

Chapter 3

Questions and evidence

This chapter provides evidence on specific questions about recent developments in the UK economy which are particularly important for the evaluation of government policy. The topics covered are wages and prices, employment and unemployment, the exchange rate, industrial exports and imports, and industrial restructuring.

3.1 Wages and prices

(a) Has the recession reduced wage inflation?

Having rejected incomes policy, the present government intended in principle to restrain inflation by restricting growth of the money supply. But the money supply has grown unusually fast. In practice the main forces which might have restrained the rate of increase of money wages have been cash limits imposed on the public sector and the financial squeeze on public and private industry induced by the high exchange rate for sterling, the recession of output and high interest rates. The bargaining position of employees may also have been weakened by the rise in unemployment and by the government's insistence that it will not bail out jobs put at risk by wages in excess of what employers can afford.

Here we examine the general rate of increase in money wages in recent years, and the pattern of settlements during 1980, to see how effective these pressures have been. We use the tax and price index published by the CSO as a convenient benchmark for assessing the buoyancy or otherwise of settlements and earnings. Changes in this index show how much pre-tax money pay would have had to rise in order to compensate an average taxpayer for changes in prices and tax rates (including national insurance contributions). Real take-home pay will implicitly have risen or fallen in any period depending on whether money earnings rose by more or by less than the tax and price index.

Chart 3.1.1 shows the ups and downs of wage settlements and earnings in recent years. After an increase in inflation in 1974-5 which was fed by cost-of-living payments, real wages fell during 1976 and 1977 as pay policy brought settlements

well below increases in the tax and price index. In general this depression of real wages was recouped in 1978 as pay policy broke down and in 1979 when the present government formally renounced pay policy.

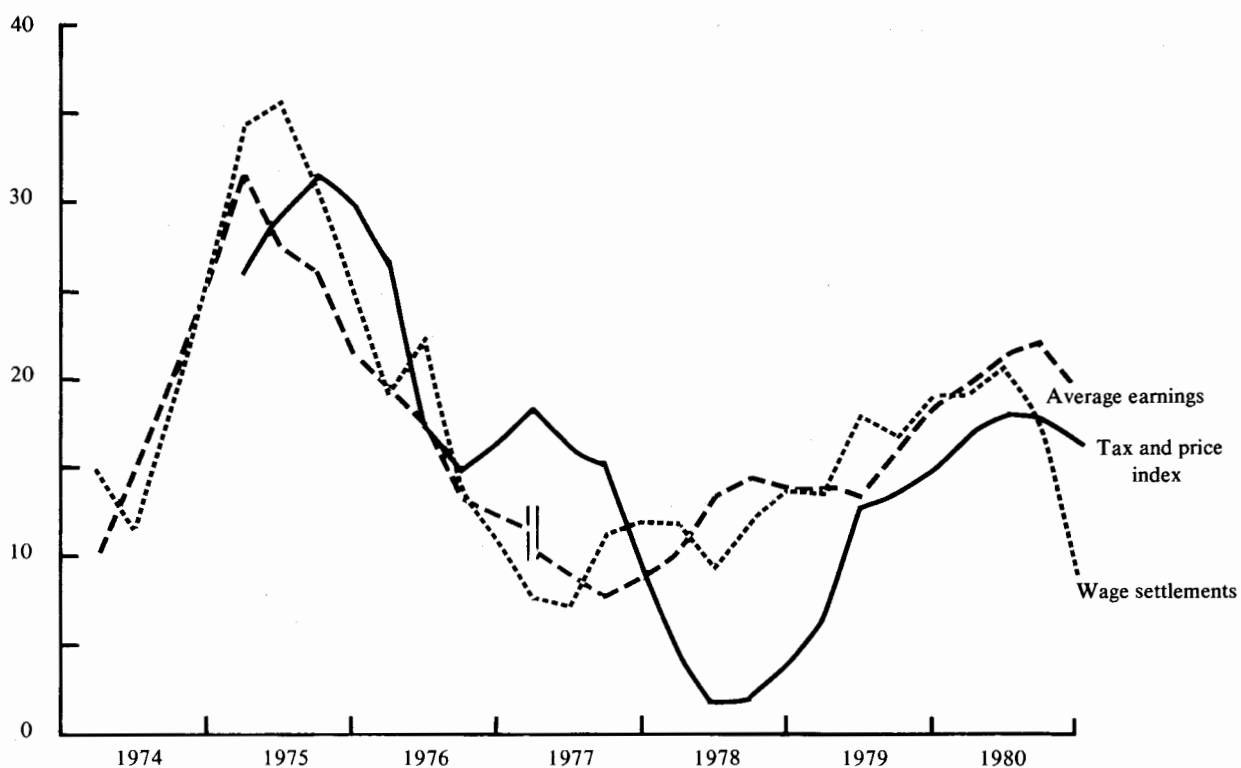
Wage settlements showed no sign of being depressed by recession until well into 1980. But in the last quarter of the year they fell sharply below the tax and price index and the annual increase in average earnings started to come down.

In Chart 3.1.2 we have divided money earnings into three groups — the public sector (including nationalised utilities), manufacturing, and the rest of the private sector. The first group should be relatively the most affected by cash limits and the second group by the strength of sterling. The third group may have been affected by the general state of recession and high unemployment. In 1979 and throughout 1980 public sector earnings in fact remained well ahead of increases in the tax and price index because of the catching-up which followed several years of public sector pay restraint under the previous Labour government. In the manufacturing sector the annual rise in earnings fell below the tax and price index towards the end of 1980, while in the rest of the private sector, less directly vulnerable to the high exchange rate, the rise in earnings just kept ahead of price and tax increases.

Charts 3.1.3-3.1.5 show that wage settlements in all three groups have in most cases fallen below the tax and price index since August 1980 (the majority of manufacturing settlements have been below the index since May). The impression given by the charts is that the various pressures connected with cash limits, the high pound and recession are holding settlements in all sectors on average at about 5% below the tax and price index.

Relatively low wage settlements in the manufacturing sector are hardly surprising at a time when unit labour costs are some 40% higher than normal relative to those of competitors and when manufacturing output has fallen 15% in a single year. The common practice of roughly keeping up with tax and price changes was bound to be modified in such extreme circumstances.

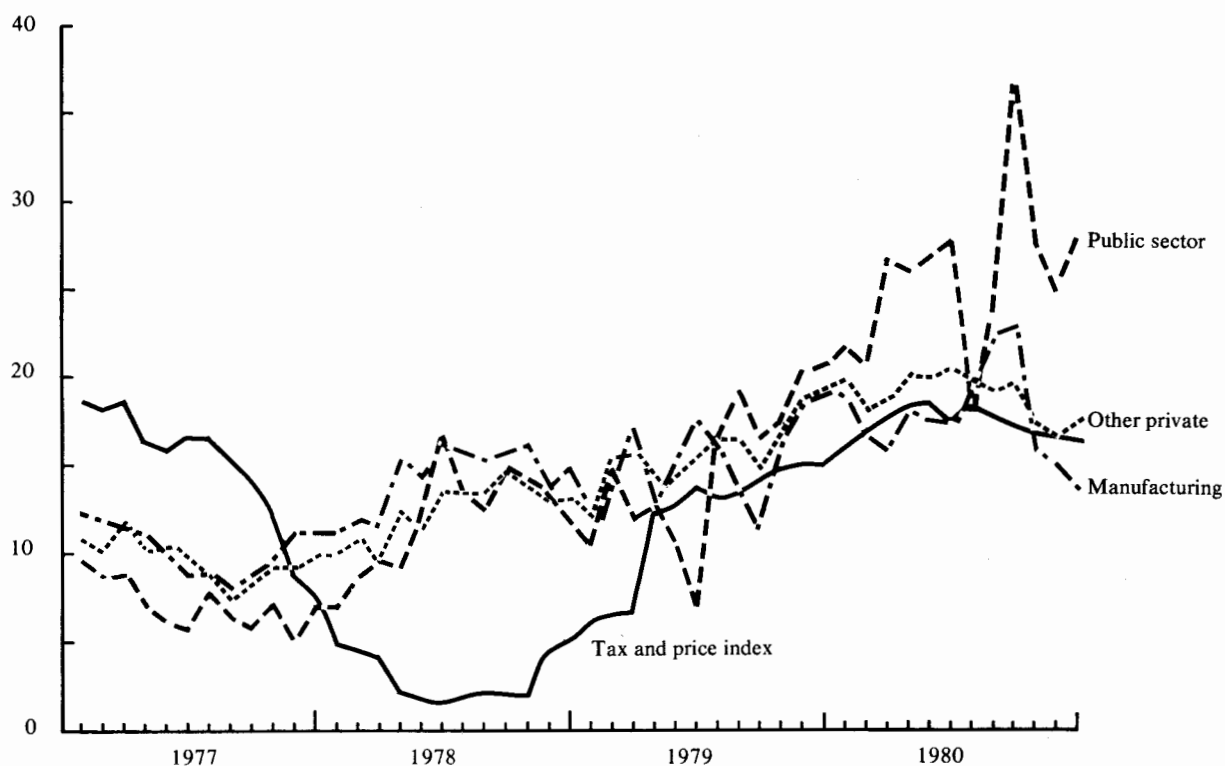
Nor is the squeeze on public sector pay



Sources: *Monthly Digest of Statistics*, *Department of Employment Gazette*, *Time Rates of Wages and Hours of Work* (Department of Employment)

Note: The break in the line for average earnings marks a switch from the 'old' to the 'new' series published by the Department of Employment.

Chart 3.1.1 Wage settlements and average earnings, 1974-80
(percent increases over same quarter in previous year)



Source: *Department of Employment Gazette*

Chart 3.1.2 Average earnings, 1977-80
(percent increases over same month in previous year)

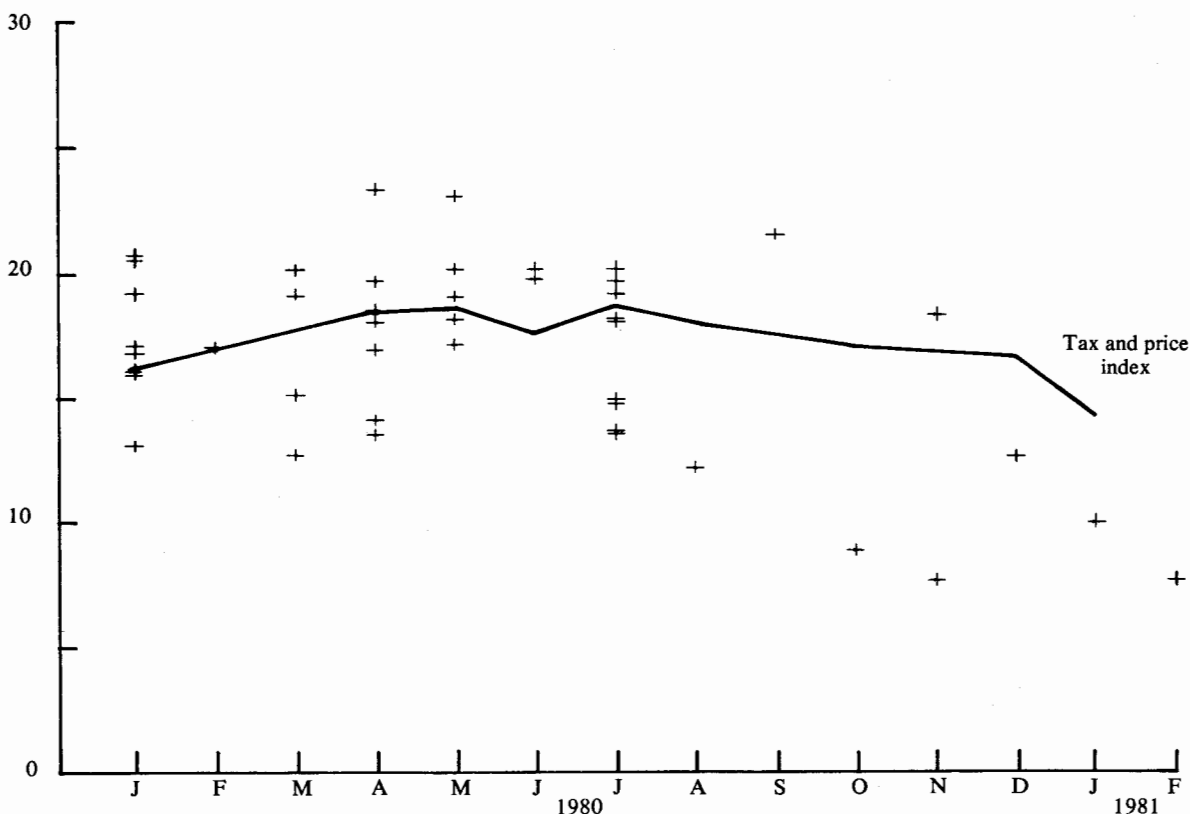
settlements at all unusual. In the 1970s, the Heath government's attempt to de-escalate wage inflation by applying the 'n-1' formula to the public sector, the 1972-74 incomes policy and the Labour government's Social Contract all had a detrimental effect on the relative pay of public sector workers. The reaction of public sector unions led eventually to militant action which forced the government to concede 'catching-up' deals. This time the squeeze on public sector pay is already being resisted with some success. Gas and electricity workers are likely to obtain more than the 10-11% offer they have rejected and water workers are in the process of deciding whether to accept a 13% offer. Civil servants have embarked on an unprecedented programme of disruptive action to secure an improvement in a government offer of 7½% and to prevent the dismantling of the machinery which has traditionally kept public sector pay in line with private sector pay.

Low settlements in the private sector outside manufacturing are not necessarily or entirely to be explained by high unemployment. Some industries such as road haulage are very directly affected by the squeeze on manufacturing. In some other cases

traditions of comparability with manufacturing, or indeed with parts of the public sector, may have helped to hold settlements down.

To some extent, the fall in wages relative to prices is more than we would have expected in the absence of a formal incomes policy and it is quite probable that a high level of unemployment has modified, at least temporarily, workers' attitudes to real wage reductions, particularly in sectors where the high exchange rate has dramatically squeezed profit margins and directly threatened jobs. However, given the pressure by the government in the public sector and the possibility that declarations of policy by the government also have had some moderating influence, it is difficult to disentangle the effects of recession or to assess how long these effects might last.

So far there is no clear or strong indication that recession will depress the growth of money earnings in any enduring way. If the pressure on manufacturing is relieved by a continuing fall in the exchange rate and if action by public sector employees nullifies cash limits, it is quite possible that the rise in average money wages could once again catch up with price and tax increases, whatever the level of unemployment.



Sources: Income Data Services Ltd, Department of Employment and national press.

Note: Each mark represents a wage settlement expressed as an increase on a year ago. In all three charts, only settlements made at roughly annual intervals have been included and staged settlements have been cumulated and recorded as a single settlement on the date of implementation of the first stage. In the public sector, new money settlements have not been converted to an annual equivalent rate of increase, but most settlements were made between 9 and 12 months after the previous 'normal' settlement: all comparability settlements have been excluded from the analysis. Data for recent months are incomplete.

Chart 3.1.3 Public sector wage settlements, 1980-81
(percent increases over twelve months)

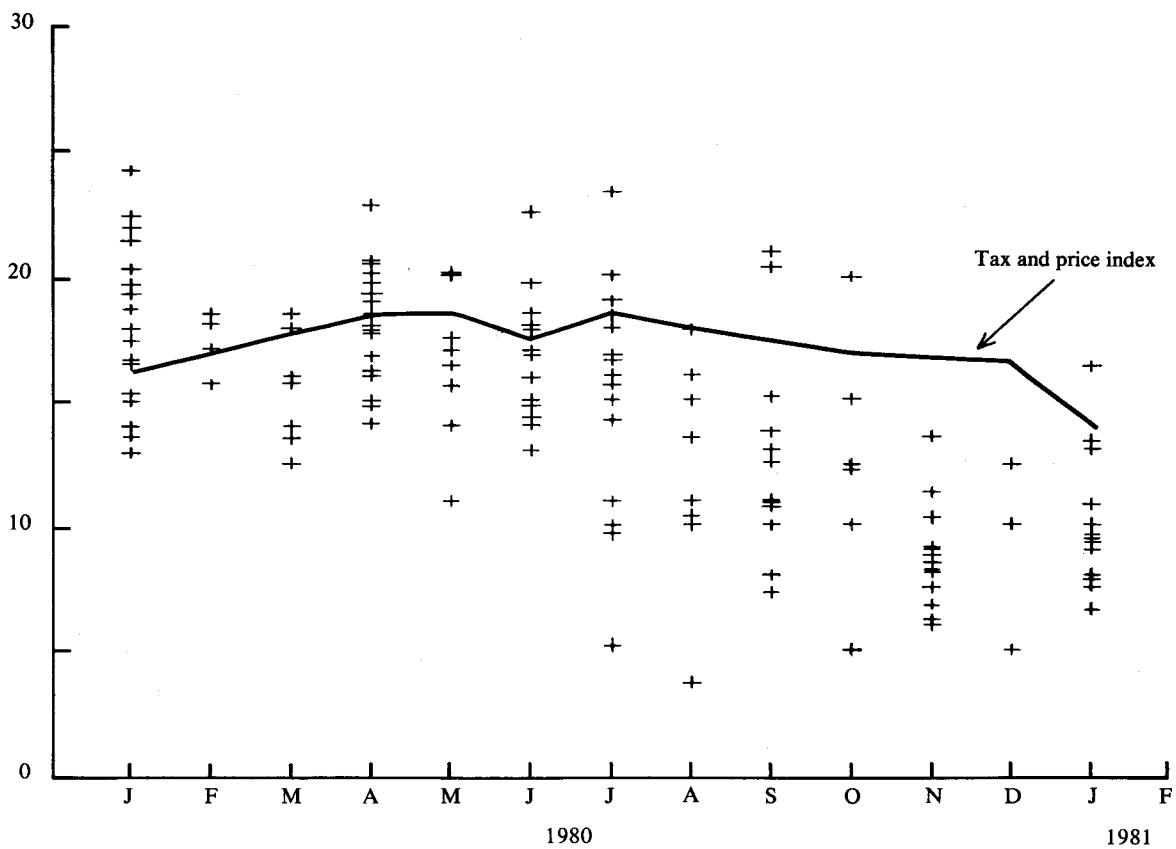


Chart 3.1.4 Wage settlements, 1980-81, in manufacturing
(percent increases over twelve months)

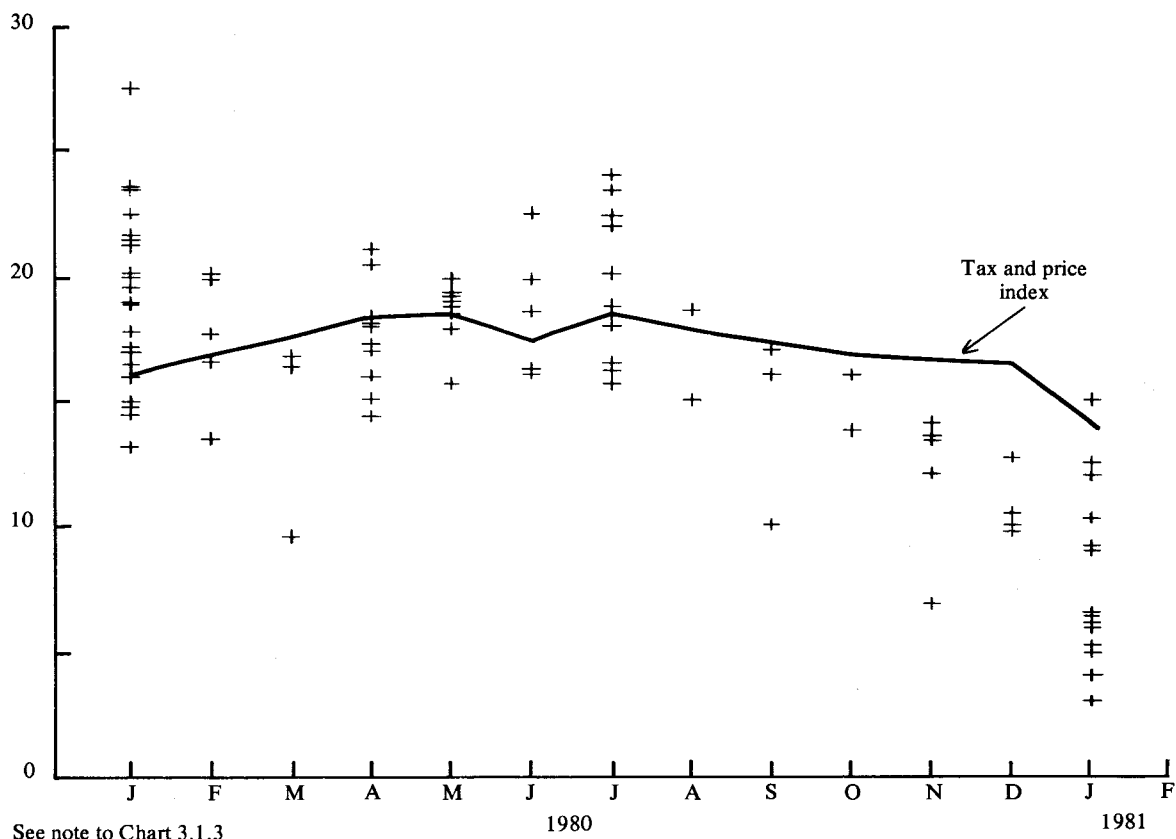


Chart 3.1.5 Wage settlements, 1980-81, in the private sector other than manufacturing
(percent increases over twelve months)

(b) Has the recession held down prices?

The combination of stagnant consumer demand, collapsing domestic industrial markets and the very high real exchange rate for sterling might be expected to reduce inflation by putting severe pressure on firms to reduce profit margins in the hope of sustaining their sales.

Here we examine changes in wholesale prices charged by manufacturers relative to their costs of production and changes in retail prices relative to wholesale prices. These comparisons ought to show whether profit margins have in fact been squeezed.

For manufacturing we construct an index of normal historic unit costs of production.* This cost index abstracts from changes attributable to variations in capacity utilisation and allows for lags in the production process. For the manufacturing sector as a whole we net out costs of components, etc. passing from one firm to another. The index is thus formed from normal unit costs of labour, fuel and raw materials

*K. J. Coutts, W. A. H. Godley and W. D. Nordhaus, *Industrial Pricing in the United Kingdom*, CUP, 1978.

weighted according to their share in total costs of the sector. In the past this cost index has generally given good predictions of changes in wholesale prices charged by manufacturers for home sales. With constant profit margins on *normal* costs, profits actually achieved have varied with capacity utilisation. The question to be examined here is whether recent pressures on manufacturers have led them to reduce their mark-ups on normal unit costs, implying an unusually sharp fall in profits in the present recession.

Table 3.1.1 shows that prices charged by manufacturers had risen considerably more than the normal cost index when the system of official price control based on allowable costs was dismantled in 1977, leaving the government with only residual investigatory powers. From the second to the fourth quarter of 1980, however, prices have risen less than the normal cost index. Comparing the last quarter of 1980 with the last quarter of 1979, wholesale prices only rose by about 14½% while normal costs rose by nearly 18%. It thus appears that mark-ups on normal unit costs were reduced a little during 1980. There has probably been more discounting of list prices than

Table 3.1.1 Changes in manufacturing prices and costs 1977-1980

		per cent changes over previous quarter		
		Wholesale prices ^a	Normal historic unit costs	Discrepancy
1977	Q1	5.5	2.3	+3.2
	Q2	4.5	1.8	+2.7
	Q3	2.6	1.6	+1.0
	Q4	1.9	1.1	+0.8
1978	Q1	2.3	0.7	+1.6
	Q2	1.9	1.6	+0.3
	Q3	1.9	2.2	-0.3
	Q4	1.9	1.8	+0.1
1979	Q1	3.1	2.3	+0.8
	Q2	4.6	3.7	+0.9
	Q3	5.6	4.4	+1.2
	Q4	3.3	4.3	-1.0
1980	Q1	6.1	5.2	+0.9
	Q2	3.7	5.3	-1.6
	Q3	2.6	3.8	-1.2
	Q4	1.3	2.4	-1.1
1981	Q1 ^b	2.6	1.8	+0.8

^a Home sales by manufacturing industry (excluding food manufacturing).

^b Partly estimated.

Sources: *Department of Employment Gazette*, January 1981 and various issues. *Monthly Digest of Statistics*, January 1981 and various issues.

Table 3.1.2 Changes in wholesale and retail prices 1977-1980

		per cent changes over previous quarter			
		Retail prices		Cost of goods purchased by retailers ^b	Discrepancy
		All items	Relevant items ^a		
1977	Q1	5.0	4.6	4.8	-0.2
	Q2	4.5	4.3	3.8	+0.5
	Q3	1.5	2.1	3.0	-0.9
	Q4	1.5	2.1	2.2	-0.1
1978	Q1	1.7	1.7	2.0	-0.3
	Q2	2.8	2.1	2.6	-0.5
	Q3	1.7	2.1	2.4	-0.3
	Q4	1.7	2.0	2.2	-0.2
1979	Q1	3.1	2.4	2.5	-0.1
	Q2	3.7	3.6	2.7	+0.9
	Q3	6.7	8.7	7.6	+1.1
	Q4	2.8	2.4	3.8	-1.4
1980	Q1	4.8	3.1	4.3	-1.2
	Q2	5.8	4.5	3.9	+0.6
	Q3	2.1	1.4	2.3	-0.9
	Q4	1.9	1.3	1.6	-0.3

^a Goods sold by retailers, excluding food, drink and tobacco, (durable goods, clothing and footwear, vehicles and miscellaneous goods).

^b Weighted average of wholesale prices and import unit values for relevant items, adjusted for the VAT increase in July 1979, and lagged six weeks.

Sources: *Department of Employment Gazette*, January 1981 and various issues. *Monthly Digest of Statistics*, January 1981 and various issues.

usual and goods may have been sold off cheap in the process of destocking. But the shortfall in price increases relative to costs up to the end of 1980 is too small to indicate any substantial change in underlying pricing practices.

Some idea of the effects of the recession on retail margins can be gained by comparing changes in wholesale and retail prices. To make the comparison as close as possible we remove items like housing, fuel and light, and food from the retail price index. The resulting index for 'relevant items' is shown in Table 3.1.2. In recent years movements in the retail price index for goods (excluding food) sold by retailers have closely matched changes in wholesale prices (including prices of relevant imports). There is only weak evidence of any fall in average retail margins in 1980. Comparing the last quarter with the same quarter the year before, the cost of goods purchased by retailers rose by 12½% and retail prices rose by 10½%. The discrepancy is barely significant and, as in the case of manufacturers' prices, may easily be explained by price cuts on surplus stocks. There is thus no evidence that the recession is substantially reducing profit mark-ups in any enduring manner.

3.2 Employment and unemployment

(a) How extensive is overmanning?

It is well known that there has been little overall growth of labour productivity since the mid-1970s. This can hardly be attributed to a reduction in the competitive pressures which stimulate the introduction of new technology and working practices. It may to some extent reflect delays in the adjustment of employment to under-utilisation of capacity. The main reason must have been job-saving practices, including government-sponsored schemes.

Here we examine changes in employment in manufacturing, other industries (construction, gas, electricity and water, transport and communication) and private services to see how extensive job-saving has become and to assess whether the fall in employment in 1980 implied any reduction in the degree of overmanning.

To obtain estimates of job-saving from aggregate data, it is necessary to form a view about the 'normal' movement of employment relative to output. Charts 3.2.1-3.2.3 show the history of

output and employment in each sector*. The dotted lines show employment predicted as a function of output with minor adjustment lags† and, in the case of 'other industries', corrections for the effects of rationalisation in electricity supply and railways‡. It will be seen that up to 1974 employment in manufacturing and other industries was close to the level predicted as a function of output. (The number of jobs in private services was below the predicted level from 1967 to 1973 because SET caused a substantial reduction in employment in services.)

The charts show that in all three sectors employment has been abnormally high relative to output since 1975 or 1976. Recent reductions in employment in manufacturing and other industries have been modest compared with reductions in output. In private services employment has increased steadily while the growth of output has fallen back.

Table 3.2.1 shows year-on-year changes in employment, actual and predicted, between 1973 and 1980. The discrepancies give a rough measure of 'abnormal' job-saving. By 1980 the cumulative discrepancy between actual and predicted changes

in employment amounted to an additional 2 million jobs in all three sectors combined. The implied estimates of job-saving in manufacturing and other industries amount to some 400,000 each; the estimate for private services is nearly 900,000, discounting the discrepancy in 1973-4 when SET was abolished.

There is no sign of a significant general reduction in overmanning in 1980, despite the sharp fall in employment in manufacturing. Indeed it looks as though overmanning or 'concealed unemployment' in private services has continued to rise.

For manufacturing, at least, there is not too much mystery about why jobs have been preserved. Table 3.2.2 shows the estimated number of jobs supported by government schemes up to mid-1979. These were heavily concentrated on manufacturing and are sufficient to account for much of the job-saving in that sector. Although the largest scheme, the Temporary Employment Subsidy, has since ended, it has been replaced by Temporary Short-time Working Compensation which helped to finance no less than 680,000 jobs in January 1981 when some 14% of manufacturing operatives were on short-time.

The huge extent of job-saving in other industries and private services can only be explained as a reaction to unemployment and the ready availability of labour. There is much historical and geographical evidence that service productivity tends to be low at times, and in areas, of high unemployment. It seems that a large part of the impact of the present recession in the UK has been absorbed in this way.

*To facilitate comparisons of the two series on the chart, the output series have been divided by a series of trend productivity, derived from the period 1962 to 1974, to give the output and employment series on the chart the same trend up to 1974.

†The estimates of predicted employment were obtained by the method described in the notes to Table 3.2.1.

‡An allowance has also been made for the impact of SET on recorded employment in construction.

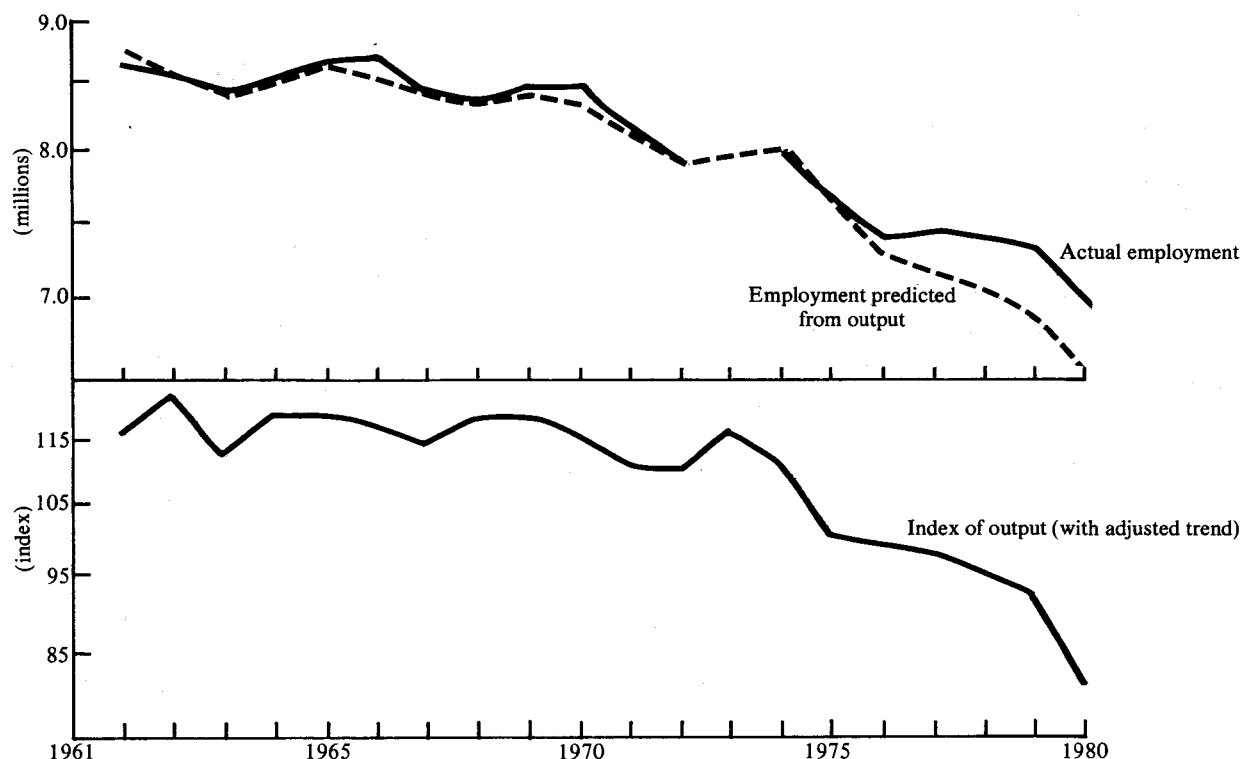


Chart 3.2.1 Employment in manufacturing

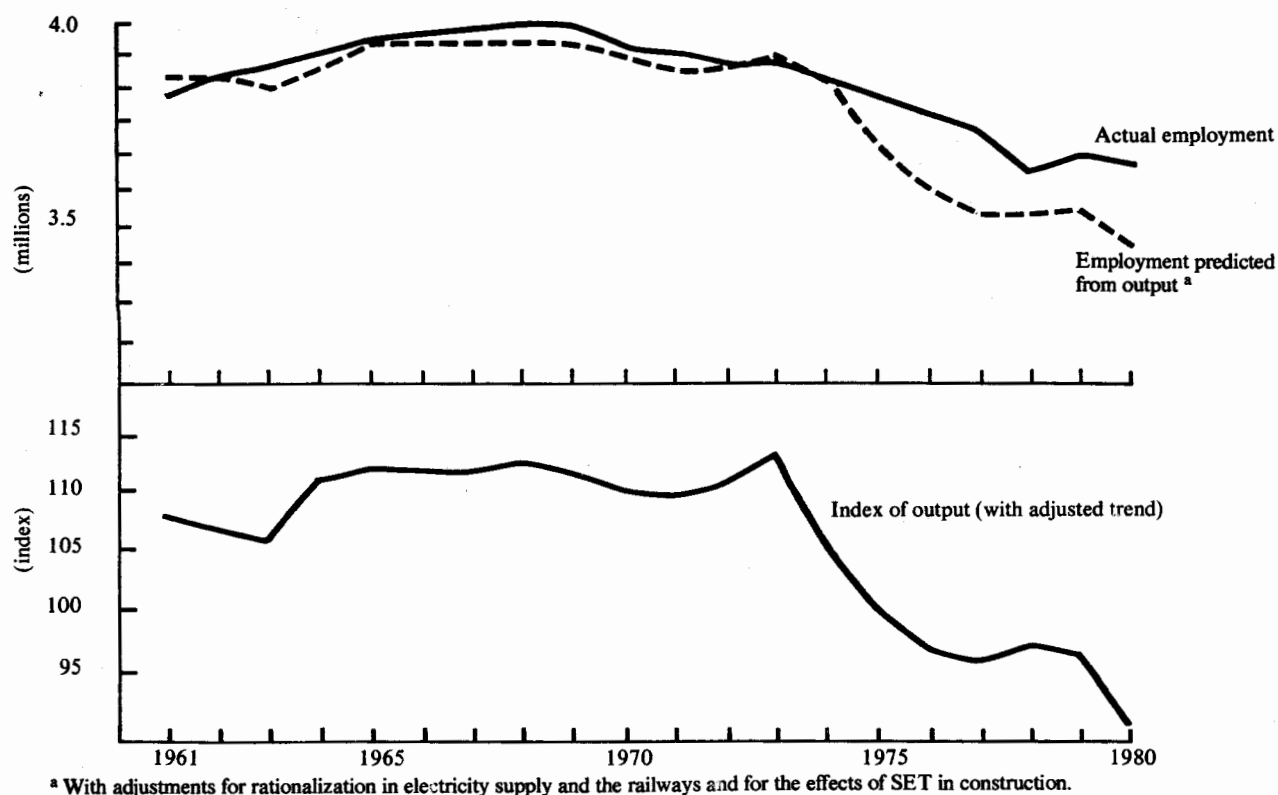


Chart 3.2.2 Employment in other industries

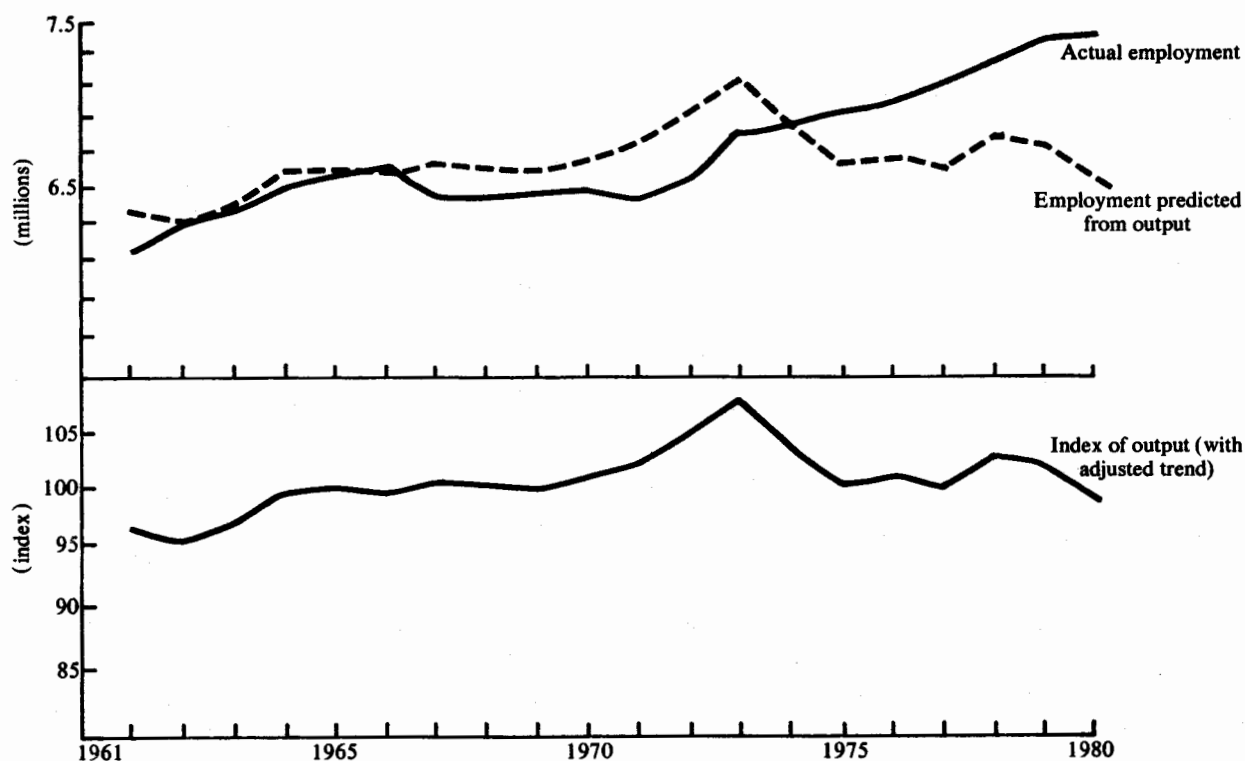


Chart 3.2.3 Employment in private services

Table 3.2.1 The discrepancy between actual changes in employment and those predicted as a function of output (thousands)

	Manufacturing			Other industry ^a			Private Services ^b		
	Actual	Predicted	Discrepancy	Actual	Predicted	Discrepancy	Actual	Predicted	Discrepancy
1973-74	+ 41	+ 46	- 5	- 65	- 83	+ 18	+ 30	-288	+ 318
1974-75	- 385	- 384	- 1	- 48	-191	+143	+ 80	-226	+ 306
1975-76	- 242	- 373	+131	- 48	-126	+ 78	+ 57	+ 38	+ 19
1976-77	+ 46	- 98	+144	- 52	- 65	+ 13	+116	- 67	+ 183
1977-78	- 34	- 127	+ 93	+ 1	+ 1	0	+153	+186	- 33
1978-79	- 78	- 170	+ 92	+ 50	+ 3	+ 47	+147	- 48	+ 195
1979-80	- 355	- 332	- 23	- 28	- 92	+ 64	+ 20	-186	+ 206
1973-80	-1007	-1438	+431	-190	-553	+363	+603	-591	+1194

^a Construction; Gas, Electricity and Water; Transport and Communication.

^b Excludes private professional and scientific services.

Notes: Predicted changes in employment were calculated from the model

$$\ln E = \alpha + \beta t + \gamma \ln Q + \delta \ln Q_{-1}$$

where E is employment and Q is output. Trend coefficients α and β were fitted on data for 1962 and 1974. The assumed value of γ and δ were:

	γ	δ
manufacturing	0.25	0.4
other industry	0.4	0.4
private services	1.0	0.0

Table 3.2.2 Industrial distribution of jobs or adults supported under various employment measures during the periods shown, Great Britain (thousands)

	Period	Manufacturing	Other Industries	Private Services	Total
Temporary Employment Subsidy	Aug 75 - Mar 79	473.0	28.4	33.8	540.3 ^a
Small Firm Employment Subsidy	July 78 - June 79	68.7	6.3	7.1	82.2 ^b
Short-time Working Compensation (textiles, clothing and footwear)	May 78 - Mar 79	8.4	-	-	8.4
Temporary Short-time Working Compensation	April 79 - June 79	11.7	-	0.1	11.8
Adult Employment Subsidy	Aug 78 - June 79	n.a.	n.a.	n.a.	1.4
Job Release Scheme	April 78 - June 79	n.a.	n.a.	n.a.	42.1
Total ^c		561.8	34.7	41.0	644.1

Notes:

^a including 5.1 in Agriculture and Mining and Quarrying

^b including 0.2 in Agriculture

^c excluding the Job Release Scheme

Source: *Department of Employment Gazette*, No 79. The period covered in this table relates to the information provided in the *Department of Employment Gazette* article. Only the TSTWC and JRS are now in effect, and both continue to accept new claims.

(b) Do official unemployment figures overstate the true increase?

There is much controversy about the significance of official figures on registered unemployment. We have already seen that in one sense there is a presumption that they vastly understate the impact of recession, in that there is a huge amount of 'concealed unemployment' or under-employment implied by overmanning and short-time working. Here we shall treat all employment, whether full-time or part-time, as genuine and go on to consider whether the rise in officially registered unemployment overstates or understates the number of people who have no job at all but would work if jobs were more readily available.

We start from three benchmarks. One is the size and composition of the population of working age. From this we can calculate changes in the number of people who might be expected to want to work if participation rates (i.e. the propensity of different groups to seek work) did not change. Table 3.2.3 shows that this 'demographic' contribution to changes in labour supply amounted to an increase between 1973 and 1980 of some 320,000 men and 460,000 women.

The second benchmark is the number of people who say they have been working, or have recently sought work, in response to census or survey questions. The comparison of survey estimates with demographic changes tells us the actual change in labour force participation. Thus between 1973 and 1980 it appears that some 280,000 fewer men actually worked or sought work, implying a fall of nearly 600,000 in male participation. On the other hand the rising trend of women's participation yielded a net addition of about 170,000 to the number at work or seeking work, bringing the total increase in female labour supply up to some 630,000.

What do the reported changes in participation mean? The long-run decline for men has been due mainly to earlier retirement and the growth of further education. The fall in male participation since 1973 has been particularly rapid and has been concentrated in the age groups 45-64 and 65 and over (see Table 3.2.4). The accelerated fall must have been due to schemes to encourage early retirement and to the difficulty of finding jobs. Part must be regarded as involuntary.

The participation trends for women show a marked break around 1977. As can be seen in

Table 3.2.3 Changes in employment, unemployment and labour supply in the UK

(thousands)

	1961-66	1966-73	1973-75	1975-77	1977-79	1979-80	1973-80
<i>Males:</i>							
1. Demographic contribution	+409	+ 81	- 16	+136	+109	+ 89	+318
Implied change in participation	-184	-547	-165	-130	-149	-150	-594
2. Labour supply (survey estimate)	+225	-466	-181	+ 6	- 40	- 61	-276
Implied change in registration	- 8	-154	+ 85	+156	- 79	- 8	+154
3. Employment and registered unemployment	+217	-620	- 96	+162	-119	- 69	-122
of which:							
registered unemployment	+ 12	+262	+223	+344	-119	+202	+650
<i>Females:</i>							
1. Demographic contribution	+ 80	-190	- 45	+115	+317	+ 75	+462
Implied change in participation	+555	+729	+291	+344	-315	-150	+170
2. Labour supply (survey estimate)	+635	+539	+246	+459	+ 2	- 75	+632
Implied change in registration	+ 45	- 18	+103	-139	+298	+ 53	+315
3. Employment and registered unemployment	+680	+521	+349	+320	+300	- 22	+947
of which:							
registered unemployment	- 18	+ 30	+ 69	+240	+ 14	+114	+437

Sources: Demographic contribution: Activity rates (1966 Census of Population) multiplied by annual mid-year estimates of total population (OPCS).

Labour Supply: Censuses of Population, 1961, 1966 and 1971 (OPCS); European Economic Community Labour Force Surveys, 1973, 1975, 1977 and 1979 (EEC).

Employment: Employees in employment, employers and self-employed, and H. M. Armed Forces, June each year, not seasonally adjusted (Department of Employment).

Registered unemployment: Wholly unemployed, excluding adult students but including school leavers, June each year, not seasonally adjusted (Department of Employment).

Table 3.2.4, participation rates for married women of all ages fell back sharply between 1977 and 1979 after having risen continuously since the war. This was almost certainly a response to the worsening of job opportunities. For both men and women the survey evidence suggests that the recession has considerably discouraged participation. To this extent the official figures will have tended to understate the true rise in unemployment.

The final benchmark we must now bring in is the sum of employment and registered unemployment. To the extent that this has risen more than survey estimates of the labour force, official figures may be overstating the rise in unemployment. Between 1973 and 1980 there has indeed been a discrepancy of about 150,000 for men and 300,000 for women in this sense.

Why did the sum of registered unemployment and employment rise more than survey-based estimates of labour supply? One answer would be double counting. More people may have held several jobs and more of those registered as unemployed may in fact have had jobs. But there is another equally plausible explanation. Normally there is a considerable number of people in the process of changing jobs, by no means all of whom bother to register as unemployed in the brief interval between quitting their old job and starting a new one. When unemployment rose and new jobs became harder to find, people may have changed jobs less frequently or have taken the

precaution of registering as unemployed between jobs. The rate of job turnover in manufacturing certainly slowed down in 1975 and again in 1980 when unemployment rose rapidly. It seems likely, therefore, that registration of unemployment has been made more complete because of the greater difficulty and risk attached to finding a new job.

Overall, the bias implied by more complete registration of unemployment seems to have been of a similar magnitude to the opposite bias which has occurred as people have been discouraged from participation in the labour force. The official figures therefore give a reasonable estimate of the true increase in unemployment. They are not necessarily correct in detail and they almost certainly consistently under-estimate the number of married women who would like to work.

(c) Which groups have suffered unemployment most?

The official figures of registered unemployment are disaggregated by sex and age-group, and can be compared with population data to give some impression of the incidence of unemployment on different groups of people. Table 3.2.5 shows that, on the basis of official figures, the only group suffering a substantial incidence of unemployment in the mid-1960s was elderly men. By 1973 men in most age-groups were significantly affected and by July 1980 there was a very high incidence of unemployment recorded for school-leavers and

Table 3.2.4 Changes in activity rates in the post-war period by age, sex and marital status
(percentage points per year)

	1951-61	1961-66	1966-71	1971-73	1973-75	1975-77	1977-79
Males:							
aged 15-19/16-19 ^a	-0.9	-0.8	-1.9	-1.3	-0.6	+1.0	+0.3
20-24	-0.3	+0.1	-0.5	-0.4	-0.1	0	+0.4
25-44	0	-0.1	-0.1	0	-0.1	0	-0.2
45-64	+0.3	-0.3	-0.1	0	-0.3	-0.6	-0.7
65+	-0.6	-0.3	-0.8	0	-2.0	-1.0	-1.6
Females:							
Single, widowed, and divorced							
aged 15-19/16-19 ^a	-0.8	-1.0	-1.1	-1.9	-0.8	+1.2	+0.3
20-24	-0.2	-0.5	-1.1	-1.5	-0.6	+0.5	+0.6
25-44	+0.4	-0.1	-0.8	-0.3	-0.3	-0.2	-0.2
45-59	+0.9	+0.5	+0.1	0	-0.1	-0.6	-0.5
60+	+0.1	+0.2	-0.4	-0.4	-0.6	-0.8	-1.0
Married							
aged 16-19	+0.3	+0.5	-0.4	+3.2	+2.0	+1.4	-2.0
20-24	+0.5	+0.4	+0.4	+2.8	+1.5	+2.4	-0.7
25-44	+0.8	+1.7	+0.9	+2.5	+1.8	+2.0	-0.2
45-59	+1.1	+2.7	+3.6	+2.5	+0.6	+1.1	-0.5
60+	+0.3	+1.0	+0.4	-0.2	-0.2	-0.5	-1.2

^a 16-19 after 1971.

Source: 1951-71 Census of Population; 1973-79 EEC Labour force survey.

Table 3.2.5 Unemployment by age and sex and for specific groups in the population, Great Britain, July

	(% of the relevant population)		
	1966	1973	1980
<i>Males:</i>			
by age:			
school leavers	1	1	32
others under 20	1	4	12
aged 20-24	1	3	9
25-54	1	2	5
55-59	1	3	5
60-64	4	7	11
minority groups: ^a	n.a.	2	7
<i>Females:</i>			
by age:			
school leavers	1	1	30
others under 20	1	2	11
aged 20-24	1	1	6
25-34	0	0	3
35-54	0	0	2
55-59	0	1	2
married:	0	0	2
minority groups: ^a	n.a.	1	4

^a New Commonwealth and Pakistan: to May only.

Source: Department of Employment Gazettes Population estimates from OPCS; and various sources.

young people of both sexes. The true incidence of unemployment on some groups will have been worse than the figures in the table imply. The 1980 figures for adult women would be considerably higher if expressed as a proportion of those at work or seeking work. The figures for married women and elderly people of both sexes would be higher if those who have been discouraged from registering as unemployed were added in. The figure for racial minorities would be worse had July figures been available for then the disproportionate effect of unemployment amongst school leavers from racial minorities would have been included.

Nevertheless it is clear that the burden of unemployment has been very uneven with young people particularly badly affected. This may easily become a chronic condition because in the past, whenever there has been a reduction in unemployment, groups suffering the highest incidence of unemployment have usually been the last to benefit from the general improvement in job opportunities.

3.3 The exchange rate

Why has sterling been so strong?

Between November 1976 and January 1981 the exchange rate for sterling relative to a weighted average of other currencies appreciated almost continuously by a cumulative total of more than

30%. This sustained rise in sterling was entirely unprecedented. In previous years sterling had been falling at about the rate needed to compensate for excess inflation, keeping UK costs of production roughly in line with those of foreign competitors. It is important to try to assess why the rise occurred, if only to assist a judgement of how far, and under what pressures, the exchange rate is now likely to fall again.

It is reasonably certain that the immediate source of upward pressure on the exchange rate in 1977 and 1979 was a substantial net inflow of financial capital (see Table 3.3.1). In both years the UK had a deficit on current account and long-term capital flows and in 1977 the authorities intervened heavily by selling sterling to moderate the rise in the exchange rate. On the other hand, in 1978 when sterling temporarily fell back they intervened to support the rate and in 1979 and 1980 they appear to have made only small direct efforts to limit its continuing rise. They cannot be said to have pushed sterling up but their willingness to support the rate in 1978 and their passive stance in 1979-80 must have helped to sustain the confidence of financial investors.

How far was the confidence of investors really justified? By the end of 1976 the UK had accumulated quite large debts and during the next three years there was a further large cumulative deficit on current account and long-term capital movements. Yet, paradoxically, the identified net financial liabilities of the UK were very much reduced (see Table 3.3.2). One reason for this was a considerable valuation gain as gold reserves were revalued relative to official debts (especially those denominated in foreign currency). But the main statistical reason why the UK's recorded net external debt fell is less reassuring. It lies in the 'balancing item' — unidentified transactions amounting to a net inflow of over £7 billion in three years. It is possible, indeed likely, that part or all of this consists of an unidentified increase in private liabilities. The true net external debt of the UK may indeed have been rising, not falling, since 1976.

The ultimate test of security for investors in sterling is the stability of the current account and long-term capital flows. After more-or-less continuous deficits, these turned positive in the third quarter of 1980 (see Table 3.3.3) despite the adverse effects of the high exchange rate on UK exports and import penetration. The 1980 surplus was in fact due to the severity of the UK's internal recession. The recession has in a certain sense been the agency whereby earlier confidence in the rise in the sterling has become justified. But the justification seems likely to be short-lived since the recession and the adverse effect of the high exchange rate on UK industries are now a matter of concern to the government. But it is not really plausible that the rise in the exchange rate in previous years was caused by far-sighted anticipation of a 1980 trade surplus achieved through severe recession since the 1980 recession

Table 3.3.1 UK balance of payments, annual flows 1969-80

(£ billion)

	Current account	Long-term capital ^a	Structural flows ^b	Financial capital ^c	Balancing item ^d	Official intervention	Change in weighted exchange rate ^e
1969	+0.5	-0.3	+0.2	+0.1	+0.4	-0.7	fixed rate
1970	+0.8	-0.3	+0.5	+0.8	0.0	-1.3	
1971	+1.1	-0.4	+0.7	+2.1	+0.3	-3.1	
1972	+0.2	-0.5	-0.4	-0.1	-0.8	+1.3	-10%
1973	-1.1	-1.2	-2.3	+1.3	+0.2	+0.8	- 9%
1974	-3.4	-0.5	-3.8	+0.2	+0.2	+1.6	- 1%
1975	-1.7	-0.1	-1.8	+0.2	+0.1	+1.5	-11%
1976	-1.1	-0.9	-2.1	-2.2	+0.6	+3.6	-17%
1977	-0.3	-0.2	-0.5	+4.6	+3.2	-7.4	+ 5%
1978	+0.6	-1.7	-1.1	-1.8	+1.8	+1.1	- 1%
1979	-1.7	-3.6	-5.2	+4.6	+2.3	-1.7	+10%
1980 ^f	+2.3	-2.3	-0.1	-0.3	+1.1	-0.8	+11%

^a Capital transfers, official long-term capital, direct investment, investment by overseas oil companies in UK, 'oil and miscellaneous' UK private investment overseas.

^b Current account plus long-term capital.

^c All other identified capital transactions.

^d Unidentified transactions.

^e Change in sterling effective exchange rate, December to December.

^f Estimated from data for first three quarters.

Sources: *UK Balance of Payments*, 1980 edition; CSO Press Release, December 1980; *Financial Statistics*, December 1979; *Economic Trends*, January 1981.

in the UK was not generally forecast until after it had started to occur.

The identified financial inflows which contributed to the rise in sterling in 1977 and 1979 consisted mainly of foreign investment in UK banks and in the UK public sector (see Table 3.3.4). A little over £1 billion of the inflow in 1977 in fact came from overseas borrowing by public corporations — a response to the preceding 1976 crisis. The inflows in 1977 were surprising in that UK interest rates were being cut rapidly. In the first half of the year sterling still stood at a

heavy forward discount and 'covered' investment in sterling was marginally unprofitable vis-à-vis investment in the dollar (see Table 3.3.5). The move into sterling in 1977 probably had more to do with the unwinding of positions taken during the crisis of the previous year than with any expectation that sterling would rise steadily in the future.

By the beginning of 1978 the fall in UK interest rates seemed to have been sufficient to kill off financial inflows. In the second quarter of the year sterling fell back, despite official support, to a level only 1% higher than at the end of 1976. But then a new, more sustained upward pressure gradually developed. Throughout 1978 and 1979 UK interest rates were progressively raised from 6% to over 16% and although dollar interest rates were rising too, the differential in favour of the UK built up to over 3%. In mid-1980 as US rates fell, the differential in favour of the UK went much higher still.

During the whole period from mid-1978 to mid-1980 during which sterling rose by a total of 20%, the forward rate stood at a discount against the dollar and all other major currencies except the lira, but since the forward discount tended to be less than the interest differential, covered investment in sterling was not unprofitable. Forward buyers of sterling and uncovered investors were making substantial gains as the rate continued to go up. It seems probable that the

Table 3.3.2 Changes in the UK's net external financial assets, 1977-79 (£ million)

Identified net assets at end-1976 ^a	-7,205
balance on current account and long-term capital ^b	-6,553
gains from changes in valuation	+3,824
unidentified inflows ^c	+7,361
Identified net assets at end-1979 ^(a)	-2,573

^a Excluding oil companies

^b See table 3.3.1 (also includes £195 million allocation of SDRs)

^c Balancing item

Source: *UK Balance of Payments*, 1980 edition

Table 3.3.3 UK balance of payments, quarterly flows 1977-80

(£ billion, not seasonally adjusted)

		Current account	Long-term capital	Structural flows	Financial capital	Balancing item	Official intervention	Change in weighted exchange rate ^a
1977	1	-0.7	+0.2	-0.5	+1.5	+0.9	-1.9	+2.3%
	2	-0.5	-0.2	-0.7	+0.4	+1.2	-0.9	-0.6%
	3	+0.5	+0.1	+0.6	+1.2	+0.8	-2.6	+1.5%
	4	+0.4	-0.3	+0.1	+1.5	+0.2	-1.9	+2.2%
1978	1	-0.5	-0.2	-0.7	+0.2	+0.7	-0.2	+0.5%
	2	+0.2	-0.3	0.0	-1.8	+0.4	+1.5	-4.4%
	3	+0.4	-0.6	-0.3	+0.4	+0.1	-0.2	+2.3%
	4	+0.5	-0.8	-0.5	-0.1	+0.6	0.0	+0.8%
1979	1	-1.2	-1.2	-2.4	+1.6	+1.5	-0.7	+2.8%
	2	-0.4	-0.5	-0.8	+1.3	+0.3	-0.8	+5.1%
	3	+0.2	-1.0	-0.8	+1.2	-0.1	-0.3	+2.2%
	4	-0.4	-0.8	-1.2	+0.5	+0.6	0.0	-0.1%
1980	1	-0.4	-0.9	-1.3	+0.4	+1.4	-0.5	+3.7%
	2	-0.3	-0.9	-1.2	+0.8	+0.7	-0.2	+1.9%
	3	+1.2	-0.1	+0.1	-0.4	-0.4	-0.3	+3.3%

See notes to Table 3.3.1

^a Changes between third month of each quarter.Additional sources: *Economic Trends*, September 1980.

Table 3.3.4 Identified financial capital flows, 1969-79

(£ billion)

	Banks and money market ^a	Overseas investment in UK public sector	Private portfolio ^b	Trade credit	Other	Total
1969	+0.2	-0.1	+0.1	-0.2	0.0	+0.1
1970	+0.9	0.0	0.0	-0.4	+0.3	+0.8
1971	+1.9	+0.1	+0.1	-0.2	+0.2	+2.1
1972	+0.7	+0.1	-0.4	-0.2	-0.3	-0.1
1973	+0.7	+0.2	+0.5	-0.2	+0.2	+1.3
1974	+1.3	+0.3	+0.9	-0.7	+0.3	+2.0
1975	+0.2	0.0	0.0	-0.5	+0.6	+0.2
1976	-1.3	+0.2	+0.3	-1.1	-0.4	-2.2
1977	+1.8	+2.2	+0.4	-0.3	+0.5	+4.6
1978	-0.3	-0.1	-1.1	-0.5	+0.1	-1.8
1979	+4.9	+0.9	-0.5	-0.8	+0.1	+4.6

See notes to Table 3.3.1

^a Changes in external sterling liabilities and overseas currency borrowing and lending by UK banks.^b Overseas investment in UK company securities and UK private portfolio investment overseas.

Table 3.3.5 The exchange rate and interest differentials, 1977-80

(% p.a.)

		UK Treasury Bill rate	US Treasury Bill rate	Difference	Forward premium for sterling	Covered interest differential	Speculative inflow ^a (£ billion)	Change in exchange rate ^b (3 months)
1977	1	10.9	4.8	+6.2	-6.6	-0.5	+2.4	+2.3%
	2	7.6	4.9	+2.7	-4.3	-1.6	+1.6	-0.6%
	3	6.4	5.7	+0.7	-0.9	-0.2	+2.1	+1.5%
	4	5.8	6.2	-0.4	+0.7	+0.4	+1.8	+2.2%
1978	1	6.0	6.6	-0.6	0.0	-0.6	+0.9	+0.5%
	2	8.4	6.8	+1.6	-2.6	-0.9	-1.5	-4.4%
	3	9.2	7.6	+1.7	-2.7	-1.1	+0.5	+2.3%
	4	11.5	9.0	+2.4	-1.3	+1.1	+0.5	+0.8%
1979	1	12.3	9.7	+2.5	-2.1	+0.5	+3.1	+2.8%
	2	12.4	9.7	+2.7	-2.0	+0.8	+1.6	+5.1%
	3	13.8	10.1	+3.7	-2.2	+1.4	+1.1	+2.2%
	4	15.7	12.3	+3.4	-1.4	+2.0	+1.1	-0.1%
1980	1	16.7	14.2	+2.5	-2.1	+0.4	+1.8	+3.7%
	2	16.6	9.1	+7.5	-5.4	+2.2	+1.4	+1.9%
	3	15.0	10.4	+4.7	-4.0	+0.7	-0.8	+3.3%
	4	13.9	14.3	-0.4	+1.8	+1.4	n.a.	+2.0%

See notes to Table 3.3.1

^a Includes identified financial flows and balancing item.^b Changes between third month of each quarter.Source: *Financial Statistics*, various issues.

whole process was self-sustaining so long as the interest differential remained in the UK's favour. In 1979 and the first half of 1980 huge money market inflows were sufficient to cover the deficit on trade and long-term capital flows. By the end of 1980 a fall in UK interest rates and a sharp rise in US rates had wiped out the differential in favour of the UK, and indeed, a net financial outflow began. But by this time the internal recession had cut imports to the point where trade, invisibles and long-term capital flows yielded a significant net surplus which was sufficient to cover the financial outflow. Moreover the forward rate for sterling rose, no doubt because the trade balances of other major currency countries were proving more vulnerable to high oil prices than was that of the UK.

On past form, confidence in the forward market is likely to prove fragile. Forward rates have tended to follow, rather than lead, spot rates except before turning points when they have nearly always moved in the 'wrong' direction. The history of financial speculation in sterling is not comforting. In 1971 large funds moved in, despite a negative interest differential, ahead of the huge fall in sterling from June 1972. In 1976 large funds moved out, despite a big positive interest differential, ahead of the prolonged rise in sterling after November of that year. Once the speculative

error is realised, the authorities seem likely to have a difficult time. The fall in sterling which started in 1972 continued at a fairly rapid rate for over 4 years with only a brief respite when OPEC funds arrived in 1974. During that period the UK authorities continuously maintained interest rates higher than those in the USA and spent about £9 billion of foreign exchange in attempts to cushion the fall in sterling. There is little reason to suppose that they will find it easier to control runs on sterling this time round.

3.4 Industrial exports and imports

(a) Have exports been surprisingly strong?

It is widely suggested that UK exports have so far held up surprisingly well in face of the current world recession and the high exchange rate for sterling.

Table 3.4.1 shows that, according to OECD data, the view that world recession is depressing UK export markets has little or no substance. In both 1979 and 1980 the volume of demand in UK export markets increased by an average of 6% per year — about the trend rate for the 1970s as a whole. On the other hand the UK's overall market share fell particularly fast in the past two years.

Table 3.4.1 Export performance

(annual average %)

	1970-73	1973-75	1975-78	1978-79	1979-80
Growth of UK markets	9	3	7	6	6
Growth of UK exports	7	1	6	0	1
Average shortfall of exports	-2	-2	-1	-6	-5

Source: *OECD Economic Outlook*

Note: The shortfall is the difference between growth of markets and growth of exports, both in volume terms. The data make no allowance for changes in the product composition of demand for UK exports.

On this evidence UK exports are not doing well at all.

Oil from the North Sea provides a substantial and rising component of total UK exports. Table 3.4.2 gives a breakdown of changes in the volume of exports by commodity group and, for manufacturers, by destination. Total exports of manufactures have been roughly constant in volume terms since 1977. Within this total, the volume of exports of intermediate goods has increased, especially during the past year. Exports of chemicals rose in 1978-9 but have since fallen back. The volume of exports of other semi-manufactures and capital goods has changed little. Exports of cars and other consumer goods have been falling since 1978. The main components cushioning the fall in exports of manufactures in

1980 seem to have been a recovery in sales to OPEC and growth in sales of aircraft, aero-engines and electronic equipment to the USA and Europe. These are for the most part markets where costs are less important, or affect sales only with considerable delay.

Table 3.4.3 shows how the rise in sterling, first relative to the US dollar and then, in 1979, relative to European currencies as well, has combined with domestic inflation to raise UK labour costs per unit of output by around 50% relative to the average in competitor countries. CBI surveys have documented how the effects of this unprecedented loss of international competitiveness have been feeding through. General export optimism, having been much strengthened by the fall in sterling in 1976, was

Table 3.4.2 Exports by commodity group and destination

(£ billion, 1979 prices)

	1975	1976	1977	1978	1979	1980	1980 4th quarter (at an annual rate)
Food and raw materials	3.36	3.52	3.88	4.45	4.39	4.74	4.96
Energy	2.32	2.78	3.82	4.84	6.42	6.72	7.00
Manufactures ^a	26.61	29.01	31.40	31.67	30.87	31.14	30.60
of which:							
Chemicals	3.13	3.88	4.41	4.82	4.91	4.66	4.50
Other semi-manufactures ^b	5.54	6.21	6.60	6.54	6.65	6.26	5.93
Cars	0.95	1.04	0.99	1.07	0.84	0.77	0.73
Other consumer goods	2.33	2.82	3.13	3.22	3.10	3.03	2.87
Intermediate goods ^c	6.37	6.37	6.56	6.81	6.88	7.38	7.51
Capital goods ^c	6.48	6.48	6.67	6.29	6.22	6.41	6.35
Total exports	32.83	35.75	38.96	40.34	40.64	43.00	40.97
Manufactures ^{a, d}							
by destination							
EEC	7.96	9.66	10.65	11.04	11.81	11.58	11.30
Rest of Europe	4.38	4.78	5.44	4.95	4.82	5.35	5.17
North America	3.14	3.51	3.52	3.67	3.49	3.37	3.38
OPEC	3.21	3.78	4.47	4.43	3.11	3.62	3.71
Rest of World	7.92	7.27	7.33	7.58	7.65	7.22	7.04

^a Includes erratic items like precious stones, ships, aircraft and North Sea installations.

^b Excludes precious stones.

^c Excludes ships, aircraft and North Sea installations.

^d Exports at 1979 prices multiplied by shares of value at current prices.

Sources: *Monthly Digest, Overseas Trade Statistics*.

Table 3.4.3 Indicators of export potential

	1976	1977	1978	1979				1980				1981
	Average	Average	Average	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Exchange rate relative to:												
US dollar	1.81	1.75	1.92	2.02	2.08	2.23	2.16	2.25	2.28	2.38	2.41	n.a.
ECU	1.61	1.53	1.51	1.49	1.56	1.61	1.53	1.60	1.64	1.67	1.78	n.a.
Relative normal unit labour costs (1975 = 100) ^a	93.7	89.8	97.8	102.7	112.5	119.0	119.7	127.3	134.5	141.8	145.0 ^b	n.a.
Export trends: ^c												
Export optimism	+25	+17	-4	-4	-7	-40	-32	-30	-21	-57	-34	-20
Export orders ^d	+39	+28	+11	+5	+7	-11	-6	-12	-6	-35	-17	-10
Export deliveries ^d	+49	+36	+13	+9	+20	+4	+4	-9	+2	-30	-18	-11
Factors limiting export orders (% of respondents)												
Prices	48	55	63	58	67	69	76	76	74	83	82	81
Foreign demand	47	39	36	41	33	37	39	39	34	34	42	37
Delivery dates	15	21	18	21	17	14	20	13	12	6	8	4

^a Decrease implies increased competitiveness.

^b Estimate.

^c Balance of respondents indicating increase (+) or decrease (-).

^d Expected trend over next four months.

Sources: Eurostat, IMF, CBI Industrial Trends Survey.

already fading in 1978. Expectations about orders turned down sharply in the second quarter of 1979, since when respondents in the surveys have anticipated a continuing fall. Expectations about export deliveries did not turn firmly negative until the third quarter of 1980. Prices became overwhelmingly the most important factor limiting export orders at the same time as expected orders turned down. Delivery dates became entirely insignificant as a limit on orders at the same time as expected deliveries turned down. All the CBI indicators confirm that the average lag between loss of price competitiveness and a fall in the

volume of export sales is well over a year and imply that the over-valuation of sterling in 1980 will result in an appalling export performance by the UK in 1981 and 1982.

(b) Has import penetration reached its peak?

In the past year the volume of imports has fallen sharply. One reason for this fall must have been the UK's internal recession and destocking. Does it also provide an indication that, at last, import penetration is reaching its peak?

Chart 3.4.1 shows that in manufacturing as a

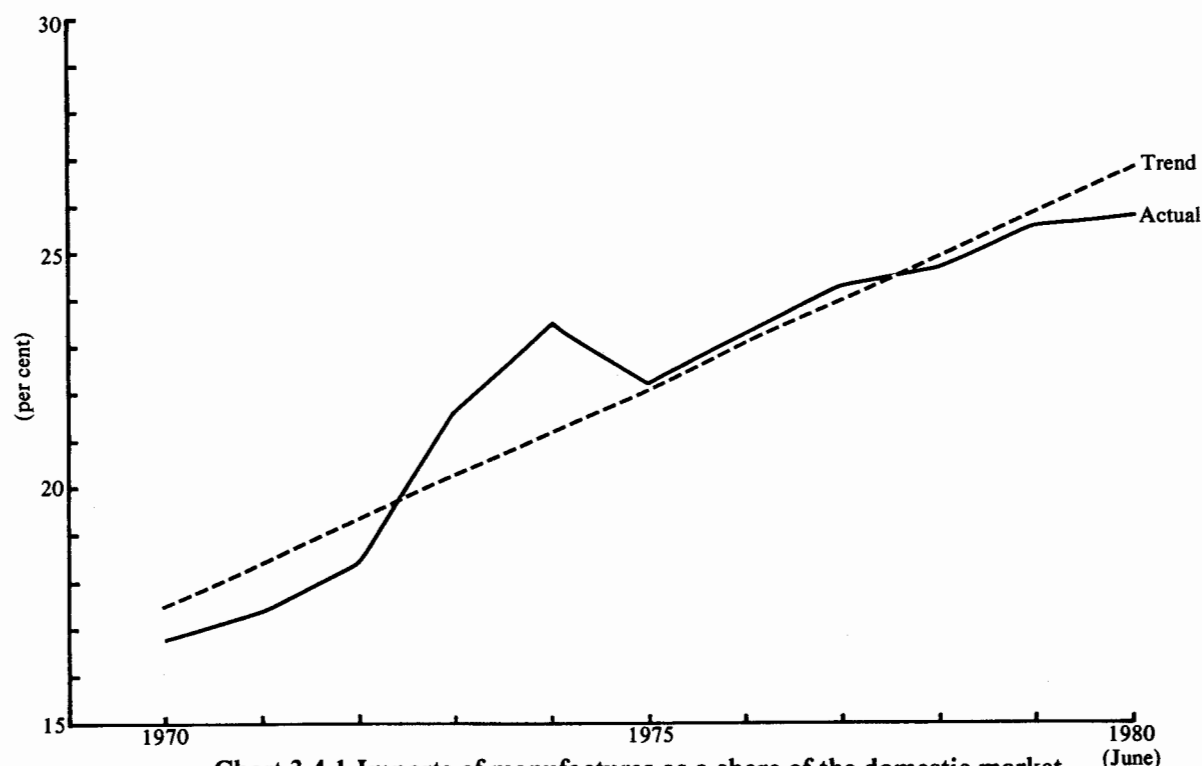


Chart 3.4.1 Imports of manufactures as a share of the domestic market
Sources: British Business, Monthly Digest

whole, the rise in import penetration slowed down a little in 1979 and up to June 1980. Unfortunately the chart also shows that after import penetration slowed in previous recessions it subsequently resumed its relentless increase. In 1975 import penetration actually fell back significantly. Up to June 1980, in a sharper recession, it was still rising.

Table 3.4.4 shows that the total volume of UK imports fell only marginally in 1980 as a whole but was much reduced by the last quarter. Destocking appears to have been a major influence. Comparing the last quarter of 1980 with the average for 1979, the volume of imports of cars fell by almost 50%, chemicals by nearly 20%, other semi-manufactures by 13% and intermediate and capital goods by 4-5%. Imports of manufactured consumer goods other than cars increased by 4%. The fall in the total volume of imports of manufactures was about 6% less than the fall in domestic manufacturing output.

A particularly worrying sign is the fact that imports of manufactures from the USA increased by some 8% in real terms over the same period. Sterling rose relative to the dollar some two years before it started rising relative to European currencies. It may be that the loss of price competitiveness vis-à-vis European suppliers has not yet made its effects on import penetration fully apparent.

Overall, if we assume that there are lags in the import pipeline similar to those in the pipeline for

UK exports of manufactures, it seems likely that import penetration will continue to rise in 1981.

3.5 Industrial restructuring

Does present restructuring provide hope for a better industrial performance in future?

The wave of factory closures and labour redundancies which has been taking place may imply that some firms and plants will be better placed to compete successfully in future. It also involves an immediate loss of production capacity. Here we briefly review data on the restructuring which has been taking place and then examine measures of industrial performance in the aftermath of previous 'shake-outs'.

Table 3.5.1 shows that the recorded number of redundancies in 1980 was nearly 500,000, much higher than in previous years and twice the level in the 1975 recession. Company liquidations in the manufacturing sector doubled in the last year. Evidence of the positive aspect of restructuring — creation of new firms and jobs — is weak. In 1980 there was a small rise in new company and VAT registrations, but investment in manufacturing fell 9% and investment intentions, as measured by the CBI survey, were sharply curtailed.

Table 3.5.2 gives some indicators of the performance of the manufacturing sector during

Table 3.4.4 Imports by commodity group and supplying area

(£ billion, 1979 prices)

	1975	1976	1977	1978	1979	1980	1980 4th quarter (at an annual rate)
Food and raw materials	9.54	10.28	10.09	10.12	10.70	9.68	9.29
Energy	7.41	7.41	6.15	5.93	5.78	4.89	4.45
Manufactures ^a	19.41	21.15	23.48	26.39	29.69	29.30	26.97
of which:							
Chemicals	1.89	2.29	2.46	2.97	3.40	2.89	2.74
Other semi-manufactures ^b	5.83	6.29	6.35	7.05	7.81	7.69	6.76
Cars	0.96	1.23	1.64	1.71	2.60	1.98	1.31
Other consumer goods	2.75	3.02	3.33	3.74	4.48	4.59	4.65
Intermediate goods ^c	2.88	3.11	3.52	3.95	4.64	4.70	4.44
Capital goods ^c	2.83	3.00	3.25	3.79	4.44	4.58	4.21
Total imports	37.04	39.41	40.30	43.22	46.93	44.93	41.78
Manufactures by origin ^{a, d}							
EEC	8.29	9.45	10.65	12.24	14.54	13.66	12.53
Rest of Europe	3.93	4.00	4.41	5.54	5.71	5.28	5.15
North America	3.22	3.42	3.55	3.62	3.94	4.76	4.26
Rest of World	3.97	4.26	4.87	4.99	5.50	5.59	5.02

^a Includes erratic items like precious stones, ships, aircraft and North Sea installations.

^b Excludes precious stones.

^c Excludes ships, aircraft and North Sea installations.

^d Imports at 1979 prices multiplied by shares of value at current prices.

Sources: *Monthly Digest, Overseas Trade Statistics*.

Table 3.5.1 Industrial restructuring

	Redundancies officially recorded (000s)	Company liquidations	
		Total	Manufacturing
1974	127	3720	n.a.
1975	250	5398	n.a.
1976	167	5939	1319
1977	158	5831	1179
1978	173	5086	1076
1979	187	4537	1039
1980	491	6871	2100

	New company registrations (000s) (all sectors)	No. of VAT registrations in manufacturing (000s)	Index of manufacturing investment 1975 = 100	CBI Investment Intentions Survey
1974	42	112	107	-10
1975	46	115	100	-27
1976	56	117	94	+19
1977	55	119	100	+26
1978	64	121	107	+16
1979	65	125	110	+6
1980	68	127	101	-31

Sources: *British Business*, CBI

Table 3.5.2 Industrial performance following years of labour shake-out

(manufacturing industry)

	Annual percentage changes in real terms						Index of normalised relative costs 1975 = 100
	Employment	Output	Productivity	Investment	Exports	Imports	
1967	-3.1	+0.6	+3.5	-2.4	-1.3	+11.8	113
1968	-1.0	+7.1	+7.9	+6.7	+14.3	+17.1	99
1969	+1.3	+3.7	+2.3	+7.0	+12.5	+5.6	101
1970	-0.2	+0.4	+0.7	+7.7	+1.0	+6.4	102
Average 1968-70	0.0	+3.7	+3.6	+7.1	+9.3	+9.7	101
1971	-3.3	-1.1	+2.3	-6.6	+10.4	+9.2	105
1972	-3.5	+2.5	+5.7	-13.5	+1.2	+18.3	104
1973	+0.7	+9.1	+8.7	+2.1	+15.1	+21.4	92
1974	+0.5	-1.2	-1.4	+9.9	+4.0	+4.9	95
Average 1972-74	-0.8	+3.5	+4.3	-0.5	+6.8	+14.9	97
1975	-4.8	-7.0	-2.5	-6.9	-2.9	-6.5	100
1976	-3.2	+2.0	+5.4	-5.6	+9.0	0.0	94
1977	+0.7	+1.9	+1.6	+5.5	+8.3	+11.0	90
1978	-0.8	+0.4	+1.1	+7.5	+0.8	+12.4	98
Average 1976-78	-1.1	+1.4	+2.7	+2.5	+6.0	+7.8	94
1980	-6.0	-9.0	-3.0	-9.0	+0.9	-1.5	137

Sources: *Economic Trends*, *Monthly Digest of Statistics*.

Table 3.5.3 Labour shake-outs and changes in trading performance by industry

	Employment change % 1970-74	Gain in exports	Changes in trading performance (per cent of output)				
			1970 to 1974	1974 to 1978	1970 to 1974	1974 to 1978	Net competitive gain
Textile machinery	-15.7	3.5	-5.4	-2.1	-18.8	-1.8	-20.6
Scientific & ind. instruments	-15.3	5.6	-5.3	0.3	7.1	-3.7	3.4
Machine tools	-15.3	-3.0	-14.8	-17.8	2.2	-1.9	0.3
Electrical machinery	-15.2	9.2	-9.3	-0.1	19.5	0.0	19.5
Industrial engines	-8.8	-7.4	-5.2	-12.6	12.3	+1.3	13.6
Office machinery	-8.1	-2.7	-6.1	-8.8	-2.9	-8.1	-11.0
Domestic electrical appliances	-6.8	3.6	-15.0	-11.4	2.7	-2.7	0.0
Other machinery	-2.3	4.6	-8.6	-4.0	1.6	0.0	1.6
Unweighted average	-10.9	1.7	-8.7	-7.1	3.0	-2.1	0.9
Construction equipment	2.5	6.4	-3.5	2.9	15.9	-1.4	14.5
Mechanical handling equipment	5.3	7.2	-8.0	-0.8	5.7	-1.3	4.4
Industrial plant & steel work	6.7	2.7	-3.1	-0.4	2.9	0.0	2.9
Agricultural machinery	7.4	5.0	-13.1	-8.1	1.8	-3.2	-1.4
Pumps, valves, compressors	9.2	1.9	-4.5	-2.6	7.9	-2.5	5.4
Electronic capital goods	17.1	5.4	-5.7	-0.3	15.3	0.0	15.3
Telephone apparatus	18.1	1.4	-2.4	-1.0	-1.2	-1.2	-2.4
Electronic components	24.3	7.7	-10.8	-3.1	6.5	-2.8	3.7
Broadcasting equipment	30.0	6.0	-20.9	-14.9	4.8	-1.5	3.3
Electronic computers	48.2	21.2	-11.4	9.8	10.6	-12.4	-1.8
Unweighted average	16.9	6.5	-8.3	-1.9	7.0	-2.6	4.4

Note: Net competitive gain is defined as the gain in exports $(1 - \mu) \Delta X$ less the loss of imports $\Delta \mu (\bar{X} + \bar{H})$ at 1975 prices, where X denotes exports, H the home market and μ the import penetration ratio, $\frac{M}{H+X}$.

and after recessions in 1967, 1971 and 1975. In all three cases employment fell over a two year period, the size of the fall increasing each time round. There was very little subsequent recovery in manufacturing employment, despite the fact that industry was aided on all three occasions by a substantial devaluation of sterling.

The 1967 and 1971 recessions were each followed by a two year period of rapid growth in output and productivity; indeed productivity continued to grow in the year of labour shake-out itself. This experience contrasts sharply with 1975 and 1980 in which productivity fell during the labour shake-out. The recovery in output and

productivity after 1975 was significantly less than after the earlier recessions.

The recovery after all three previous recessions was accompanied not only by devaluation but also by rapid expansion of world trade in manufactured products. Exports grew fast. This is unlikely to occur again in the next year or two because UK cost competitiveness has deteriorated by nearly 50% compared with the situation in the recovery phases of earlier cycles. The level of competitiveness achieved then could not be restored in the early 1980s without a huge and unprecedented devaluation which would have very serious consequences for the rate of inflation.

Manufactured imports grew rapidly (faster than exports) in the recovery phase of previous recessions in spite of the devaluations which took place.

In short there is nothing in the present situation to suggest that the possible medium term benefits from the shake-out of labour in 1980 are going to be larger or more sustainable than those after earlier recessions. Indeed there is good reason to suppose that the post-recession recovery, if it occurs at all, will this time be much weaker than before.

Table 3.5.3 shows that little or no comfort can be gained either from comparison of the

experience of different engineering industries. There is no sign that industries which undertook shake-outs of labour in the early 1970s made any subsequent gain in competitiveness relative to those which had expanded their employment. The latter group continued to have a considerably better export performance than those which cut their manpower. The comparison implies that redundancies and closures achieved no more and no less than a contraction of the industry in question and contradicts any idea that in general shake-outs are a necessary first step on the road to recovery.