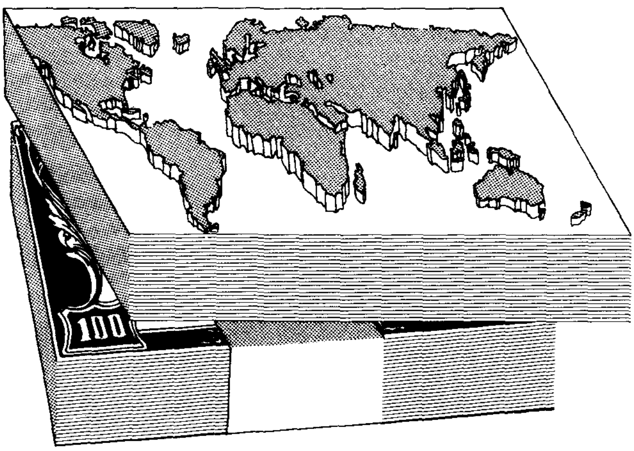
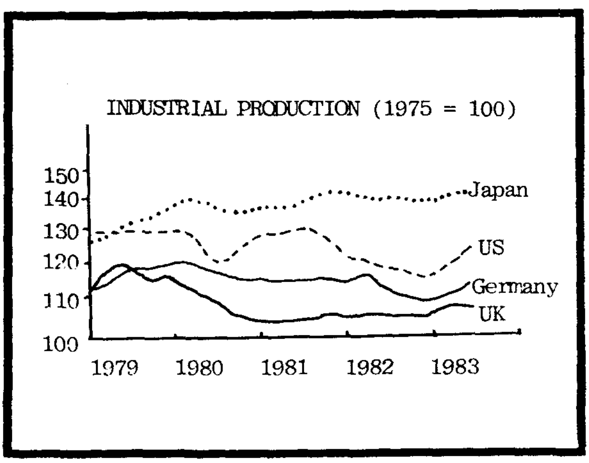
QUARTERLY ECONOMIC COMMENTARY

The World Economy

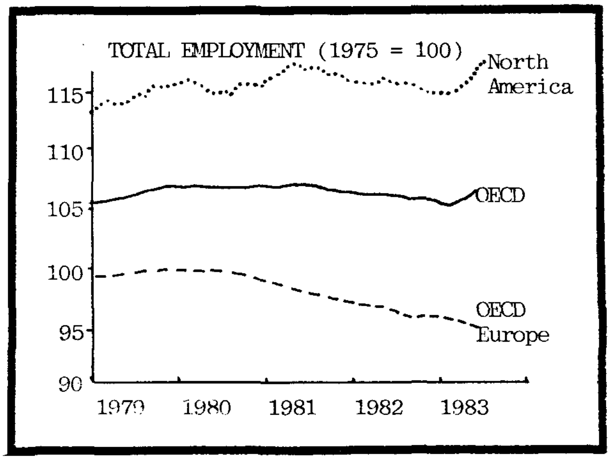


The recovery in the world economy gathered pace in recent quarters with increases in aggregate output and employment and a decline in the overall level of unemployment. Nonetheless, the recovery remains patchy with the strong performance of the US economy not yet fully emulated elsewhere. There is little sign of any immediate revival of inflationary pressures or regrettably of any pronounced downward trend in interest rates. The US budget deficit and the debt problems of some developing countries continue to loom large in international financial markets, the former remaining apparently intractable, the latter simmering continuously in the background. While a sustained recovery will reduce debt burdens it will do little to solve the US budgetary dilemna.

OUTPUT



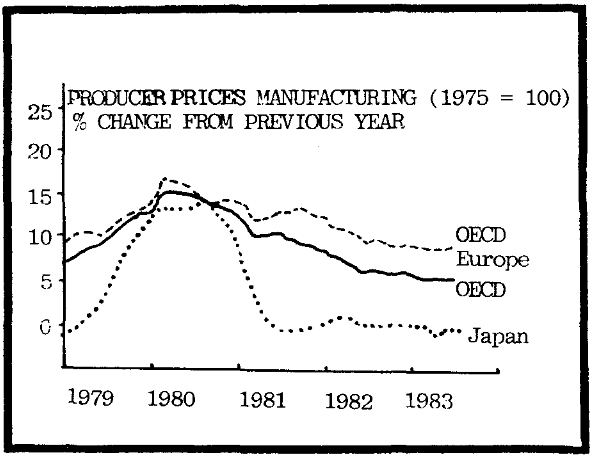
With the exception of Italy, industrial production was on an upward trend in all the major OECD economies by the end of the summer. The extent of the upturn varies between countries, being strongest in North America and Germany, but somewhat hesitant in the UK and France. Leading indicators for industrial production suggest that the upturn will be maintained into 1984 in the OECD area. Capacity utilisation is rising in most of the major economies, France and Italy excepted, but still remains below 1981 levels. Growth to date has been most rapid in the US and the UK, but there is increasing evidence that the upturn is spreading to other countries. Recovery is most evident in those countries which followed restrictive policies during 1981/82 but not at all apparent in those such as France and Italy where the reduction of inflation and budgetary deficits was accorded a lower priority during the downturn.



LABOUR MARKETS

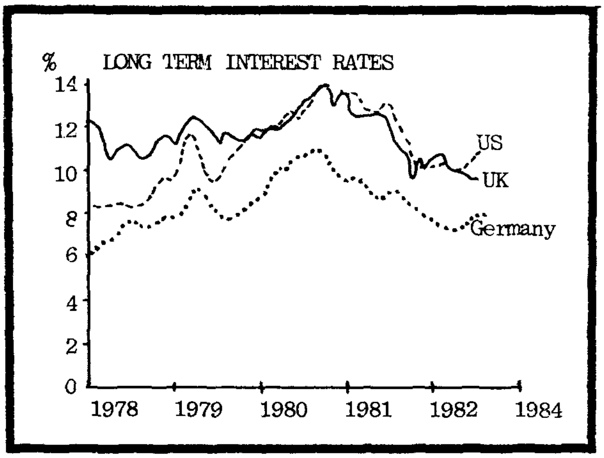
Total employment in the OECD area has been increasing since the second quarter of this year. Disaggregation by country reveals a less encouraging pattern however with employment rising only in Canada, the United States and Japan but falling in the other major OECD members. The downward trend in total employment is most pronounced in OECD Europe. Unemployment totals reveal a complementary pattern with total unemployment in the OECD area peaking in the second quarter. However, the subsequent decline is due entirely to falling unemployment in the North American continent. Outside of North America there are no signs even of a levelling off in the numbers out of work. Indeed, amongst some of the major European OECD members, such as Germany, unemployment is expected to rise significantly in 1984 even though GDP growth in excess of 3% is confidently expected. Considerably more rapid growth is required to absorb the demographic bulge in the labour force as the baby boom of the late sixties reach employable age.

INFLATION



There are few signs of a revival of inflationary pressures. Consumer price inflation bottomed out during the second quarter in most economies and has shown only a slight acceleration in recent months. This is not a particularly reliable index of inflation as the experience of particular countries is affected by domestic changes in indirect taxes and by exchange rate movements. Broader measures of inflation which do not share these defects, such as the GDP deflator, show no signs of resuming an upward trend. The rate of increase of average earnings in manufacturing seems broadly stable in the major economies, though at widely differing rates, ranging from just over 3% in the US and Japan, through 7% in the UK, to almost 11% in France. Wholesale price inflation remains largely unchanged in the OECD area, with a slight acceleration in OECD Europe being counterbalanced by deceleration in North America.

PROGNOSIS



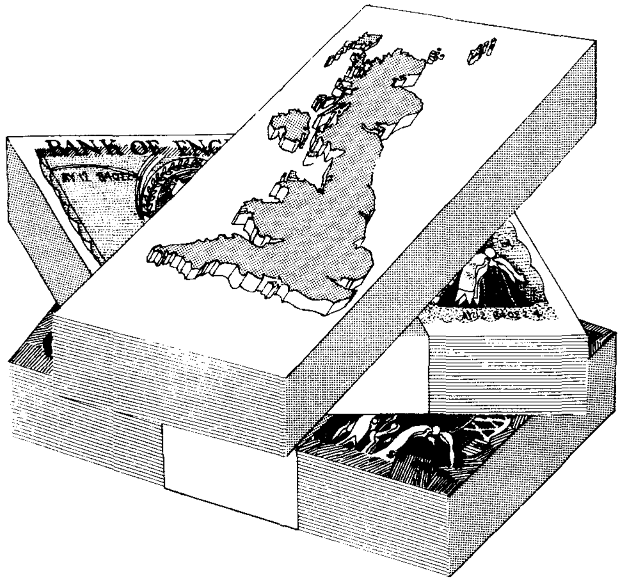
The recovery in the US economy, now entering its second year, is perceptibly spreading to other countries. The overvalued dollar and persistent US budget deficits have generated strong demand for imports to the US, a demand which its trading partners, amongst them the UK, have met. As the US balance of trade has slipped further into deficit, there have as yet been no signs of a collapse of the dollar and American interest rates have remained high. Nominal interest rates worldwide have remained high as a result and do not fully reflect the deceleration in inflation over the year to the second quarter. The worldwide trend of both short and long term interest rates has been upward over the last quarter. More significantly, there have been no signs of a sustained fall in real interest rates which remain at historically high levels. The high real cost of money deters both fixed investment and stockbuilding, two components of demand whose strength is vital to the propogation of recovery worldwide.

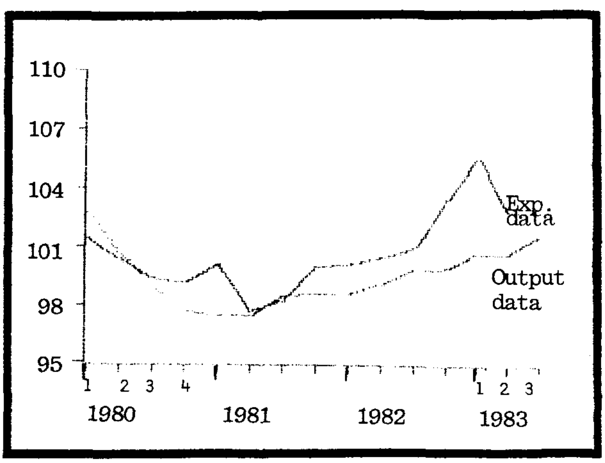
The continuing US budget deficit remains a source of concern. Roughly half of the 1983 deficit is estimated to be structural, meaning that it is not a reflection of cyclical factors such as depressed tax revenues and increased transfer payments during the recession. The most recent projections by the US Council of Economic Advisers imply a continuing growth of the structural component over the coming five years on present policies. As a result the overall deficit is expected to grow even though its cyclical component will contract rapidly given the pace of the American recovery.

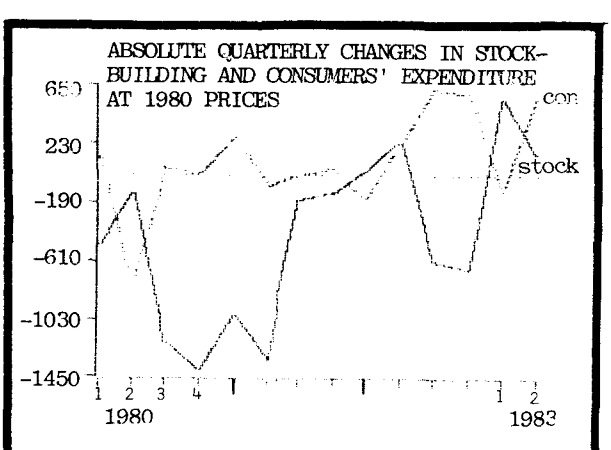
Why be concerned about this? Deficits must be financed. Generally speaking, the larger the deficit the higher the interest rates required to finance it. High US interest rates reduce American investment and keep international interest rates higher than they would otherwise be. A convincing committment to reduce the scale of the US deficit would therefore exert downward pressure on interest rates worldwide. Such a commitment is unlikely over the coming year as the required spending cuts would not be perceived by President Reagan as improving his re-election prospects. Worldwide nominal interest rates are therefore likely to remain high during 1984.

This does not mean that the worldwide recovery will be any slower as a result over that time period because the deficit in itself acts as a stimulus to demand. It does mean that the character of the recovery will be different with the emphasis less on investment and stockbuilding and more on consumers' expenditure. This in turn increases inflationary pressures as capacity constraints manifest themselves at an earlier stage in the cycle when investment in new capacity is retarded. It also increases protectionist pressures in the US as domestic firms remain uncompetitive given the overvaluation of the dollar and it increases the size of the required readjustment to US fiscal policy when that eventually takes place. The post election year is therefore likely to see a significant tightening of US budgetary policy, a realignment of exchange rates vis a vis the dollar and a downward trend in worldwide interest rates. The knock-on effects on the world economy may include some hesitation in the pace of recovery in the short run, but the foundation for a more sustainable long run expansion.

The British Economy





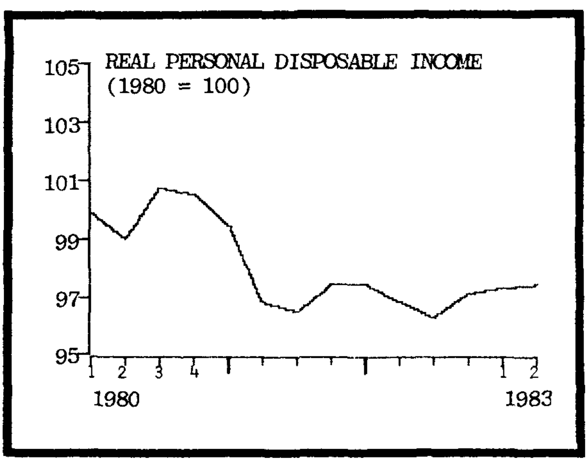


MACRO-ECONOMIC TRENDS

There is no doubt but that the British economy is growing. The actual pace of growth remains rather uncertain however. Recently published national accounts estimates rebased to 1980 prices date the trough of the recession to the second quarter of 1981. All three measures of GDP agree on this. Where they disagree is in documenting what has happened since then. The income and expenditure estimates suggest that the economy expanded by about 5% in the two years to June, while the output measure, hitherto considered the most reliable, implies growth at only a little over 3%. The individual measures differ not only on the scale of the recovery but also on the interpretation of macroeconomic trends since the turn of the year. The output measure implies stagnation between the first and second quarters followed by relatively rapid growth in the third, while the expenditure measure recorded a fall in GDP in the second quarter. Third quarter expenditure estimates are not yet available.

Whatever the exact magnitude of the recovery the turnaround in the economy over the two years to June was based overwhelmingly on consumer demand and a slowdown in stock liquidation. These two components more than account for GDP growth over that period. However because it was precisely these two components of demand which grew most rapidly, the associated leakage into imports has been very large, equalling almost half the stimulus to demand from consumption and stockbuilding. Over the recovery period, public expenditure, especially that of local authorities, fixed investment and exports have also contributed to growth. Their combined contribution however has been less than that of either stockbuilding or consumption.

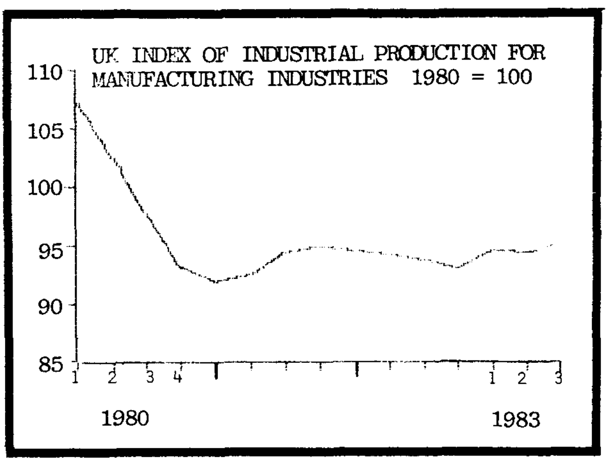
While all components of demand contributed to the recovery when the period from the trough of the cycle to June this year is taken as a whole, the pattern during the first six months of 1983 has been somewhat different. During that time the stimulus to growth came primarily from stockbuilding and consumers expenditure, with a small contribution from government expenditure. Whereas the former two components contributed equally to growth over the two year period since mid 1981, the contribution of stockbuilding was more than twice as important as that of consumers' expenditure during the first half of this year. By contrast with the two year period as a whole, the contribution of fixed investment and exports to GDP growth was negative in the first two quarters. Preliminary third quarter figures suggest a negative contribution from stockbuilding coupled with buoyant consumers expenditure and a further fall in investment.

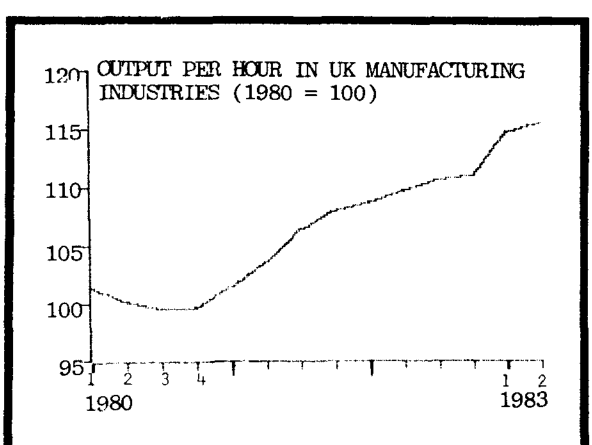


The continuation of the present pace of growth therefore requires that exports, fixed investment and consumption expand in coming quarters. An expansion of exports and investment is particularly important given the high import content of consumption. Revised national accounts data show that real personal income troughed in the fourth quarter of last year and grew in each of the successive quarters. This, combined with a steep fall in the personal savings ratio from 11.7% in mid 1982 to 8% a year and a marked increase in household indebtedness, is what has underpinned the recovery in consumers expenditure. In the third quarter the volume of consumers' expenditure was up 3.3% on the comparable quarter of the previous year.

It is now clear that fixed investment also bottomed out in the middle of 1981, thereafter rose fairly strongly till the first quarter of this year before falling during the second. Private sector investment recovered somewhat earlier than that of the public sector, which continued to decline till the middle of 1982. Though the volume of private sector investment is currently some 10% higher than at the trough, practically all of this growth came during 1982 and private investment has been decelerating during the first half of this year. The most buoyant component in private investment has been dwellings. Housing starts are running some 10% higher than a year ago while investment in plant and machinery has been almost stagnant. There are some signs that this latter type of investment may soon recover. Investment intentions recorded by the CBI survey have been positive on balance since May of this year while the most recent investment intentions survey by the Dept. of Industry suggests a slow recovery in manufacturing investment during the latter half of next year.

Export performance this year has been disappointing with the volume almost stagnant in the second and third quarters. For the year as a whole exports are likely to be marginally down on 1982 even though performance in North American and EEC markets has been encouraging. By contrast, the large increase in import volume recorded during the first quarter of this year was sustained into the second, while the third quarter recorded a further increase. Even if there is no additional volume increase during the final quarter, imports this year will have increased by over 6% on their 1982 level. While a substantial part of the additional imports comprise raw materials and inputs for British industry, imports of finished manufactures have increased markedly. The current account of the balance of payments, after moving into deficit during the second quarter, is estimated to have returned to a small surplus during the third. Nonetheless, the visible balance remained in deficit and the year as a whole is certain to show the first recorded deficit on visible trade in British history.

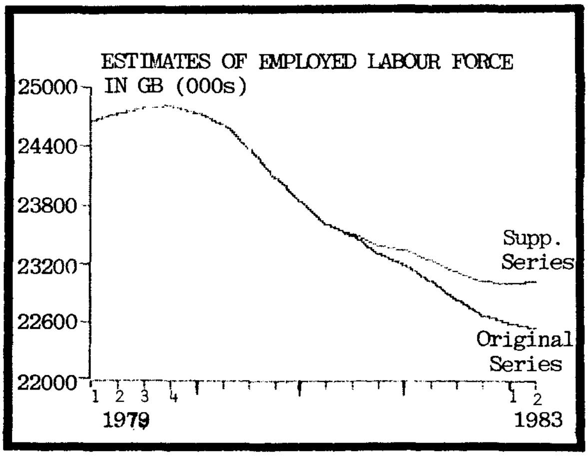




Manufacturing output continues to edge slowly upwards with the most recent CBI survey suggesting that this trend will be maintained over the coming four months. CSO data suggest that growth has been strongest in intermediate good industries and slowest in those supplying investment goods. Productivity growth continues strongly, with productivity per man-hour in manufacturing up some 7% in August compared to a year earlier. This, combined with the deceleration in the rate of wage inflation over the last two years, helped to depress the annual rate of increase of wages and salaries per unit of output in manufacturing to 2.4% during the second quarter. Sterling fell by about 2% in trade weighted terms during the autumn, which, allied with the low rate of increase of unit wage costs, should maintain the trend towards greater export profitability and reduced competitiveness of imports apparent since the final quarter of last year. The annual rate of increase of prices of manufactured goods for the home market remained at 5.3% in September, while retail price inflation decelerated marginally to 5%. In the absence of any sustained fall in sterling's effective exchange rate it is hard to see inflation rising to an annual rate of more than 6% in the coming half year. Indeed, if mortgage rates fall by 1% in the New Year, the annual inflation rate would be about 0.3% lower.

THE LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT



Department of Employment estimates of the "employed labour force in Great Britain" indicate some improvement in labour market conditions. The most encouraging indicator is again the 'supplementary series' which, on revised estimates shows an increase of 18,000 during the second quarter of 1983. However, this series is based on the questionable assumption that conventional measures of employment continue to underestimate numbers in the self-employed and services sector to the same extent as during 1979-81. In concrete terms, the Department of Employment are **assuming** that the number of self employed is growing by 25,000 each quarter in calculating the supplementary series. If that assumption is accepted, then compared to an average quarterly fall of 91,000 during 1982, the second quarter's increase of 18,000 following a first quarter fall of 42,000 represents a significant improvement during 1983. The "basic" series continued to record a decline in total employment during the second quarter, though at a much slower rate than that of the past year. Figures for the 'employees in employment' category, again from the supplementary series, also record an improvement. The net loss of 8,000 jobs during the second quarter compares with an average quarterly reduction of 113,500 during 1982, and an estimated fall of 42,000 during the first quarter of 1983.

Within the manufacturing sector the period from June 1982 to June 1983 (provisional figures) reveals an average fall of approximately 5% in the numbers of employees in employment. Metal manufacture (down 11.5%), Mechanical Engineering (down 8.3%) and Shipbuilding and Marine Engineering (down 8.3%), appear to have been the major areas of labour shedding. Job losses in these sectors accounted for more than one third of the total fall in manufacturing employment even though these three sectors combined account for less than one fifth of the manufacturing workforce. But again, within these categories, and the total, the rate of decline has decelerated appreciably during 1983 with estimated job losses during August of only 3,000.

The October CBI survey augurs a further slow deceleration in the pace of job losses with a balance of 24% of respondents expecting to reduce employment over the next four months. This compares with a figure of 25% in the July survey and a balance of 27% reporting an actual reduction in employment over past four months to October.

The problem of a high level of unemployment persists, with a seasonally adjusted figure for Great Britain in October of 2,826,700, excluding school leavers. This represents a fall of 7,900 since September and an unemployment rate of 12.1% for all employees. The national figures mask a wide regional dispersion. Regional unemployment rates range from the South

East at 9.10% to the North at 16.2%. The regions of Scotland, Wales, North, NorthWest, Yorkshire and Humberside, which traditionally experience levels of unemployment above the national average, continue to do so. They are joined by the West Midlands, normally a prosperous region, reflecting the dispropotionate impact of the recession on manufacturing employment. Variations by sex are equally marked with national male and female rates of 14.6% and 8.5% respectively. However, these figures are distorted by obvious differences in registration propensities between the sexes.

Seasonally unadjusted estimates reveal that approximately 163,000 school leavers registered as unemployed during October. This level should fall appreciably in the coming months, mainly as a reflection of the increasing influence of the Youth Training Scheme. Approximately 200,000 persons were involved in this scheme at the end of September 1983, representing a significant proportion of the estimated 613,000 people covered by special employment and training measures in Great Britain. It is estimated that the overall effect of those provisions on the unemployment count is to reduce it by 395,000 people.

Direct comparison of the October figures with those for earlierperiods is problematic given the changes in the administrative methods used to compile the series. Bearing this in mind the figures are indicative of a continuation of the recent trend toward a slower underlying rate of increase in uneployment. Unemployment flow statistics confirm that substantial numbers of persons continue to enter and leave the register monthly. Between September and October, the inflow and outflows were 405,000 and 433,000 respectively. Again these figures exclude school leavers of whom 48,000 joined and 70,000 left the register. An adequate number of observations does not yet exist to seasonally adjust the flow data. However, the series on a claimant basis is now a year long so twelve monthly comparisons are possible. Such comparisons will not be invalidated by seasonal influences. Inflows currently appear to be running somewhat below those of a year earlier, outflows however appear broadly unchanged. The monthly inflow of vacancies continues to rise slowly but steadily. Thus from both supply and demand perspectives labour market conditions appear to be deteriorating less rapidly. Unemployment spells of long duration do however continue to pose a serious problem (see Economic Perspective) with over one in three of the unemployed having been on the register for over a year. This figure rises to about three in five for spells in excess of 6 months. Not surprisingly, those aged 55 and over are disproportionately represented with more than two out of three currently unemployed for over 6 months. Even the young are not immune, almost half of those under 25 on the register have been unemployed for at least six months.

PROGNOSIS

The British economy is certain to continue growing throughout 1984. Little acceleration of the pace of growth seems likely and some slight deceleration seems the most probable outcome. Consumers' expenditure will be less buoyant than during the current year, with the resulting shortfall only partially filled by rising exports and fixed investment. Little acceleration of either earnings or price inflation seems probable and those in employment will see further increases in their real disposable incomes. Corporate profits will continue to improve, facilitating investment and restraining money supply growth. World trade is likely to expand, taking British exports with it, while the somewhat slower pace of domestic growth will restrain imports. Unemployment is likely to remain close to present levels.

INDUSTRIAL RELATIONS

WAGES AND HOURS

The current wage round appears to have raised fewer difficulties than might have been expected. This may be because a number of industries and large companies, such as British Leyland and some public utilities, signed agreements in the last wage round that extended beyond the 12 month period. The wage agreements that have been made appear to show a continuing fall in the level of settlements, now averaging between 5 and 7%.

What has featured prominently in current wage bargaining, however, and particularly in present negotiations in the engineering industry, is the attempt to cut working hours. The Confederation of Shipbuilding and Engineering Unions is determined to cut the present 39-hour week, won in 1979 and not renegotiable before 1983, to 35 hours, without loss of pay. This claim is weakened, however, by the failure of Vauxhall and Ford workers to get a cut in hours, Vauxhall accepting a high pay settlement, and Ford taking longer holidays. However the claim in engineering will gain strength from the recent acceptance by Reed Corrugated Cases, a member of the Reed International Group, of a 35-hour week for manual workers and a harmonisation of these hours with white collar staff. In addition the Metal Box Company conceded a 35-hour week for its 5,000 workers earlier this year, although this was only achieved after employees accepted a continuous shift system, giving 24 hour production. A cut in hours has also been achieved by manual workers in ICI and in some other chemical companies. Whether engineering workers will also accept a shift system as the price of a further cut in hours will soon become obvious. These trends, however, suggest that there may be something of a move towards shorter hours in some of the capital intensive industries where labour costs are perhaps less critical than in other industries.

The interest in cutting the length of the working week has received some impetus from events in Europe. Evidence exists of a trend towards a shorter working week in Europe in recent months, particularly in Belgium and the Netherlands. In both countries, collective agreements have allowed the working week to be cut below 40 hours, the effects on costs being offset by suspending the indexation of pay rises and by reducing the social security payments of companies that take on labour as a result of these agreements. France has also begun to cut the working week. In 1982, legislation allowed it to be cut to 39 hours without loss of pay, and further cuts are now being pursued through collective bargaining. But despite these trends the evidence in different European countries that shortening the work week has created or saved jobs is very limited. This may in part reflect the fact that where the length of the work week has been cut, weekly wages in general have not been proportionately reduced. It seems likely therefore that despite the long-running campaign of the TUC on this issue in Britain, the gains that the unions are likely to make may be small, especially since few unions seem willing to make wage agreements at significantly less than the rise in the cost of living.

While few problems have been experienced so far in the negotiation of pay and hours, this may change if the climate of recovery is maintained. If it is the rate of increase in unemployment rather than the absolute level that largely determines worker reaction to these issues, a change in these reactions could appear in the coming months.

STRIKES

British Telecom Dispute

A most significant dispute has been developing in recent months between British Telecom (BT) and the Post Office Engineering Union (POEU). The POEU has organised a steadily escalating series of actions against privatisation of the telecommunications industry, beginning with a day of action in October 1982, a series of demonstrations and strikes in April 1983, and more recently a range of industrial action at a number of BT centres, including a refusal to connect Mercury Communications to the BT telecommunications system. Mercury sought an interim injunction against the POEU, restraining it from its actions; this was initially rejected by the High Court but has now been upheld by the Court of Appeal.

In its industrial action, the POEU tended to concentrate its activity primarily against BT, dropping its direct actions against Mercury. The latter would almost certainly have been seen as secondary action and, under the 1980 Employment Act, would probably have failed to qualify for legal immunity. This allowed the POEU to argue that although it opposed privatisation, its main dispute was with BT and that it was concerned primarily about the threat to jobs that would arise if Mercury entered the industry. Since BT's suspension of a number of POEU engineers was evidence of a dispute between an employer and its employees, this was, in the POEU's view, how the dispute should be viewed.

In addition, the POEU stressed that their action has been concerned wholly or mainly with terms and conditions of employment. The relevant 1974 legislation provided that industrial action was to be considered lawful where it was 'connected with' terms and conditions of employment. The 1982 Employment Act narrowed the definition of lawful industrial action, to give immunity from legal action only where it is concerned 'wholly or mainly' with the terms and conditions of employment. Since the POEU has been concerned with emphasising, as it sees it, the threat to its members' jobs if Mercury entered the industry, it tried to establish a case for its actions based mainly on this argument.

It would seem that one of the objectives of the 1982 Employment Act in narrowing the definition of lawful industrial action was to withdraw immunity from 'political' strikes or protest movements over government policy, including privatisation. The Appeal Court decision has now established in law this interpretation of the 1982 Employment Act, by deciding that the POEU was essentially conducting a campaign against privatisation rather than involved in a trade dispute with its employer. It appears to have accepted that the POEU action was not wholly or mainly concerned with issues surrounding the terms and conditions of employment, hence was not a lawful industrial action, immune from legal proceedings by injured parties.

This is obviously not the end of the matter. Mercury claims it has lost a significant amount of business as a result of the POEU action, and that considerable uncertainty has been created in the telecommunications industry which Mercury claim has affected its development. A case for damages against the POEU seems likely. Equally important is the possibility that Mercury may soon be given more favourable conditions by the government so that it can compete more effectively with BT. If this happens it is possible that the POEU will see this as a further threat to the jobs of its members and react accordingly.

Worker Participation in Industry

A long running debate has been conducted now for many years on the desirability of providing some mechanism by which companies might inform and consult their employees on the structure, functioning, future plans and investment programmes of the company. The debate has also embraced the desirability of appointing employees as board members of the company, either to a single tier board or to the supervisory board of a two-tier system. These issues have surfaced regularly during the last few years, within the recent past when the Caterpillar Tractor Co and the Dunlop Company appear to have made major decisions on plant closures, affecting about 2,000 jobs, without apparently consulting the trade unions or the employees concerned and most recently in the debates at the CBI Conference in Glasgow. The issues will be further discussed when the government shortly publishes a consulative paper on the subject.

These two general problems have been under review at the EEC for a number of years. The end result of these deliberations are contained in two Directives; the Fifth Directive dealing with Board representation and the Vredeling Directive dealing with informing and consulting employees. Both have been discussed by the European Parliament and have passed through the European Commission. They are now before the Council of Ministers for approval, requiring a process of consultation in member countries.

Since the British government, the CBI, the Engineering Employers' Federation and many similar bodies have stated their belief in a voluntary system of consultation and participation, and their strong opposition to any legal enforcement, it seems unlikely that the government will have modified its position in any way at the end of the period of consultation. Experience in this field over the last few years would seem to support the view taken by the government. The Bullock Commission (Cmnd. 6709) (1977) and the Williams Committee (Cmnd.7231) (1978) both attracted very limited support for proposals along similar lines.

In addition, the two main experiments in the use of Worker Directors, in the Post Office and in British Steel, have not been outstanding successes. The two year experiment in the Post Office, which ended in 1979, was recognised by most people to have made little contribution to the improvement of labour relations or the public accountability of the organisation. The experiment in the steel industry has been operating for the last 15 years, initially with Divisional and later with Main Board Employee Directors. This appears to have made a more significant contribution to industrial relations than the experiment at the Post Office.

The main factor affecting attitudes to any Employee Director system is likely to be the re-emergence in the last 10 years of joint consultation. Such a system is now operating in perhaps 40% to 50% of establishments in the private and public sector, dealing with a wide range of issues, and involving employees in examining matters that affect them. The apparent success of such a system will make it very difficult to argue for any alternative arrangement, especially on a legally enforceable basis.