growth during the remainder of this year with growth on a fourth quarter to fourth quarter basis likely to be of the order of 6.5%. Though similar expectations of some slowdown in the US economy have been frequently voiced in the past, the recent fall in the index of US leading indicators suggests that a deceleration is now imminent. For the OECD area as a whole growth from fourth quarter to fourth quarter is likely to amount to 4%, marginally faster than expected some months ago. In particular, growth rates have been revised upwards in Germany and Japan, and marginally downwards in the UK and France.



Industrial production in the OECD area increased by 8.4% in the year to April. The bulk of this increase was accounted for by the US and Canada where industrial output rose by almost 13% during the twelve month period. For OECD Europe and the EEC the annual rate of increase was

much more modest at just under 3.5%. The figures for manufacturing are marginally higher than those for industry as a whole.

The changing character of the recovery reflects its broader geographic spread. With the exception of the US economy, the trade balance and private investment have now assumed the stimulatory role fulfilled in the early stages of the upturn by consumers' expenditure. The US trade deficit has its partial counterpart in the surpluses of Germany and Japan, where as a result domestic demand is now expanding. Rapid productivity growth has translated into strong corporate balance sheets. The availability of internal finance and the stable inflation outlook have induced a recovery in business investment and, to a lesser extent, in stockbuilding. However, the persistent upward trend in real interest rates threatens the investment revival, as debt retirement becomes an increasingly attractive alternative use of corporate funds.

#### LABOUR MARKETS

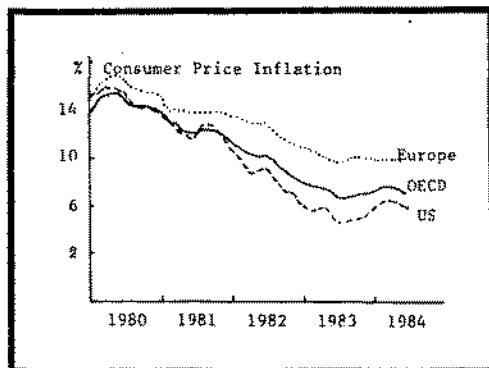
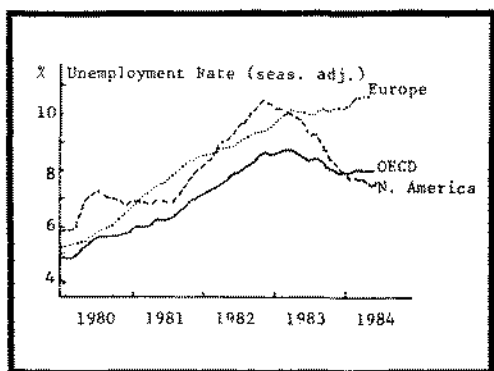
The rapid pace of expansion notwithstanding, unemployment in OECD Europe continues to increase and now exceeds 11% on the OECD's standardised measure. Amongst member countries only the US, Sweden, Australia and Austria have experienced a sustained downward trend. The American experience, where the standardised unemployment rate is less than 8% and falling, reflects the conjunction of rising employment, up by 3.9% in the year to the first quarter of 1984, and a sharp slowdown in labour force growth. Employment in the US has increased in line with output to a much greater extent than in most other OECD economies. The more favourable US employment experience reflects in part a considerably lower rate of increase of real wages since 1973 and more marked changes in the relative price of energy than have occurred in the OECD as a whole. Both of these factors have tended to encourage greater use of labour, and particularly of unskilled labour, in the production process.

While some other member states, such as Canada, Britain and the larger Scandinavian



countries have recorded increases in employment in recent quarters, these have been insufficient to absorb natural growth in the labour force, with the result that employment and unemployment have increased in tandem over the past year. OECD forecasts suggest that all European countries with the exception of France, Belgium and Greece are likely to experience increases in employment over the coming twelve months. In general however, the increases are unlikely to arrest the upward trend of unemployment except in the UK, Germany and Scandinavia.

point reached in mid-1983, there is little sign of any sustained acceleration. Indeed in several cases, for example, Germany, France and Italy, modest deceleration continues. Major international inflation differentials still exist however with inflation in OECD Europe markedly higher than in the OECD area as a whole. The average annual OECD inflation rate of 5.4% in May subsumes a European rate of 8.7%, and an EEC rate of 7%. Within the EEC itself, national rates of inflation range from 2% in Germany and 4.5% in the UK to 7.5%, 11% and 17% in France, Italy and Greece, respectively.



In those countries where an increase in employment has been recorded, there is no obvious uniform sectoral pattern. In the British case the increase has occurred almost entirely in the service sector with manufacturing employment at best only stabilising in recent months. In the US the increase in employment has been more broadly based with approximately two jobs being created in industry for every five created in services. Whereas the net increase in employment recorded in the US occurred primarily amongst males, with a male-female ratio of 3:2, growth in employment in Britain has occurred entirely amongst females, with a heavy bias towards part-time employment. This bias has also been apparent in other EEC countries.

While retail price inflation at the aggregate OECD level shows little sign of acceleration, the extent of any deceleration over the coming year is problematic. On the one hand latent inflationary pressures still exist, while on the other, the continuing weakness of dollar-denominated oil and commodity prices acts to restrain any acceleration of inflation. Amongst the latent pressures is the level of capacity utilisation in many member states which is now at or approaching previous cyclical peaks. Despite widespread unemployment and accumulating evidence that downward wage flexibility creates jobs, organised labour is increasingly seeking compensation for the "sacrifices" of the recession years.

## INFLATION

Though the annual rate of inflation in the OECD area is now about 1% above the low

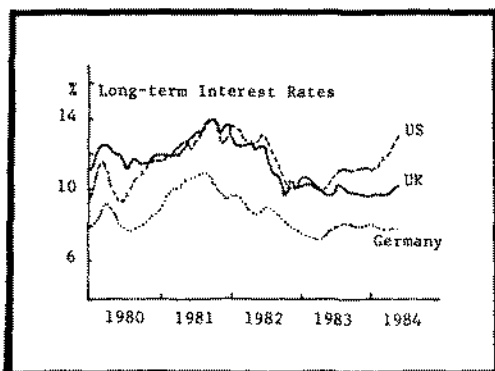
The upward spiral of the dollar has acted to dampen inflationary pressures in the US, but has had the opposite effect in those countries whose currencies have weakened.

For such countries the strong dollar and the associated trend of international interest rates have both increased import prices of dollar-denominated raw materials and raised the cost of borrowing. Both feed indirectly into producer prices, with the latter also directly affecting consumer prices through mortgage rates. In the face of a recovery in the demand for labour the wage moderation of the last few years may prove difficult to sustain now that the decelerating phase of inflation is at an end.

### PROGNOSIS

On a global basis, the pace of growth this year is markedly faster than that experienced in 1983. For the OECD as a whole, GNP is likely to expand by 4% compared to less than 2.5% last year. As the year advances growth should decelerate in the US and accelerate elsewhere. 1985 is expected to see a continuation of this pattern but with growth both in the US and elsewhere somewhat slower than in 1984.

The maintenance of a generalised recovery is crucially dependent on a reversal of the persistent upward trend of real interest rates. Failure to tackle the underlying US structural budget deficit has been the prime cause of rising American and international interest rates.



The inevitable measures to tackle the US deficit must initially slow the pace of growth in the US economy with consequent repercussions on the exports of America's trading partners. Amongst these partners are many debt-ridden developing countries. While dollar depreciation would reduce their debt burden, the associated slowdown of US import demand would simultaneously reduce their foreign exchange earnings used to service outstanding debt. Dollar depreciation would also depress internal demand in developing countries by reducing the domestic currency proceeds of earnings from commodity exports. It is not clear therefore that a reduction in interest rates wrought by a reduction of the US budget deficit would initially remove the threat to the stability of the international financial system posed by Third World indebtedness.

In the event of a successful program to reduce the US budget deficit and subsequent depreciation of the dollar, America's industrialised trading partners would also face a slowdown in export demand. This would result both from a slowing of the pace of expansion in the US and an improvement in the competitiveness of US producers.

In the short run therefore measures to tackle the US budget deficit must slow the pace of global expansion. Such a slowdown is the converse of the stimulus which the deficit has provided to the world economy over the past three years. Given the depth of the 1979-81 recession, a fiscal stimulus was required, but not on the scale and duration of that administered by the American Administration. The US deficit was instrumental in pulling the world economy out of recession, but now threatens, through its effects on foreign exchange and financial markets, the durability of the recovery.

Though the short run effects of remedial action in the US must slow the pace of global expansion, in the longer run elimination of the structural component of the deficit would provide a foundation for sustained expansion of the world economy over the remainder of this decade. It would at the same time help to defuse the latent threat to the stability of the international trade and financial systems posed by the

present level of global real interest rates. That in turn would offer some prospect of making significant inroads into present levels of unemployment, prospects which on present policies are acknowledged to be almost non-existent.

The longer the US authorities delay in introducing discretionary measures to tackle the deficit, the more likely that such measures will be forced on them by events themselves. The present scale of the twin US trade and budget deficits is not sustainable indefinitely. The budget deficit manifests itself in rising interest rates. Even though interest payments in the US are tax-deductible to a greater extent than in most other countries, such provisions can only reduce and not eliminate the effects on debtors when rates are rising. Rising US interest rates must therefore eventually cause a slowdown in domestic demand.

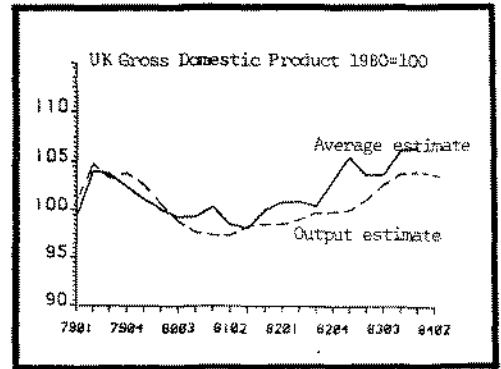
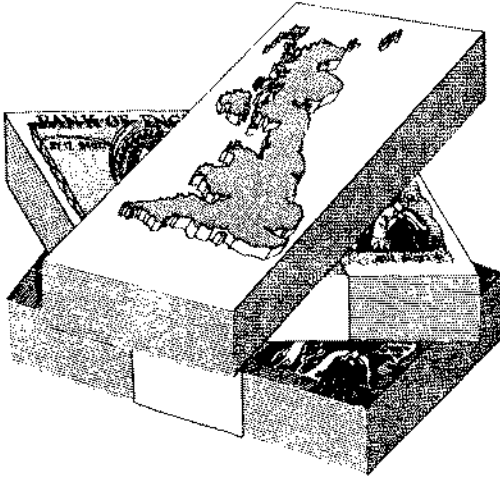
Such a slowdown would reduce the trade deficit, but **increase** the budget deficit as tax revenues fell below the Administration's optimistic forecasts. The financing of an even larger deficit would add to the upward pressure on interest rates, in turn further depressing both US domestic demand and tax revenues. Long-postponed measures to tackle the deficit would then become essential, but would coincide with and deepen an existing cyclical downturn. Far better to take such measures in the near future, when the economy is in a strongly expansionary phase and when their effect would be contra-cyclical, than have them act pro-cyclically during a period of slowdown.

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# The British Economy

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unemployment close to present levels into 1985.



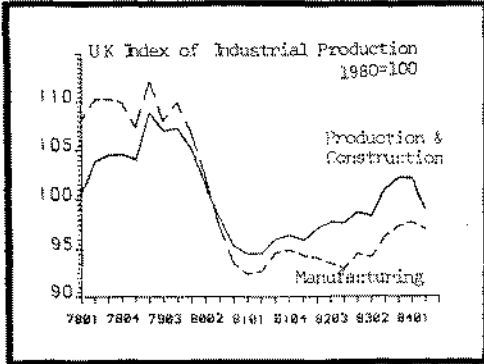
## MACROECONOMIC TRENDS

Growth in the British economy came almost to a halt during the first half of 1984. The output measure of GDP, usually considered the most reliable, was practically unchanged during the first three months of the year, with preliminary estimates pointing to a fall of about 0.5% during the second quarter. It is unlikely that the annual growth rate will reach 2.5% this year. Official end year inflation targets are also unlikely to be achieved. Employment should continue to increase, but less rapidly than in 1983. The slower pace of employment growth, coupled with the overhang of unregistered jobless, will maintain registered

Stagnation in the first quarter primarily reflected a contraction in the volume of consumers' expenditure and a renewed bout of destocking. The fall in consumption reflected a marked decline in real personal disposable income from the unexpectedly high level of the fourth quarter of last year and the maintenance into the first quarter of the higher savings ratio recorded since the middle of 1983. Two factors peculiar to the first quarter also acted to depress the level of consumers' expenditure: the late occurrence of Easter and a heavy take-up of new life assurance policies in anticipation of Budget measures to abolish tax relief on life premia. The contraction in consumers' expenditure and the return to destocking more than offset increases in fixed investment and exports and a marginal fall in imports.

Preliminary estimates suggest that the output measure of GDP fell by about 0.5% during the second quarter. Though consumers' expenditure again resumed its upward path, destocking continued and there was little growth in either exports or fixed investment. Government expenditure did however increase rapidly and during the

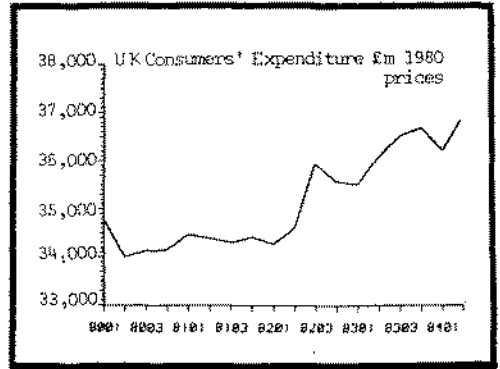
first four months of the financial year was 7.5% higher than the corresponding period last year. Since the planned increase in government spending in 1984/5 is only 5.75%, some slowdown in this component of demand is implied in later quarters if targets are to be met.



The general level of output during the second quarter was depressed by industrial unrest with the index of production falling by 3% compared to the first three months of this year. As a result industrial output in the second quarter was little changed from that of a year ago. The principal cause of the poor second quarter industrial performance was a quarter-to-quarter drop of 8% in the index for energy and water supply industries. The narrower manufacturing output index, which does not include these particular industries, has not been as dramatically affected by the coal dispute. Manufacturing output during the second quarter, though marginally down on the first, was still 2.5% higher than the corresponding quarter last year. Even this figure is misleading as it reflects strong output growth in the third, and to a lesser extent fourth, quarters of 1983, since when the volume of manufacturing output has been on a downward trend.

Consumers' expenditure resumed its interrupted upward trend during the second quarter, rising by 2% from its depressed first quarter level. Even though the volume of retail sales in the second quarter was the highest ever recorded, sales during the first half of the year were only 0.7% above those of the latter half of 1983. Since the turn of the year

the CBI-FT survey of distributive trades has recorded a succession of months where sales expectations have not been fulfilled. The monthly pattern of retail sales has become quite erratic, with a further dip recorded in July. The miners' dispute, through its effects on the disposable income of those affected, must act to depress demand, while the substantial rise in mortgage rates will reduce discretionary household income and spending.



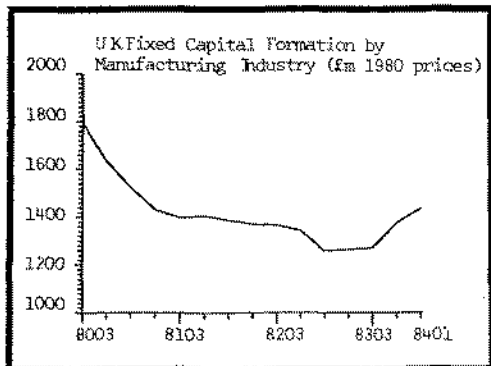
The direct and indirect effects of the prolonged disruption in the coal industry are likely to reduce the annual rate of growth of GDP this year by about 0.5%. The growth profile last year was such that, even if GDP during the remainder of 1984 remains almost unchanged from its first quarter level, the year-on-year growth rate will still approach 2%, though the fourth quarter to fourth quarter rate would be markedly lower. Resolution of the miners' dispute and a return to growth during the final quarter would be unlikely to bring the out-turn to more than 2.5%, well short of official Treasury forecasts.

The attainment of a growth rate significantly in excess of 2% this year relies on fixed investment and exports fulfilling in part the stimulatory role played by consumers' expenditure and stockbuilding during the earlier stages of expansion. It appears that a marked recovery in private fixed investment is in fact taking place. The volume of industrial investment in the first half of this year was 13% higher than in the corresponding period of 1983. For manufacturing the increase was even higher at 15%. However,

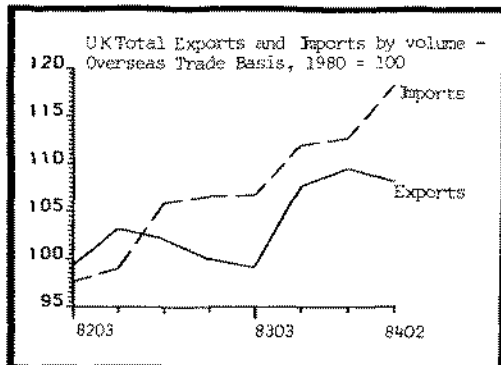
the recovery in investment occurred almost entirely in the first quarter with little further growth during the second.

The increased contribution of investment to aggregate demand reflects a significant improvement in the financial surplus of the corporate sector and some rescheduling of projects in the light of the Budget changes in the structure of capital allowances. The most recent DTI Investment Intentions Survey suggests a rise of 9% in the volume of fixed investment in the course of this year. The forecast increase for manufacturing investment is somewhat greater, with intentions particularly strong in metals, engineering, vehicles and textiles. Even if the predicted increase occurs, manufacturing investment will still be about 30% below peak levels reached in 1979. Allowing for the contraction in manufacturing since that date, it would appear that investment in this sector is currently taking place at a pace broadly similar to peak pre-recession levels.

While fixed investment appears to be fulfilling the role envisaged for it in 1984 forecasts, it is difficult to say the same of exports. The volume of exports during the first half of the year was



1% up on that of the final quarter of 1983, while the volume of imports increased by 3% over the same period. The current account surplus of 1983 was maintained during the first quarter of the current year but replaced by a substantial deficit during the second.



The second quarter deficit stemmed from a marked deterioration in the balance of visible trade, which swung from approximate balance in the final quarter of 1983 and the first quarter of 1984 into a deficit of £1.3bn during the second. The bulk (£800m) of the second quarter deficit was accounted for by a sharp fall in the surplus on oil as domestic stocks were built up in anticipation of further disruption in the Gulf and as imports of fuel oil to power stations were increased to reduce reliance on coal during the miners' dispute.

Nonetheless, the behaviour of the non-oil account during the second quarter was not particularly encouraging. Even though sterling's effective exchange rate was 4% lower in the first half of 1984 than in the latter half of 1983, the volume of non-oil exports has shown little change since the final quarter of last year. Exports to European countries fell marginally during the second quarter while those to developing countries continued their downward trend. Only exports to centrally planned economies recorded any marked increase. Though the volume of exports has shown little further growth since the final quarter of last year, the level during the first half of this year was still some 6% above the average for 1983 as a whole.

Price inflation remained close to 5% during the first half of this year, before falling to 4.5% in July. Average earnings in the whole economy continue to increase at just under 8%, but at over 9% in manufacturing. Consequent real income gains for those in employment would therefore be considerable even in the absence of recovery in corporate

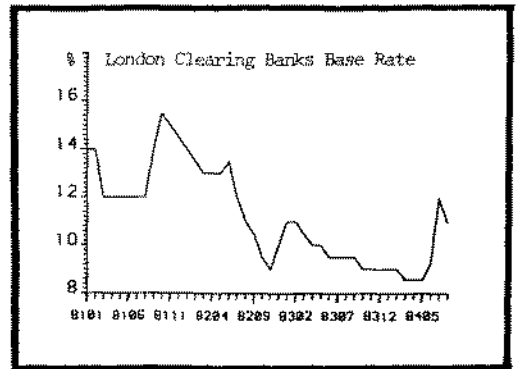
dividends and reductions in the real burden of taxation. Since the vast majority of the labour force fall into this category aggregate real personal disposable income this year is likely to increase by almost 3% on its 1983 level.

Stable price inflation appears to bolster consumer confidence, which, coupled with the marked upward trend in disposable income, underpins the somewhat slower growth of consumers' expenditure now that the downward trend in the savings ratio has been reversed, at least for the present. The savings ratio rose to 9.2% during the first quarter compared to 8.3% in the corresponding period a year earlier. A resumption of the downward trend in the ratio would appear crucially dependent on inflation remaining at present levels or falling further. Historical data suggest that there is scope for a permanent fall of 1.5 - 2% in the savings ratio from present levels if inflation were perceived to stabilise at 5%.

The official target of 4.5% inflation at the end of the year no longer seems attainable. Though only the food and housing components of the Retail Price Index were increasing at annual rates in excess of 4.5% over the twelve months to June, and while there is some evidence of a deceleration in the rate of increase of food prices, in recent months, this will be more than offset by the effects of sterling's depreciation and the increases in interest rates in July. It is unlikely however that the annual rate will exceed 5.5% by the end of the year. The prospect of a continued reversal of the upward trend in interest rates will act to bring the inflation rate back towards official targets during 1985, though their attainment is by no means certain.

A swift reduction in interest rates to levels compatible with actual and prospective inflation is vital to the maintenance of the recovery, official protestations notwithstanding. Present levels of real interest rates, already historically high before the July increases, must act to depress activity in both the personal and corporate sectors. Rising interest rates not only reduce discretionary personal income as mortgage commitments increase, but also make consumer credit, one of the foundations of the upturn to date, increasingly unattractive. Though the personal sector

is in aggregate a net lender, the redistribution of income within the sector wrought by rising interest rates is likely to reduce the marginal propensity to consume by diverting income from younger to older people. For the corporate sector, rising real interest rates reduce the rate of return on investment projects, an effect which will be reinforced over time by the reduction in capital allowances. Repayment of corporate debt becomes an increasingly attractive alternative to investment in plant or inventories as interest rates rise.



## THE LABOUR MARKET

### EMPLOYMENT AND UNEMPLOYMENT

The primary source of information on the numbers in work (the "employed labour force") used to be the annual Census of Employment. However, the annual census fell victim to one of the Rayner reviews and survives only in an emasculated triennial form, the two most recent being in 1978 and 1981. In the interval between censuses official quarterly estimates of the numbers in work are based on monthly and quarterly surveys of employers, with subsequent revisions of the estimates when the results of the next Census of Employment or Labour Force Survey become available.

When the preliminary results of the 1981 Census of Employment were published in mid-1983, it was obvious that substantial upward revisions were required to the survey-based quarterly estimates for the period 1978-81. Just how substantial was not initially

realised as the preliminary results of the Census themselves were extensively revised upwards in the latter half of 1983. An obvious question then presented itself, namely what was to be done with the post 1981 estimates of employment which, being survey-based, were obviously flawed? The solution adopted was to assume that the quarterly underestimation of employment revealed over the period 1978-81 was still continuing and to make an appropriate cumulative adjustment to the survey based estimates each quarter.

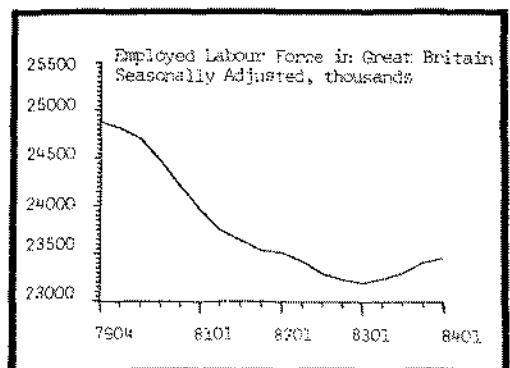
This rule of thumb did not meet with universal approval. The reason for the scepticism was straightforward: On the face of it 1978-81 represented quite a different phase of the economic cycle than 1981-83. The former included a period of rapid expansion to mid-1979, followed by a steep descent into recession. The latter, by contrast, was a period best described as bouncing along the bottom. It was not at all obvious that the evolution of employment would be similar in both periods.

However, in the absence of further data independent commentators could do little more than draw attention to what they considered the somewhat dubious nature of the official estimates. Such additional data has just become available from the 1983 Labour Force Survey. The latest information suggests that the CSO estimates for the employed labour force in the period 1981-83, even with the controversial ad-hoc adjustment, were again too low!

Quarterly estimates of employment since June 1981 have therefore had to be revised yet again to render them consistent with the Labour Force Survey results. For quarters after June 1983 the CSO have decided that the published estimates will assume that the regular monthly surveys are continuing to underestimate numbers employed by the same margin as over the period 1981-83. The latest figures compiled on this basis suggest that the total number of people at work in Britain increased by 188,000 in the twelve months to last March. The numbers registered as unemployed were broadly unchanged over the same period.

The weak recovery in Britain's traditional industrial sectors is reflected in the changing pattern of employment. Given that non-oil industrial production in Britain is still more than 10% below its 1979 peak, it is not surprising that employment in this sector has continued to fall, with that in manufacturing down by 103,000 in the year to March. In the service sector, by contrast, employment increased by 335,000 over the same period. Most parts of the service sector recorded increases in employment, with particularly large gains in retailing and wholesaling, banking and finance, and business services. By contrast most parts of manufacturing shed jobs, though there were exceptions, of which the most obvious were high tech industries. In addition however, employment also increased in some parts of mechanical engineering, metal goods and industries associated with construction.

The increase in employment has occurred almost entirely amongst women, who filled 181,000 of the 188,000 net new jobs created in the twelve month period. The pattern which emerges is therefore one in which new jobs are primarily in services and primarily for women. In addition, job creation has been overwhelmingly biased towards part-time work, with the number of full-time females in employment actually falling by 31,000 in the year to March. Yet as far as the CSO estimates of total employment are concerned no distinction is made between full and part-time work. A continuing scepticism is in order when an increase in employment of 188,000, announced with much fanfare, is in reality an increase of less than half that number in full-time jobs.





Given such sluggish growth in the number of full-time jobs, coupled with a large pool of unregistered jobseekers, it is not surprising that the numbers registered as unemployed have continued to creep upwards. The number of adults unemployed (excluding school-leavers) increased by almost 65,000 in the year to June. The increase was entirely accounted for by increased female unemployment, the numbers of adult males registered falling by 14,000 over the period.

The number of vacancies increased marginally during the second quarter, but was still below the levels recorded at the end of 1983. About half of the additional vacancies notified during the second quarter were on official employment creation schemes. However, even allowing for this, the monthly inflow of vacancies notified to jobcentres was marginally higher in the second quarter than during the first. The engagement rate of employees in manufacturing continued to increase during the second quarter and was accompanied by a slight fall in the rate of employee separations.

#### **INDUSTRIAL RELATIONS IN BRITAIN**

The miners' strike, whatever its outcome, will have widespread effects for some time. It is likely to dominate the TUC debates in September, to figure prominently in any assessment of the role of the law in industrial relations, and to shape future trends in labour law, police tactics and methods of union organisation in a national strike. It seems likely also to be seen as a test of union alliances: Indeed, one of the interesting features of the dispute thus far has been the limited assistance other unions have been able, or indeed willing, to give the miners. This is in stark contrast to traditional statements of solidarity.

The strike has also been notable for the massive movement of pickets about the country. This has triggered similar police movements and the bringing into operation of sophisticated co-ordination arrangements across forces. Mass picketing has been characterised by violence and intimidation. Considering that no existing miners are being made

compulsorily redundant under the present proposals for the industry and that the voluntary redundancy terms on offer are better than those available to steel workers and others, the level of violence and intimidation is unexpected. One possible explanation is that political grievances and aspirations appear to increasingly determine the NUM's conduct of the dispute. The aggressive action of the miners reflects their strong disapproval of the strict market conditions under which government policy is being conducted, conditions long alien to their industry and which to many in it seem inappropriate in conditions of high unemployment.

Another unexpected feature of the strike has been its duration. In spite of limited social security payments, there has been little evidence of any large scale drift back to work. In an unknown number of cases financial indebtedness may have proved less unpalatable than the prospect of violent intimidation. While NUM funds and donations from other unions and local authorities have been used to support the strike, little is known about the extent of local help operating through food distribution centres etc. Equally little is known of the extent of any increased indebtedness or associated declines in personal savings which may be occurring. At the individual level pressures to return to work cannot but increase with the approach of winter. It remains to be seen whether the counter pressures, both legal and illegal, of striking colleagues increases *pari passu*.

But perhaps the most interesting feature of the strike to date has been the opportunity to test the usefulness of the recent employment legislation. So far there has been little attempt to invoke the civil law to deal with secondary picketing, although widespread successful use of the law and resulting financial pressures on the NUM might be expected to bring a rapid end to the strike. The paradox remains that secondary picketing was outlawed in 1980, as a response to changes in union tactics and increased use of flying pickets, consequently failure to implement the law may only serve to bring it into disrepute.

But instead of greater use of the law reliance seems now to be placed on the co-ordinated movement of massive numbers of police. Whether containment is preferable to enforcement of the law is debatable.

Certainly it must be accepted that the preferred strategy may be determined by political as much as by any other considerations. In addition, if the NCB takes out an injunction against the Yorkshire area of the NUM, for example, but then fails to use it, or only attempts to activate it at a much later date, the court may not be willing to grant the request. It may be felt that the employer is using the law at a time and under conditions that suits him, rather than suits the courts. When considering alternative strategies in the dispute, greater use of the law has therefore to be considered with care.

An industrial relations issue quite distinct from the coal dispute but equally likely to have repercussions in coming months and to be the subject of heated debate at the TUC Congress is the new style company agreement advocated by the electricians union (EETPU). The new style of agreement includes employee consultation arrangements, arbitration as the final method of resolving disputes, and sole negotiating rights. The EETPU has recently concluded an agreement of this kind with Hitachi at Hirwaun in South Wales. This is only the most recent in a series which includes Toshiba at Plymouth, Sanyo at Lowestoft and Inmos at Newport. Perhaps a dozen of these agreements are now operating, many in the high technology sector of industry.

The Toshiba agreement was the first to be struck and became effective from April 1981. It gives sole recognition and bargaining rights to EETPU, all employees enjoy staff conditions of employment normally associated with monthly paid staff and the company agrees to promote membership of the union and participation in its affairs with union dues being collected through a check-off system. Separate disciplinary and grievance procedures and complete flexibility of labour within and among departments are provided for. All issues affecting employees are negotiated in a representative Advisory Board. Disagreements are dealt with under a three-stage procedure, the last stage of which is a binding pendulum arbitration system. Here, an arbitrator accepted by both parties is required to find in favour of either the company or the union: A compromise solution cannot be recommended.

These agreements generally do not contain a specific commitment to reject the use of the strike weapon. Only in a few cases, such as the Hitachi agreement, is there a commitment to resolve disputes without the use of any form of industrial action. It is this type of agreement that poses the greatest concern to other unions and which is likely to be the subject of heated debate at the TUC Congress. The attraction of these types of agreements, at least to EETPU, is the numbers that can be enrolled in membership. But since only the EETPU is subsequently recognised by management, employees who are members of other unions see no benefit in retaining that membership.

A number of unions in the plants concerned have therefore objected strongly to the EETPU strategy. The electricians union has argued that in many cases it is a question of making an agreement of this kind or no agreement at all. The counter-argument proffered by other unions is that the same ends could largely be achieved using existing agreements which operate a cooling-off period when conciliation and arbitration fail to solve a dispute. They argue that agreements of this type are preferable to the virtual rejection of the strike weapon. In addition, trade unions are wary of employers playing off one union against another to get EETPU-type agreements.

Faced with falling union membership, a changing occupational structure and a tight legal environment, trade unions will be forced to clarify their attitude to collective agreements of the EETPU type. At the very least it may encourage exploration of alternatives.

Another issue likely to loom large in the TUC debates in September, and in the annual negotiations on pay and conditions in the autumn, is the claim for a 35 hour week. Cuts in working hours were recently endorsed by the EEC provided they could be achieved without a rise in unit costs. Despite the British government's failure to endorse the idea, it is still likely to be a significant influence in negotiations in the autumn. The Engineering Employers' Federation are currently studying the Confederation of Shipbuilding and Engineering Union's claim for a 35 hour week as part of a general revision of the national agreement covering the engineering industry. It is possible that some cut in hours will be agreed. The idea has received continuing support from the TUC, which has operated a Campaign for

Reduced Working Time for a considerable period. The TUC argue that a number of European countries have made significant progress towards the goal of a 35 hour week and 6 weeks basic holidays with the largest reductions in hours being achieved in these countries with the best productivity records.

Although the 40 hour week has been breached, little real progress has been made in the UK. British hours of work are still generally in excess of those in Europe while holidays remain inferior. Thus normal weekly hours of work (those for which basic rates of pay are applicable) have fallen slowly in recent years and in December 1983 still amounted to 39.2 hours, with average basic holidays standing at approximately 21 days per annum; though actual holidays are often better than the minimum laid down by agreements. The persistence of overtime working in Britain is cited by the TUC in support of their case. In early 1984 approximately one third of operatives in British manufacturing were on average working 8.7 hours overtime per week.

But the main spur to British claims for a reduced working week will be the recent successful parallel claim of the German engineering union I G Metall. After a seven week strike, in which perhaps half a million workers were involved and car production throughout Europe was disrupted, I G Metall settled for a 38.5 hour basic working week from April 1985, with variations to be negotiated at plant level for different grades of workers. This arrangement applies at least until October 1986. The fall in hours is expected to raise unit costs by about 8%.

The reduction in hours secured represents significantly less than total victory for the European trade union campaign advocating a cut in hours as a means of creating jobs. In fact, it has produced a result largely in line with the long term change in working hours occurring in Germany over the last 30 years. Over the 14 years, 1955-1969, working hours in West Germany fell by 5 hours per week to 44; and from 1969-1985 they are now set to fall by 5.5 hours. British negotiators are likely to be fully aware of these changes when they negotiate new agreements in the autumn.

## PROGNOSIS

The recovery in the British economy faltered during the first half of this year. The disruption wrought by the miners' dispute, while only partially responsible for the slowdown, is likely to exert continuing dampening effects, both direct and indirect, on activity during the remainder of this year. The direct effects will be in proportion to the duration of the dispute, the indirect a reflection of its impact on the government's economic strategy. The indirect channels of transmission are interest rates, consumer prices, the exchange rate and the PSBR. All have been adversely affected to some degree by the dispute.

The sharp, but short-lived, rise in interest rates in July, coupled with the stagnation of the first two quarters shows just how fragile the recovery remains, even though it is now in its third year. Neither domestic conditions in product and money markets, inflationary expectations nor the PSBR figures justified the July increase in rates. While the associated weakness of sterling will provide some mild stimulus to exports, the inflationary effects, particularly through mortgage rate increases, may more than offset this by making it difficult to maintain even the slight downward pressure on wage settlements experienced to date.

The miners' dispute cannot wholly account for the slowdown during the first half of the year. The other contributory factor is the failure of other components of demand to compensate for the weakness of consumers' spending and stockbuilding. While there has been a recovery in investment, the same is not true of the trade balance. Export volume has been practically stagnant, imports have continued to grow.

It is difficult to identify a plausible macroeconomic response which would regain the momentum of recovery. A stimulus to domestic demand is not required - the experience of the last three years demonstrates that such a measure acts primarily as a stimulus to Britain's trading partners.

It is however much easier to identify appropriate microeconomic measures. Two in particular deserve mention. First, there must not be another government retreat on

the rationalisation of the coal industry. The adverse implications of such a retreat for other industries in secular decline, and for the future conduct of industrial relations in Britain, would be considerable. No society can long satisfy the material aspirations of its members if resources continue to be devoted to un-economic operations. What government can do is to smooth the path for the required reallocation of resources. In concrete terms this requires measures to secure alternative employment opportunities in mining communities.

The achievement of this goal would be facilitated by the second set of microeconomic measures, which would also have broader effects across the whole labour market. The required measures in this case are those which reduce the price of labour relative to capital. The government has taken some tentative steps along this path. They should go much further. Appropriate policies include the promotion of greater wage flexibility, reduction of restrictive practices, reductions in capital investment incentives and increases in incentives to hire labour. Current levels of unemployment require such measures as a matter of urgency.