The British Economy

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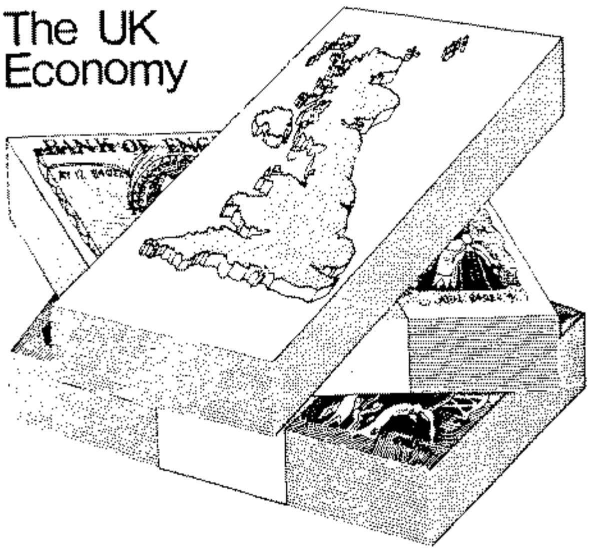
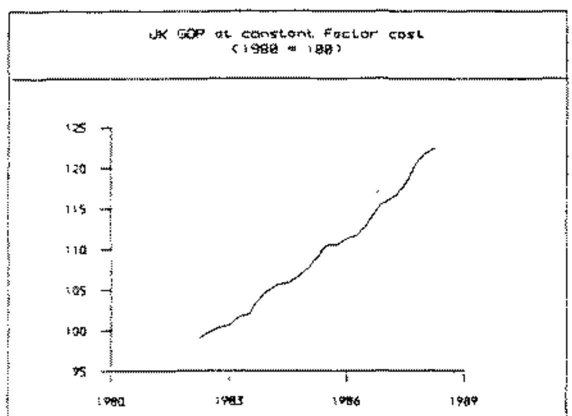


OVERVIEW

The growth of the UK economy continues at a brisk rate. Manufacturing output is especially buoyant. The absence of evidence suggesting a moderation in output growth reflects the continuing strong rate of growth in domestic demand. There is little hard evidence to date of a slow-down in consumer demand. Domestic demand growth continues to outstrip both output growth and the supply capacity of the economy. This is despite the current 'boom' in investment. The deficit on current account therefore continues to deteriorate. The underlying trade position is precarious and is symptomatic of high domestic demand and inflationary pressure. With many indicators pointing in an upward direction, the prospects for inflation are therefore the most immediate cause for concern.

MACROECONOMIC TRENDS

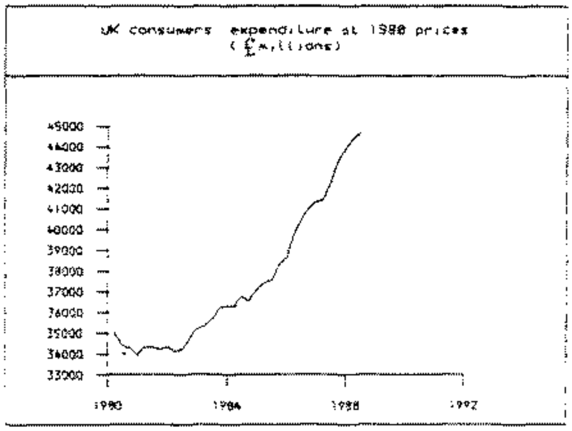
The average measure of GDP at current market prices, nominal or 'money' GDP, rose by 2.3% between the first two quarters of the year. By the second quarter, 'money' GDP was 10.1% higher than in the second quarter of 1987. After allowing for price changes the average measure of GDP at constant market prices, 'real' GDP, rose by 0.7% during the first two quarters to a level 4% higher than in the second quarter of 1987. Estimates of GDP via expenditure appear to be underrecording the UK rate of growth. If this is correct, the average measure of GDP change will also be understating the true rate of growth. The output based measure of GDP is considered to be the most reliable indicator of short-term change. This suggests that real output rose by 1.1% in the second quarter of this year to stand 5.7% above the level attained in the second quarter of last year. On the basis of this evidence it seems clear that UK economy will now produce a faster rate of growth in 1988 than the outturn for 1987. Domestic demand growth is expected to slow down in 1989 once the effects of the upward movement in interest rates begin to be felt. But to date there is little evidence of a moderation in the rate of growth of output. The CSO's coincident cyclical indicator, which attempts to show current turning points in the business cycle around the long-term trend, has been rising gradually since May.



Real consumers' expenditure rose by 0.5% between the first and second quarters, a smaller increase than the 1.5% recorded between the fourth quarter, of 1987 and the first quarter of the year. In the year to the second quarter real expenditure had risen by 5.5%, down again on the 7% rate in the year to the first quarter. During the second quarter, while expenditures on durables and services rose, there was a fall in outlays on non durable goods which was mainly concentrated on food and energy products.

Preliminary estimates for the third quarter indicate that consumers' expenditure rose by 2.2% on the second quarter and 5.7% on the corresponding quarter in 1987. The strong growth in this component of aggregate demand reflects high outlays on vehicles and the continued growth of retail sales. Provisional Department of Trade and Industry (DTI) figures for October show that the seasonally adjusted volume of retail sales rose by 1.9% over the preceding month. This can be compared with a 0.8% fall in September. That fall was taken as providing some indication of a moderation of demand growth due to the progressive 4.5% point rise in interest rate after May. The continued rise in the retail sales index appears to conflict with anecdotal evidence from retailers and the latest CBI/FT distributive trades survey. The CBI/FT survey suggested that there was a slow-down in retail sales during October, producing an outturn which was well below expectations. A balance of plus 32% reported an increase in sales compared with the same month in 1987. This was significantly below the 54% positive balance recorded in September and was lower than any month since April. The balance of retailers expecting growth to be higher in November compared with the same month last year fell to 51%. This was again the lowest balance since April. The data on retail sales therefore appear to be pointing in opposite directions. However, the three monthly average of the DTI's retail sales index does seem to suggest that the rate of growth of demand is slowing. A 1% rise in sales volumes was reported for the three months to October. In the previous three month period the rate was nearly 2%.

The evidence on the underlying determinants of the growth of consumer demand is mixed. Pressures tending to raise the rate of growth of consumer demand include the continued buoyancy of average earnings. The underlying increase for the whole economy is provisionally estimated to be 9.25% in the twelve months to September. This rate has therefore risen during the second and third quarters and should be compared with an underlying increase of 7.75% in the twelve months to September 1987. The saving ratio fell back to 3.5% but real personal disposable income (RPDI) also fell by 1% between the first two quarters of the year. Consumers' expenditure therefore grew more quickly than might have been expected from the income change due to the fall in the saving ratio. In September consumer credit rose to £26.2 billion. However, the rate of credit growth appears to be easing with an absolute increase of £321 million recorded in September compared with a £518 million rise in August.



General government consumption did not change in the second quarter following the 1.2% fall in the first quarter. By the second quarter, real government spending stood broadly at the level attained in the same quarter of the previous year.

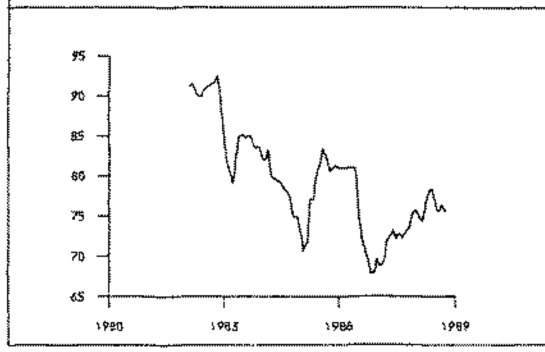
Gross fixed investment increased by 4% during the second quarter, compared with a 3.5% rise in the preceding three months. The level of investment reached in the second quarter was 10.5% higher than a year previously. Private sector investment, which accounts for the bulk - 85% - of total gross domestic fixed capital formation, rose by 12% in the year to the second quarter. Investment by public corporations rose by 14.3%, while general government investment fell by 4.5%. By type of asset, investment in dwellings continues to display the greatest percentage change, increasing by 20.4% during the year. Here again private sector expenditures rose by 26.4% compared with a 3% fall in public sector outlays. Investment in plant and machinery, other new building and works, and vehicles, ships and aircraft, rose by 10.2%, 6.3% and 2.5%, respectively. During the same period, the government's Autumn Statement predicts that manufacturing investment will rise by 18% during the year, two percentage points higher than the expectation from the June DTI survey of investment intentions. Total non-oil business investment is expected to rise by 13% during 1988.

Despite the unexpectedly good September trade figures - a £560 million deficit on current account compared with an expectation of £1bn to £1.5bn - the underlying trade position remains precarious and symptomatic of the high demand pressure in the economy. This is reinforced by the £2.46bn current account deficit provisionally recorded for October. The visible trade balance has deteriorated throughout the year on a quarterly basis. In the first quarter a deficit of £3.9bn was recorded and this was followed by increasing deficits of £4.4bn and £5.5bn in the second and third quarters, respectively. The non-oil trade deficit, on revised figures, rose from £4.4bn in the final quarter of 1987 to £4.8bn in the first quarter of the year and £5.1bn in the second quarter. Following a greater fall in export than import volumes in the first quarter, both rose again during the second quarter as world trade expanded. However, non-oil export volumes rose by 7.8% while the volume of imports increased by 8.4%. By the third quarter non-oil exports were 7.5% higher than a year earlier and the Treasury is predicting that non-oil imports will grow by 13.5% this year. The Treasury is also expecting import growth to slow significantly in 1989 - to 5% - as UK domestic demand declines and home demand is increasingly met by home supply following significant investment in new capacity. The oil surplus fell further between April and June to £0.7bn from the £0.9bn recorded in the first quarter. Lower sterling oil prices and increased domestic demand for oil were principally responsible. The Piper Alpha disaster in July will have also served to lower production in the second half of the year with the result that the Treasury is predicting a surplus of around £2.5bn in 1988 compared with the £4.2bn achieved in 1987.

The current account went further into the red as 1988 proceeded. Following the large £1bn jump in the deficit to £2.8bn, the deficit rose again to £2.9bn in the second quarter and to a provisional £4bn between July and September. The Treasury are forecasting a deficit of £13bn for 1988 as a whole and on current evidence this could well be an underestimate by some £1bn to £2bn.

In the third quarter of the year the output of the production industries - accounting for 34.5% of GDP - is provisionally estimated to have risen by 1% over the previous quarter to a level 3.5% above that achieved a year earlier. However, this figure understates the strength of output growth in British industry because the output of the energy sector was seriously affected by the Piper Alpha disaster. Output in this sector fell by 4.5% in the latest quarter to stand 5% lower than in the same period last year. Manufacturing output, in contrast, rose by 3% between July and September to a level 7% above that in the same period of 1987. Within manufacturing, the principal increases recorded in the latest quarter were in chemicals where output rose by 6%, in engineering and allied by 4%, and in other minerals by 3%. Other manufacturing industries output rose by 2%, while output in metals, food, drink and tobacco, and textiles and clothing all increased by 1%.

Sterling effective exchange rate
(1975 = 100)



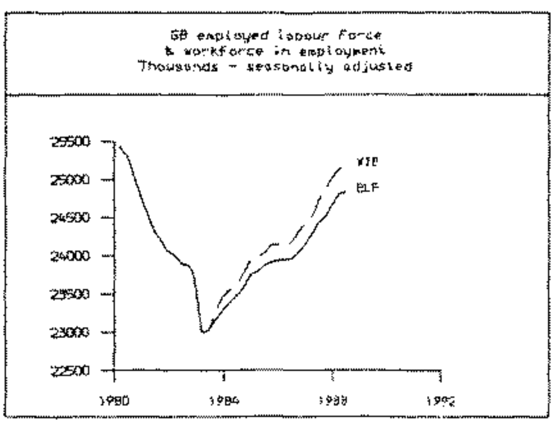
By market sector, the output of the consumer goods industries rose by 2% between the latest two quarters. The strong growth in investment demand is continuing to have a marked impact on the output of the investment goods industries which rose by 6% between July and September. A 4% increase was recorded for this sector between the previous two quarters.

THE LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

The workforce in employment - which includes the employed labour force plus participants in work related government training programmes (see September Commentary) - is estimated to have risen by 42,000 in the second quarter of the year. This can be compared with an estimated increase of 119,000 in the first quarter. In the year to June the total increase is estimated at 438,000; of this 202,000 and 237,000 are the full-time and part-time increases, respectively. Participants in training programmes increased by 34,000 over the period.

Employees in employment rose by only 8,000 in the second quarter, compared with an increase, on revised figures, of 106,000 between January and March. The number of employees in the service sector rose by an estimated 49,000 between April and June, compared with estimates of 111,000 and 131,000 in the preceding two quarters. Manufacturing employment continues its downwards movement, falling by 22,000 in the second quarter, after a rare increase of 1,000 between January and March. Recent figures available for the third quarter indicate a further fall of 18,000 in manufacturing employment. Energy and water supply continues to shed jobs with a fall of 12,000 in the second quarter and 3,000 in the third quarter, compared with reductions of 15,000 and 8,000 in the preceding two quarters. Other industries shed a further 8,000 jobs during the second quarter after increasing employment by 9,000 between January and March.



Productivity - output per head - growth continues to be high. The first quarter figures for the percentage increase on a year earlier for the whole economy have now been revised upwards to 4.1%. Information now available for the second quarter suggests that this level of productivity growth is broadly continuing with an annual outturn of 3.8%. In manufacturing, the high rates of productivity growth recorded in the first two quarters of the year of 7.6% and 6% have continued into the third quarter, with the percentage increase on a year earlier being recorded at 7.4%. The underlying increase in average weekly earnings in the year to September was provisionally estimated to have been 9.25%. The rate of growth in unit labour costs in the whole economy stood at 4.4% in the second quarter, a slight moderation on the 4.7% outturn in the first quarter. In manufacturing, the rate of growth in unit labour costs continues to be low. In the first three quarters of the year the percentage increase on a year earlier was 0.5%, 2.6% and 0.8%, respectively. High productivity growth principally accounts for high earnings growth not being translated into rapid increases in costs. Nevertheless, it is clear that on a cross-country comparative basis, the UK's unit labour costs have been deteriorating relative to those of the US, Japan, and Germany since the beginning of 1987, even though our relative position is still superior to that of 1980.

Evidence of a slackening in the rate of decline of seasonally adjusted unemployment still appears to be present. In the six months ending October, the reduction is provisionally estimated to have averaged 40,500 per month. This is lower than the six monthly average fall recorded in every month since October 1987 with the exception of May 1988. By October, seasonally adjusted unemployment stood at 2.160 million, or 7.7% of the workforce, down 31,500 on the previous month.

INDUSTRIAL RELATIONS

The extent of coverage of the IPM conference at Harrogate and the ACAS publication "Labour Flexibility in Britain" indicates the changing nature and priorities in British industrial relations. Sir John Wood, chairman of the Central Arbitration Committee, speaking to the conference, argued that collective bargaining in Great Britain had a doubtful future. In noting the rise of managerial concepts such as individualism, personal contracts and performance related pay, he questioned the extent to which collective bargaining would remain the key regulator in the relations between employees and employers. As such we should expect a rise in the rate of union derecognition.

However, with personnel or human resource management there are two major debates as to the future role of personnel which have major implications for the future contours of British industrial relations and the extent to which these are shaped by personnel specialists. The first debate concerns the importance and centrality of personnel. On one side is the view that a strong, centralised personnel function will be crucial in the development of business policy and strategy. On the other hand, some see the future of personnel in terms of a devolution of the function to general management and only a limited specialist, but subordinate role at strategic levels. The second debate is concerned with the future style of personnel management. On the one hand there are those who see personnel in traditional, largely functional terms. Here the focus is on conflict resolution, a firefighting rather than fire prevention role. This traditional approach emphasises the importance of collective bargaining, but with little forward planning. Personnel occupies an essentially reactive rather than proactive role. The contrasting view envisages a innovating role for personnel encouraging the devolution of pay bargaining; changing pay systems; individualised rewards; and introducing new techniques of recruitment, training and development. This view stresses the importance of good communications, motivation and awareness of employees.

The themes of conference highlighted elements of all these views. The contribution from British Coal stressed the devolution of bargaining, widespread changes to work practices and payment systems. British Coal's director of industrial relations for the South Yorkshire area indicated plans to introduce special sub contracts to further move away from nationally negotiated rates. Special contracts would be offered to miners to complete important, but non standard, tasks. To a degree the NUM has been by passed on the introduction of more flexible working practices and 6 day working as these have been introduced on a local basis. This practice has been adopted with similar success by British Rail in respect one unmanned stations and driver only trains. The NUM faces a further threat given the offer of sole negotiating rights to the union which supports 6 day working at the Margam complex. This will lead to increased rivalries between the NUM and the UDM. Both unions will have to respond to the threat to some 20,000 jobs and 20 pits over the next 18 months.

The conference reflected the growing concern over the provision of training. The director general of the Training Agency argued that Britain was nearly at the bottom in every aspect of youth, skills and management training. Given increased market competitiveness and the implications of 1992 training might well become the key issue for personnel. Currently 85% of monies spent on training is in wage and wage support costs for trainees, only 15% is devoted to providing training materials and courses. The proposal by West German firms in Britain to introduce their own training schemes for themselves is a further indication of the poverty of the UK government and current employer provision for training. The growing number of reports on skill shortages at all levels provides further evidence as to the need for training. A report by Oxford economists highlighted the extent of the need for change "Britain is trapped in a self reinforcing low-skills equilibrium . . . the majority of enterprises are staffed by poorly trained managers and workers producing low quality goods and services".

In several respects the need for training increases with the introduction of new technologies of production and labour flexibility. Pirellie has noted the need for common skills, interactive training and other training needs in its new cable producing factory.

Shortages of 16 and 17 year olds in South East England have prompted firms to seek different training and salary programmes. Both Tesco and Sainsburys decided to pay "rate for age" scales, rather than YTS rates, as both have failed to attract sufficient numbers via YTS programmes.

Other speakers to the conference argued that individualising the work relationship would be an increasingly dominant feature of employee relations in the 1990s. This would affect every aspect of employee relations, including the abolition of national bargaining structures, introduction of performance related pay, communications, training, development, payment systems, as well as temporary and part-time work. The cultural change implied by such developments is considerable and poses a greater burden on management rather than employees. Nevertheless, it would be naive to justify individualism in terms of providing more of what the individual employee seeks and needs than traditional collective mechanisms. Stressing individualism may weaken the commitment to equal pay and equal opportunity. Lloyds bank has indicated it will challenge the findings of a independent expert on an issue of equal pay for equal value comparing clerk typists and bank messengers. This could have widespread implications.

The CBIs survey indicted a considerable rise in the popularity of performance related pay, especially at the management levels. There is much to suggest that firms are using such schemes to reduce the significance of collective bargaining at the higher management levels. For example British Rail's ending of collective bargaining for 7000 middle managers. All four clearing banks either have or plan performance related pay, and Barclays Bank has recently announced plans to introduce performance related pay.

Changes to traditional national bargaining structures are widespread. For some time employers and others have lobbied Parliament for the abolition of the National Dock Labour Board. British Rail has announced its intention to abandon the eighty year old central pay bargaining structure and introduce five bargaining units: operations staff; civil engineers; signals staff; mechanical and electrical engineers; and service staff. It would appear likely that the new structure will embody a degree of regional pay bargaining. In anticipation of such developments the NUR has announced proposals to regionalise its structure. Ten, predominantly regional, employers in the Multiple Food Retailers Employers' Association have agreed with USDAW to end the system of industry wide bargaining. Several firms have withdrawn from the National Maritime Board and have threatened national pay bargaining in the shipping industry. P and O's intention to recognise a breakaway union poses a further threat. The announcement by Lucas to end centralised pay bargaining illustrates moves to decentralise pay bargaining down to the establishment level.

The need for further task and labour flexibility constituted a further theme of the conference. The ACAS survey of 1987 suggests that certain kinds of flexibility are becoming more widespread in Britain in both the service and manufacturing sectors. Two thirds of the firms in the survey indicated that they employed some part- time employees, this was more noticeable in the South East, providing further indications as to the pattern of emerging labour shortages. The ACAS survey found extensive use of temporary workers and sub-contractors. A quarter of respondents indicated the introduction of forms of craft and skill flexibility in the previous three years. There was evidence of a growing interest in many organisations in relaxing division between manual, technical and clerical skills. Change was also evident in terms of employment patterns with a wider introduction of shift work and flexible work hours.

The survey noted a number of implications for management, problems of quality of work, training provisions, and an increased importance for the supervisory role. Particular attention needs to be given for greater management competence to manage efficiently the more flexible working practices, and to communicate effectively with the workforce.

A feature of the new orthodoxy is the belief in the spread of homeworking. Whilst there are evident advantages the disadvantages - difficult to discipline and control the pace of work, lower career implications, less identity with the employers and, above all, the costs of technologically advanced homeworking - will restrict development. It is only when a cheap system of communication exists will there be a major expansion in such developments.

A further theme of the conference centred on the implications of 1992. Conference recognised the need not only for training but for linguistic and cultural skills. However, attention was drawn to the need for such language and cultural skills to focus on the other markets outside European. Recognition is increasingly heing given to the extent to which Britain is undertrained compared to foreign competitors. Typically, British career and wage structures do not reflect the acquisition of skills. As has been noted young people in Britain enter work with fewer qualifications and poorer training than their European counterparts. Less emphasis is placed on all round employee development than in European firms. This might suggest the need for a return to the concepts of human asset accounting not merely for assessing the human worth of a firm before a takeover, or acquisition, but for 1992 if firms wish to remain competitive and construct European project groups and management structures.

Personnel problems for 1992 will include: - the need to construct new salary and benefit schemes to promote executive mobility; profit sharing on a European scale; European graduate recruitment and training programmes; and personnel audits. The IPM, in adopting an ex MSL International consultant to succeed Sir P Lawry as its president, has indicated the need for change for 1992.

Flexibility, payment schemes and change continue to feature in education. The possible introduction of a version of performance related pay and "plant" bargaining are being discussed in Government circles. The Government is intent on the introduction of a more rigorous job evaluation and performance appraisal scheme for teachers. As yet there are no clear, or widely acceptable, definitions of what constitutes good or efficient teachers.

Changes to salary structures seem inevitable given the continuing and deepening shortages of teachers in specialist subjects of maths and physics (it is possible that the shortage in these subjects is much higher than previously thought. Schools attempt to cover for the shortage by employing non-specialist teachers and by reducing the offering of the subject), and more general shortages of teachers in the South East of England. It is apparent that a surprisingly high percentage of graduates who qualify for teaching do not enter the profession. Equally there is a large pool of inactive teachers teaching. All this implies that teaching must be made more attractive if teacher shortages are to be overcome. This will imply as much a change in Government attitude as well as adjustments to pay. An alternative strategy might be the adoption of new, ie non graduate groups, into the teaching profession.

Whilst the Government has called for trade unions to consider arbitration before industrial action (see new code of practice), it looks like rejecting the trade unions' proposals for the introduction of pendulum arbitration. The Secretary of State has asked the Advisory Committee to consider whether the limited discretion exercised by local authorities over teachers pay and conditions should be transferred to school governors. Such a move would strengthen indications of a move towards regional and even school level variations in pay and conditions.

The key industrial relations issues have focused on the regrading exercise of nursing staff. Irrespective of clashes between unions and the conduct of the Health Boards and trade unions the key issue is the job evaluation scheme. A feature of developments in the Health Service has been attempts to engender a sense of efficiency and cost consciousness. This has had the effect of monetising the employment relationship, staff have been told, via the job evaluation scheme, what aspects of their work they are being rewarded for. The government should not be surprised if staff have learnt the lesson and are working for what they are being paid to do, ie working to grade.

The ACAS Guide to Job Evaluation notes "to be successful, a job evaluation exercise must have the backing of everyone concerned - management, employees and their union representative..." Moreover the booklet identifies the clear separation between the introduction of a new and more orderly pay structure and actual wages and salaries, it notes that salary and wage costs may rise as jobs are more accurately graded. Once the grading exercise is complete it is likely that there will be new plans for regional pay for nurses and for some local flexibility so that health authorities and hospital services can recruit nurses and midwives they need in their own local circumstances.

British Rail plans for the new trainman grade, part of a range of proposals for enhanced flexibility between drivers and guards is likely to lead to disputes between NUR and ASLEF. However, such differences are a reflection of a wider issues affecting the very survival of ASLEF.

The special payments system within the Post Office, an issue which led to the national dispute, does not appear to have resolved the losses of staff. In Watford resignations remain at 58% and at 42% in North East London. Decentralisation of bargaining and a greater use of part-time and casual employees seems inevitable in the short term, although it is unclear as to whether such moves will attack the key motivational issues.

The announcement of the establishment of a joint European chemical union for 1992, with the first congress in April 1990 and a permanent secretariat in Brussels, is one of the first indications of trade union moves towards 1992. On a national level, NUPE and NALGO are considering merger. The merger talks between EEPTU and AEU have encountered difficulties over the size and function of the conference, and the issue of either appointment or election of union officials. The CPSA is discussing merger with the National Union of Civil and Public Servants, but will consider a merger with GMBU if these fail. The first implications of the expulsion of the EEPTU have appeared with the disagreement over the recruitment policies by MSF at Fords. The TUC has now undertaken the first scrutiny of single union deal, an agreement negotiated by USDAW.

The new Advisory Code on Disputes contains 103 measures. It suggests union leaders should not consider industrial action unless a very substantial majority i.e. 70% is in favour. It advises unions against taking industrial action before disputes procedures are exhausted and encourages the use of ACAS before industrial action. Unions are encouraged to inform employers before holding a ballot and should give employers sufficient notice of industrial action. However, such advice would appear not to apply to employers.

The protest over the dismissal of the few remaining trade unionists at GCHQ raises questions as to individual rights and freedoms. The ILO held that the UK government had violated convention 87, however the Government refused to yield. In the English courts the action was held to be in breach of natural justice, but the judges abstained from acting. An application under Article 11 of the European Convention on Human Rights was dismissed.

PROGNOSIS

The growth of the UK economy continues at a brisk rate. The outturn for 1988 is now expected to be greater than in 1987. Manufacturing output is especially buoyant. The absence of evidence suggesting a moderation in output growth reflects the continuing strong rate of growth in domestic demand. Consumers' expenditure is provisionally estimated to have shown strong growth in the third quarter. Retail sales rose markedly - by nearly 2% - in October. This conflicts with anecdotal evidence from retailers and the latest CBI/FT distributive trades survey, but there is little hard evidence to date of a slow-down in consumer demand. Such a slow-down will occur eventually but in the meantime domestic demand growth is probably outstripping both output growth and the supply capacity of the economy. This is despite the current 'boom' in investment which will eventually add to capacity but almost certainly at a time when demand growth is beginning to turn down. The deficit on current account therefore continues to deteriorate. The underlying trade position is precarious and is symptomatic of high domestic demand and inflationary pressure. With many indicators pointing in an upward direction, the prospects for inflation are therefore the most immediate cause for concern.

Treasury forecasts for 1989, particularly for the current account, where a £2bn improvement on 1988 to £11bn is predicted, hide some very optimistic assumptions about British economic performance during the coming year. Domestic demand is expected to moderate thus allowing a fall in import demand, to 5% from 12.5% in 1988, and domestic resources to be transferred to export production. World demand and the sterling exchange rate are expected to be appropriate to an increase in export demand. At the same time inflation is expected to peak at around 7% - 7.5% and then turn down. The economy is thus forecast to achieve the proverbial "soft landing" with limited policy intervention ie only the interest rate increases. Time will tell. But the most charitable point that can be made about the government's prognosis is that it represents the most favourable of several possible scenarios.