

The Fraser of Allander
Institute

**Quarterly
Economic
Commentary**

May 1983



FRASER of ALLANDER INSTITUTE

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 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 term and long term aspects of the Scottish economy.

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The editor welcomes contributions to the Students Brief, 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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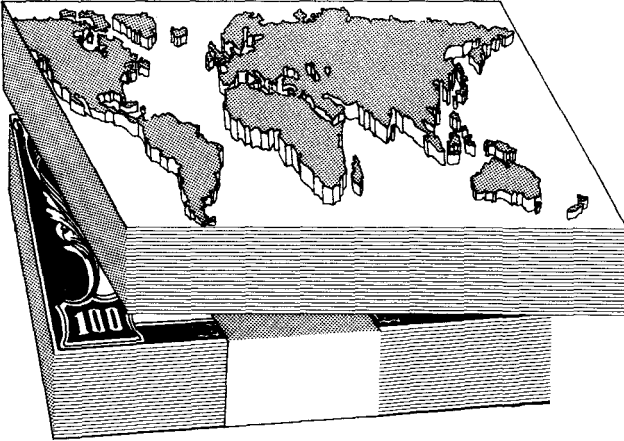
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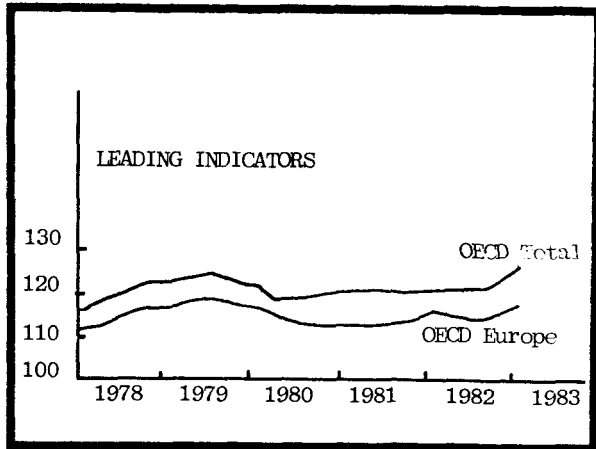
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The World Economy



Economic commentators and politicians have proclaimed a world economic recovery. The evidence in support of this conclusion is somewhat sparse at present. The OECD's leading indicator for output turned upwards in the latter half of 1982, and a recovery of industrial production has been evident in some of the major economies since the turn of the year. With few exceptions unemployment has continued to increase and real interest rates remain at historically high levels, nominal rates having failed to match the rapid deceleration in price inflation. The safest conclusion is that the trough of the world recession has been passed, but that a rapid recovery over the next year is at present based more on wishful thinking than on hard analysis.

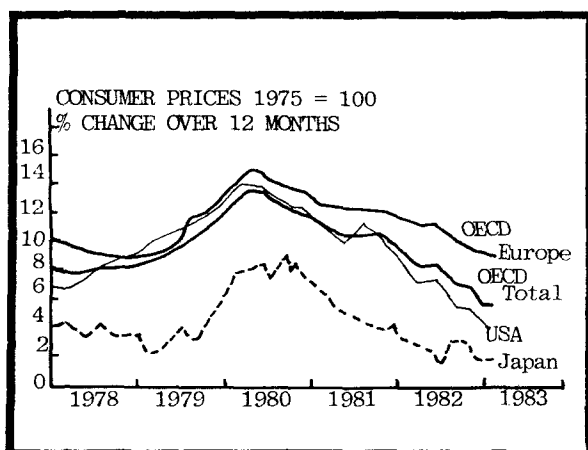
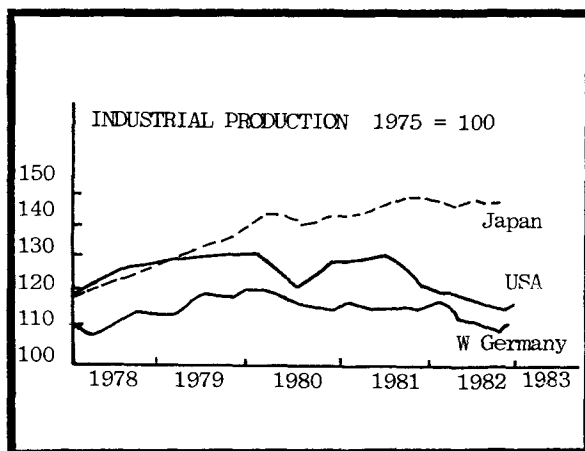
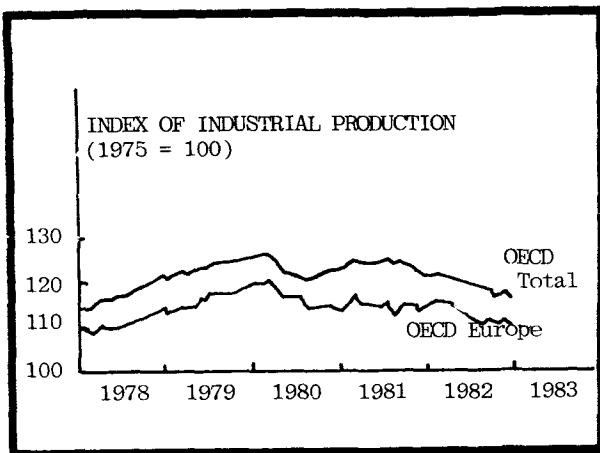


OUTPUT

The diagnosis of recovery is corroborated by recent trends in the OECD's composite leading indicator of industrial production. This indicator, which is an amalgam of trends in business confidence, labour market and financial data, has in the past proved a reliable guide to future movements in industrial output. The index turned sharply upwards in the latter half of 1982 for both the total OECD area and for OECD-Europe.

On past behaviour, a recovery in output is implied from the early part of the current year, with the recovery first becoming apparent in the US and some months later in Europe. Preliminary estimates of the actual level of industrial production in January and February support this thesis.

The US Administration now estimates that GNP rose at an annual rate of 3.1% during the first quarter of this year. Accelerating growth is forecast for the remainder of 1983, with a year on year rate of 4.7% predicted for the fourth quarter. The start of the recovery is now dated to the closing



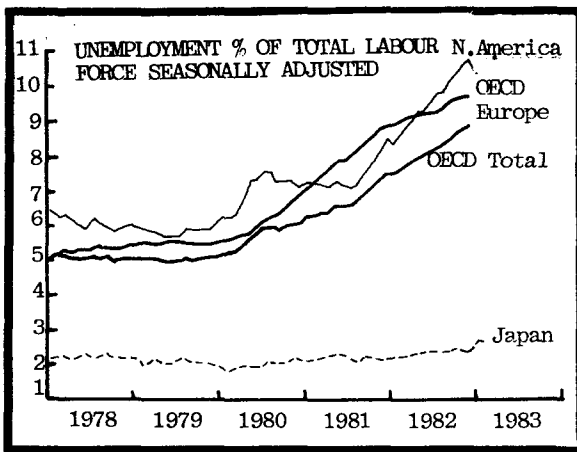
months of 1982 when industrial production bottomed out having fallen by some 9% since the onset of the recession in 1979. Growth in output was especially rapid in the first two months of this year when industrial production rose by over 1.5% from its December low. In West Germany the trough in output was also apparently passed in the last months of 1982 with a marked increase in industrial production in January of this year. However forecasts for GNP growth in Germany remain low, with little overall increase expected on the 1982 level. The zero growth forecasts conceal a sluggish first six months to be followed by a considerably higher level of activity in the latter half of this year. Business confidence in Germany has been buoyed by the election of Dr Kohl as Chancellor in his own right, and by favourable trends in the balance of payments and in inflation. By contrast the Japanese economy remains depressed, with a continuing fall in industrial production during the first two months of 1983. The official forecast of growth for this year remains at 3.4%. A stimulus was imparted to the economy in early April by measures to accelerate public infrastructural investment and to boost the construction sector.

INFLATION

The downward trend in inflation has continued into the present quarter. Its most visible measure, consumer prices, has decelerated markedly in recent months, averaging an increase of 5.7% in the year to February for the whole OECD area. For the European members the average rate of increase was considerably more rapid at 8.0%. Inflation still remains a major problem in some of the EEC member states, whose average annual experience of 6.8% conceals Greek inflation of 21.2%, French of 9.2% and German of 3.7%. Outside of Europe, consumer prices have been increasing at a slower annual rate in Japan (1.9%) and the United States (3.3%).

The rate of increase of wholesale prices has slowed, though here the deceleration has been less marked and there have been signs of a slight upturn in the US annual rate in the early months of this year. However, recent months have witnessed a fall of the order of 14% in the dollar price of crude oil whose effects will moderate any upsurge in producers prices if the recovery gathers pace.

The marked deceleration in consumer price inflation has not been paralleled by a comparable slowdown in the rate of increase of nominal earnings which increased by almost 3% more than consumer prices for the whole OECD area in the year to February. With the major exception of France, where a strict incomes policy is in force, money earnings have increased more rapidly than consumer prices in the past year. Real incomes have grown steadily for those in employment and this has been reflected in a sharp recovery in the volume of retail sales in most of the major economies since the middle of 1982. Spending on consumer durables and cars appears to have been particularly strong as purchases deferred from earlier periods have belatedly been made.



UNEMPLOYMENT

Unemployment trends have been much less encouraging than those in output or inflation. Alone amongst the major economies, only in the United States has the level of unemployment apparently reached its peak, with a sharp fall in the seasonally adjusted total at the turn of the year. Elsewhere, the trend has continued upwards though with some evidence of a slackening in the rate of increase. None of the major economies expects a sustained fall in the numbers out of work in the coming year.

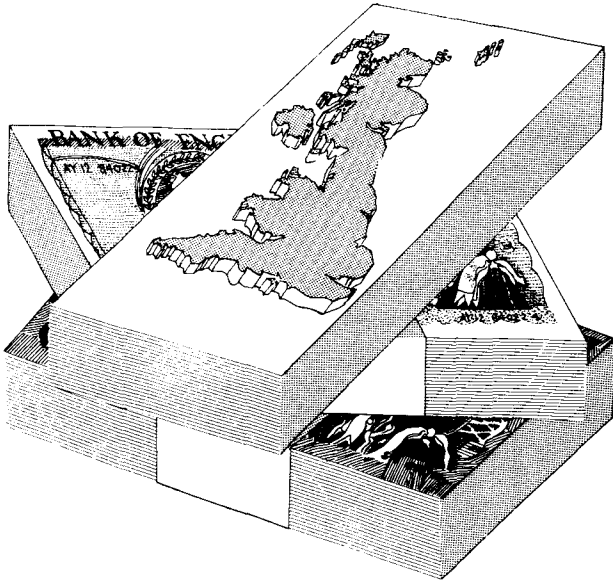
Policy makers would be well satisfied to hold current levels, and in many cases this would be a considerable achievement. The cycle in employment lags that in output. In past cycles a lag of 6-9 months before an increase in output was reflected in additional employment was the order of things. This time the lag may be markedly longer. The depth of the recession has been such that many firms no longer exist and cannot therefore simply rehire those laid off at an earlier stage of the cycle.

PROGNOSIS

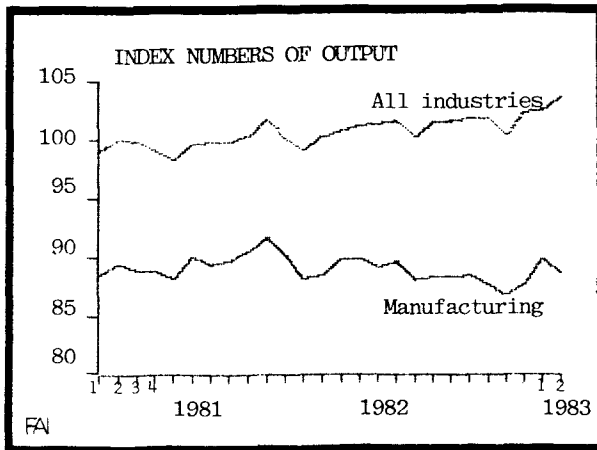
The one thing this recovery does not lack is confidence. Surveys of business opinion in all the major economies reveal a greater level of optimism amongst the business community than at any time since 1979. But confidence alone is not adequate for a sustained recovery though it certainly helps. Two constraints stand in the way of a worldwide upturn: real interest rates remain high and the response of governments to any acceleration of inflation remains unknown. The downward rigidity of nominal interest rates bears witness to the financial markets' belief that present low levels of inflation are not sustainable, yet if governments react to the expected mild acceleration of inflation in the latter half of this year with the policies of the recent past no significant recovery is likely.

The U.K. Economy

MACRO-ECONOMIC TRENDS



All the major forecasting organisations now expect reasonably rapid growth by UK standards during the current year. In recent months there have been tentative signs of an upturn. The fall in industrial production appears to have been arrested in the first two months of this year and the CBI survey of business opinion in April recorded a more optimistic outlook on the part of British firms than has been the case for several years. Retail price inflation has continued to decelerate. So too have earnings, though there the deceleration has been much less marked. Numbers of new car registrations, housing starts and the volume of consumers' expenditure in the early months of this year have been running well above the levels of the last few years. However, it is not completely clear that this is the stuff of which self-sustaining recoveries are made. Consider the various indicators:

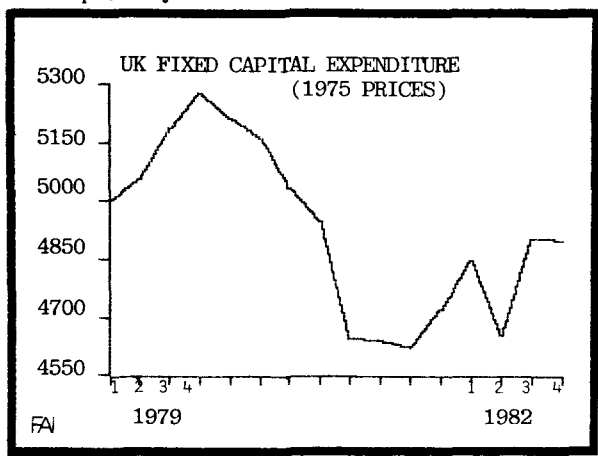


The index of industrial production for the three month period December 1982 to February 1983 was some 2.4% higher than a year earlier. But the index of output for total manufacturing was actually 0.2% lower over the same period. Though practically all sectors of manufacturing recorded some growth in output over the levels of the preceding three months, only in food, drink and tobacco, and in chemical, coal and petroleum products was the level of output above that of a year previously. Similar apparent recoveries in output occurred in the autumn of 1981 and the summer of 1982. Neither

was sustained. This time there are significant differences however. The CBI Industrial Trends Enquiry recorded a balance of 19% of respondents in manufacturing industry who expected their volume of output to increase over the next four months. By contrast the surveys of November 1981 and July 1982 taken at the time of previous "recoveries" recorded balances of respondents expecting to expand output of 1% and -3% respectively. There

is an expectation domestically that this upturn will be sustained. This was not the case previously. The external environment is also somewhat more favourable to recovery than over the previous two years (see the World Economy).

The rate of inflation in Britain fell to a fifteen year low of 4.6% in April. This is somewhat below the average for the EEC countries and for OECD member states, though there has been a pronounced deceleration of inflation in all the major Western economies with the exception of France and Italy. The fall in the annual rate of inflation has not been accompanied by a comparable fall in nominal interest rates in Britain. Consequently real interest rates have remained in the region of 5%.



High real interest rates and the weakness of the domestic economy have deterred companies from replacing or expanding their capacity. This has been particularly true of manufacturing where fixed investment slumped to £636m in the final quarter of 1982, one of the lowest figures on record. However, investment by services and the distributive trades picked up during 1982, rising by 6.3% over 1981 to £6.6bn. Some of this expenditure will have filtered through to manufacturing in the form of

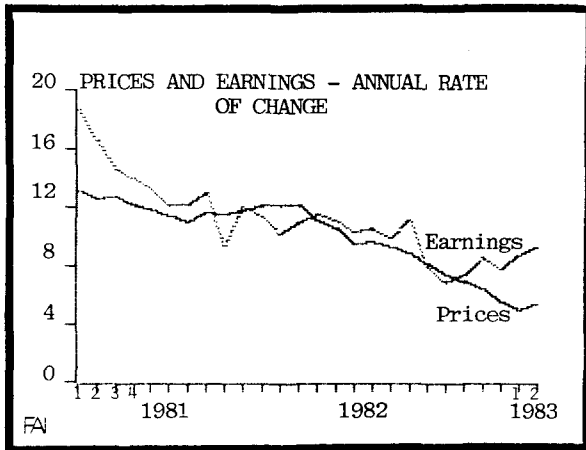
leasing. Most forecasters expect a small increase in investment during 1983 as the recovery gathers pace: the National Institute forecasts a 1.9% increase, while the London Business School expects capital spending to expand by 2.3%.

The freedom of action of the authorities to induce a fall in nominal British interest rates is constrained by a variety of factors. The future course of American rates remains unclear as Congress continues to deliberate over the President's defence programmes, while foreign exchange markets remain somewhat volatile in the run up to the election in Britain. The fall in the effective exchange rate of sterling prior to the OPEC price cut in March will also have acted as a constraint on the downward adjustment of interest rates. This constraint may have been of some importance given the emphasis on reducing inflation in British policy.

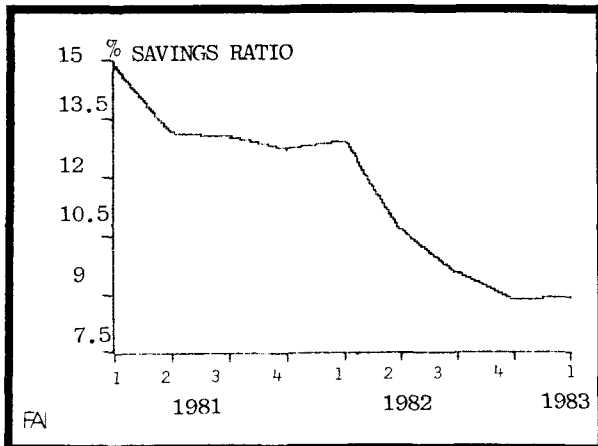
The overshoot of the 1982/83 PSBR has not contributed to lower short term interest rates. At the time of the Budget, the PSBR for 1982/83 was forecast to be £7.5bn. Four weeks later the first estimate of the actual outturn was £9.2bn. A sudden rush of spending by local authorities, nationalised industries and the Ministry injected about the same level of demand into the economy as did the Chancellor's carefully costed Budget proposals. For 1983/84, the projected fiscal deficit is £8bn, 2.75% of GDP. One of the major uncertainties affecting this target is the behaviour of oil revenues. The oil price now seems to have stabilised at about \$29, yet with sterling having appreciated quite rapidly in recent weeks, the sterling value of oil revenues should fall, thus adversely affecting the PSBR. Nevertheless the long-run effect on government finance will probably not be marked because lower oil prices should stimulate economic activity and thus boost government revenues. It would be unwise to adopt

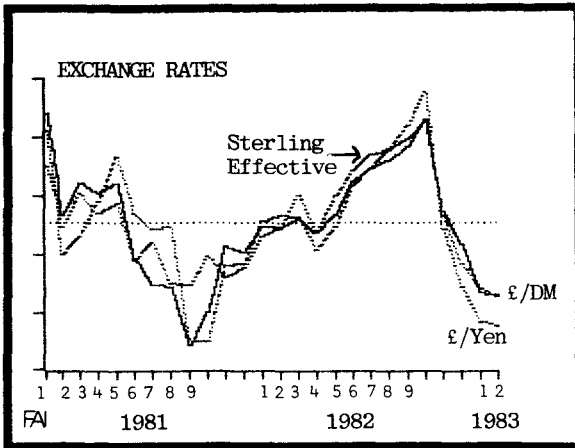
restrictive measures before some of the long-run beneficial effects of the lower oil price feed through.

The lower price of oil will also have a significant effect on the UK's balance of payments performance. In the first quarter the visible trade deficit of £253m was the result of a surplus of £1,718m on trade in oil and a deficit of £1,971m on non-oil trade. However, sterling's decline in January and February has bolstered exporters confidence as evidenced by the CBI. Though some of this advantage was lost during April and May, prospects for exporters during the remainder of 1983 seem reasonably favourable as the world economy gradually emerges from recession. In 1982, UK exports of manufactures increased by 1% at a time when world trade in manufactures fell by 3%. If this sort of performance is repeated in 1983, then the LBS forecast of 2% growth in exports may well be attained or exceeded.



While retail price inflation has fallen to an annual rate of less than 5%, earnings have continued to increase at an average rate of just under 8%. Real incomes of those in employment are therefore quite buoyant at present. However the overall level of employment has contracted to such an extent that, combined with a rising tax burden, aggregate real personal disposable income fell by 1% during the last year. The volume of consumers' expenditure nonetheless increased markedly during this period as a fall in the personal savings ratio and a rise in gross household indebtedness acted as offsetting influences. The relaxation of hire purchase controls and the ready availability of loan finance accentuated an existing trend. The rising volume of consumers' expenditure has been satisfied from three sources: destocking, new domestic production and imports. The latter in particular does not appear to have made a significant contribution and demand appears to have been satisfied in almost equal proportions by destocking and increased production. The running down of stocks, which accommodates demand without generating additional employment, does not yet appear to be at an end. This component of GNP has been strongly negative over the last three years, yet a sizeable balance of respondents to the CBI Enquiry in April expected further stock reductions over the next four months. However, the rate at which inventories are being liquidated appears to be slowing,





and this, even in the absence of a switch to inventory accumulation, represents an additional stimulus to GNP.

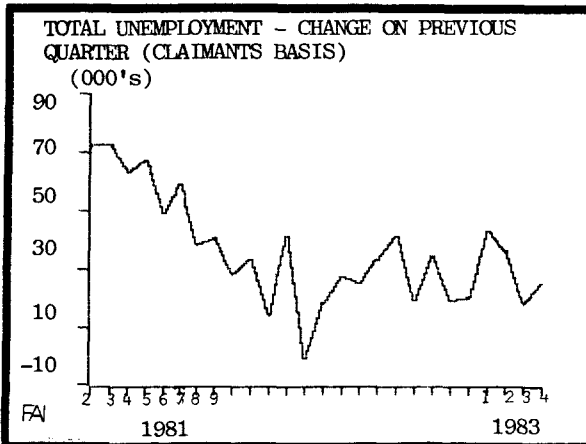
Import penetration of the British economy has been limited by the depreciation of sterling from its 1981 level. By early May the effective exchange rate of the pound stood some 10.5% below its average 1981 level. Sterling remained volatile on the foreign exchanges during the first quarter of this year. It began to slide in November and had fallen by some 14% in effective

terms by the beginning of March. Sterling rallied following the OPEC price and quota agreement in mid-March and almost half of this most recent depreciation had been reversed by the beginning of May. Nonetheless, at that time the pound had fallen by some 23% against the Japanese yen, by 10% against the deutschemark and by 6% - 7% against the French and Belgian francs, compared to its value at the beginning of November last. The inflationary effects of this recent realignment of sterling are not expected to be marked. The Bank of England estimates that a 10% fall in the effective exchange rate will add about 2% to retail price inflation over the following twelve months. The magnitude of the effect may be somewhat less in present circumstances given the coincident fall in the world price of oil and the constraints on upward price adjustments inherent in a competitive environment.

THE LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

Employment in Great Britain fell by 626,000 during 1982 while unemployment rose by only 322,000, indicating a very low take-up of unemployment benefit amongst those who became unemployed or, possible, a problem with the accuracy of the employment and unemployment statistics. It is certainly fortunate for the government that the unemployment figures have not fully reflected the deterioration in the demand for labour. As usual the decline was concentrated in the manufacturing sector. Service industry employment fell by only 83,000 so that now there are twenty-three individuals employed in services for every ten working in the manufacturing sector.



The decline in employment during 1982 was not as rapid as that during 1981, when 843,000 jobs disappeared. Similarly, unemployment rose less rapidly during 1982 compared with the previous year. Thus there do seem to be indications that the deterioration in the labour market has proceeded less rapidly during the latter part of the recession, though this is still a long way from saying that any improvement is imminent. Productivity is still increasing, though less rapidly than in 1982. As productivity improvements take place,

the scope for further increases in output per person employed will fall. The same argument applies as inefficient firms are forced out of existence, leaving those that are already efficient to maintain supplies. In the manufacturing sector, output per person employed increased by 10.3% in 1981, but by only 2.8% in 1982. A reduction in the scope for further productivity improvements partly explains this contrast and also the reduction in the rate of job loss during 1982.

LEGISLATION

During the last six months, the major piece of industrial relations legislation has been the Employment Act 1982. This became effective on 1 December 1982 except for the sections dealing with compensation and balloting under a closed shop agreement, arrangements for a statement about employee involvement in minor company affairs to be included in a company's annual report, and some other sections. The main provisions of the Act are to widen the conditions under which dismissal for non-union membership in a closed shop situation would be considered unfair, to provide a system of compensation for such cases and for similar cases occurring between 1974 and 1980. It makes void any terms in a commercial contract which require the use only of union labour; it allows trade unions to be sued where they authorise action which is not in pursuance or furtherance of a trade dispute, and to be sued also - for the first time - if the union is responsible for other unlawful action such as libel, whether or not this is connected with industrial action. The Act amends the definition of a lawful trade dispute, restricting it to disputes between employees and their own employer over matters of work conditions and jobs; it also removes legal immunity for those involved in 'sit-ins', and alters the time periods within which rights to redundancy payments, guarantee payments, notice of unfair dismissal and other rights exist.

The provisions of the 1982 Employment Act relating to the closed shop are outlined in a Draft Code of Practice for "Closed Shop Agreements and Arrangements", which was approved by Parliament in April 1983. The Code, which replaces, an earlier version based on the 1980 Employment Act, also attempts to give some practical advice about the issues to be considered before negotiating a closed shop agreement, the contents of these agreements, and the arrangements for their periodic review.

The other main piece of industrial relations legislation in recent months has been the Secretary of State for Employment's Green Paper on "Democracy in Trade Unions" (Cmnd 8778), presented to Parliament in January 1983. The TUC failed to take up the government's provision of finance under the 1980 Employment Act to allow for postal ballots in trade union elections and the Green Paper considers how this question might be dealt with by legislation. A number of critical questions are identified about the range and scope of such legislation, whether it should aim at covering all elections or only a few, how to deal with differences in union rule books etc. The different aims that legislation might adopt in order to deal with these problems are outlined.

The Green Paper is also concerned with the different approaches which legislation might take in providing for pre-strike ballots. It is argued that these ballots might be desirable under particular circumstances, and could be initiated either by a number of employers or union members. Views

are sought about future legislation on these questions.

Finally the Green Paper seeks views on the working of the 1983 Trade Union Act and the arrangements by which unions and union members are able to pursue their aims through political organisations. A number of questions are posed such as: should unions periodically ballot members to ensure whether they wish to continue to support the political objectives of unions and contribute to political funds; should contracting-in not be substituted for contracting-out; should the administration of the annual financial returns made by unions not be changed to identify more accurately the general fund and the political fund and to restrict the check-off system to the deduction of non-political contributions.

STRIKES

The number of strikes in 1982, and in the first quarter of 1983 continued to exhibit the downward trend that began in the early 1970s. For working days lost however, it is more difficult to identify a clear trend in the figures for the 70s and the early 80s; peaks occurred in the numbers of working days lost in 1972 and 1979, but in other years the figures fluctuated making a trend difficult to detect. Hence with falling numbers of strikes and a largely fixed level of days lost, the strike pattern tended to change during the 70s from being one of many short strikes in which few people were involved, to one of fewer and larger strikes, with the same broad level of days lost. Large individual strikes became more important. Hence the engineering dispute in 1979 accounted for much of the total of 29.5 million working days lost in that year, the steel strike did the same for 1980, and the NHS strike did likewise for 1982.

STRIKES 1974-1983						
	1974	1976	1978	1980	1982	1983 Q1
No of stoppages in progress	2,946	2,034	2,498	1,348	1,462	326
No of workers involved in stoppages in progress (m)	1.626	0.668	1.041	0.834	2.382	224
Working days lost in stoppages in progress (m)	14.750	3.282	9.405	11.964	7.916	1.508

Source: Department of Employment Gazette

Within the falling trend in the number of stoppages, there appears to be a decline in the proportion concerned with pay, a trend which has continued in 1983, as seen in the figures below.

CAUSE OF STOPPAGE	NUMBER OF STOPPAGES (%) FIRST QUARTER				NO OF WORKERS DIRECTLY INVOLVED IN STOPPAGES (%) FIRST QUARTER			
	1978	1980	1982	1983	1978	1980	1982	1983
Wages and earnings	58.2	45.6	39.9	36.1	65.3	57.4	77.5	46.6
Redundancy	2.5	6.0	7.6	16.4	1.7	14.2	12.7	23.1
Manning, work allocation	12.5	17.4	17.6	22.0	6.9	6.0	3.3	14.9
Conditions of work, supervision	7.7	8.2	11.0	7.1	5.8	5.7	1.3	1.8
Discipline, dismissal, hours, fringe benefits	19.1	22.8	23.9	18.4	20.3	16.7	5.2	13.6
	100	100	100	100	100	100	100	100

Source: Department of Employment

Clearly redundancy and manning problems have increased in importance in recent years, although pay continues to be the most important individual reason for strikes when looked at in relation to the number of people involved in them.

Where the Health Service dispute largely dominated the strike picture in 1982 the waterworkers dispute in January and February has dominated the strike situation in the first quarter of 1983, accounting for approximately half the working days lost. Waterworkers in Scotland were not called on to take strike action, the local authority employers agreeing to make a payment similar to that concluded for England and Wales. In the event, the Johnston Committee, reporting on 21 February 1983, provided a complex solution to the problem which involved the establishment of new consolidated basic rates of pay, a productivity payment, changes in service payments, a system of flexible hours and other changes.